



THE FORUM OF EUROPEAN SECURITIES COMMISSIONS

STANDARDS FOR REGULATED MARKETS

UNDER THE ISD

(99-FESCO-C)

December, 1999

INTRODUCTION

Regulated markets under the ISD

1. The primary objective of the Investment Services Directive (ISD) is to provide a framework to facilitate and support the operation of a Single Market in investment services.
2. In respect of markets within the European Economic Area (EEA) on which ISD instruments are traded, the ISD provides for those which meet certain criteria to be permitted to extend their operations throughout the EEA. These markets are defined as regulated markets and have in effect a European passport for their market activities which facilitates the admission to remote membership of investment firms from other EEA countries.
3. The ISD defines a 'regulated market'¹ as a market which:
 - 'appears on the list provided for in Article 16 drawn up by the member state in which the registered office of the body which provides the trading facilities is situated;
 - 'functions regularly';
 - 'is characterized by the fact that the regulations issued or approved by the competent authorities define the conditions for the operation of the market, the conditions for access to the market and, where Directive 79/279/EEC is applicable, the conditions governing admission to listing in that Directive and, where the Directive is not applicable, the conditions that must be satisfied by a financial instrument before it can effectively be dealt in on the market,
 - 'requires compliance with all the reporting and transparency requirements laid down pursuant to Articles 20 and 21.'

The need to develop standards

4. FESCO recognises that the ISD establishes some important basic requirements for EU (securities and financial derivatives) markets wishing to be recognised as regulated markets under the ISD. However, it also considers that there are a number of areas in which, for the maintenance of public confidence in regulated markets, fuller and more explicit regulatory 'standards' are needed. Common standards within the EEA are also needed because of the freedom which regulated markets have to admit as members/ participants, firms authorised in other EEA States and to provide remote access by electronic communication to firms in the EEA.
5. A major objective in establishing high standards for markets is to foster public confidence in their operation. This in turn should help to ensure that the market process plays a fully effective role in serving the needs of issuers, savers and the economy more generally. The value to the economy of markets that command public confidence is now widely recognised, and most jurisdictions are committed to establishing the regulatory standards for their markets that should help to achieve this.

¹ ISD Article 1

6. Change in the market environment – driven by advances in IT, the increase in cross-border capital flows and, most recently, the launch of the Euro – is rapid and the consequences for market structure and market regulation are likely to be profound. The development of electronic trading, in particular, is tending to fragment the arrangements that have in the past concentrated trading on single, domestically focused, national exchanges. Today, there is not only competition among exchanges but they are also forging new alliances and may have cross membership agreements with exchanges from other EEA States and from outside the EEA. New trading platforms and trading systems are being developed to trade exchange-based instruments and/or commoditised non-exchange products.
7. These developments raise significant issues for regulators. How individual regulatory authorities address them will depend on the scope of their domestic law, their overall approach to market supervision and, increasingly, their relations with authorities outside their jurisdiction. In this context, FESCO believes it will be helpful to agree on relevant standards for markets which seek to establish themselves in the EEA.

The standards

8. FESCO has therefore agreed and published these standards, which add detail to, and supplement, the ISD requirements for regulated markets. Furthermore, FESCO expects this paper to assist the European Institutions when considering any modifications to securities markets legislation in Europe. Given the pace of change, FESCO will review the standards periodically and modify them as necessary. FESCO is also examining the broader regulatory issues arising in the EEA from changes in market structure and the development of new trading mechanism and practices.
9. The paper is in three parts. This introduction is followed by the standards as concluded by the FESCO Members. The final part sets out each standard with a commentary to guide regulatory authorities and regulated markets in addressing them. The order follows that laid out in the Article 1 of the ISD (see para 3, dot 3 above). The standards therefore address:
 - the conditions for operation of the market,
 - the conditions for access to the market, and
 - the conditions governing listing and/or admission to trading.
 - The standards relate to regulated markets. There are for instance, two standards (8 and 9) that require that adequate clearing and settlement arrangements should exist for the proper performance of transactions on regulated markets. It is beyond the scope of this paper to set standards for the clearing and settlement systems themselves.
10. FESCO members will introduce these standards in their regulatory objectives and, when possible, in their respective rules. If a FESCO member does not have the authority to implement a certain standard, it will seek to commend the standard to its government and to the responsible regulatory authority. FESCO members will publicly disclose the manner in which they implement these standards.
11. In finalising this paper FESCO has consulted the Federation of European Stock Exchanges (FESE) and the European Community Options and Futures Exchanges (ECOFEX).

12. In September last year, the International Organisation of Securities Commissions (IOSCO)² adopted and published 'Objectives and Principles of Securities Regulation', focusing in particular on the following objectives:

- investor protection,
- fair, efficient and transparent markets,
- the reduction of systemic risk.

FESCO's approach in drawing up these standards has taken cognisance of these principles and objectives.

14. In developing the standards for regulated markets, FESCO has taken into account the need not to hamper financial innovation or limit competition in the supply of financial products and services.

15. Additionally, FESCO has considered whether it should promote relatively narrow and prescriptive standards for regulated markets or adopt a rather more general approach that offers regulators some flexibility to take into account such factors as the transparency of the risks involved. It has adopted the latter approach.

16. In setting these standards, FESCO has been mindful that there is no current linkage between the ISD concept of a regulated market and that of 'regulated markets' as specified in the UCITS Directive (85/611/EEC). Regulators would appropriately and usefully refer to the same standards as those set out in this report for ISD regulated markets when addressing the issue of permissible investments under the UCITS Directive.

² IOSCO has published a number of documents of importance in this area, inter alia "Transparency on Secondary Markets (December 1992), "Report on co-operation between Market Authorities and Default Procedures" (March 1996).

CORE STANDARDS FOR REGULATED MARKETS

CONDITIONS FOR OPERATION OF THE MARKET

Governance

- 1. Ownership arrangements should be transparent. Holders of proprietary interests in a regulated market who are in a position to exercise effective control and the persons at director level who determine the day to day policy of the regulated market should be fit and proper. The manner by which the regulatory authority achieves this objective may vary. Where this is not achieved by a process of prior approval, regulatory authorities should have other ways of ensuring the objective is met.*
- 2. A regulated market should pay careful attention to conflicts of interest that may arise between its commercial objectives and its regulatory responsibilities. To ensure that the public interest in high regulatory standards is upheld, a market's constitutional arrangements must provide for it to be able to carry out its regulatory obligations effectively. Securities regulators should consider these arrangements not only in respect of the regulation of trading but also in respect of any other regulatory responsibilities the operator of the regulated market may have.*

Of particular importance to securities regulators, especially in the context of 'for profit' and competing exchanges, is that there are proper regulatory arrangements that specifically address such conflict of interest in respect of the approval of the prospectus to be published for the listing or admission to trading of securities and the responsibilities concerning the ongoing information to be disclosed by the companies whose securities are listed or admitted to trading.

Management, systems and resources

- 3. Management structures and resources should be such as to enable a regulated market to deliver its service reliably and allow the operator to identify, assess and manage risk efficiently.*
- 4. The IT systems used by a regulated market should deliver high standards of reliability and minimize operational risks to the regulated market and market users.*
- 5. Financial resources should be sufficient to address the risks to which a regulated market may be exposed and to enable an orderly closure of a regulated market should that become necessary. Risk management procedures must be in place.*
- 6. Where a regulated market exercises regulatory responsibilities and is allowed to delegate a function for which it has regulatory responsibility, it should exercise due care and diligence in doing so. In any event it must retain full regulatory responsibility for the exercise of that function and should notify the regulator in advance of such arrangements.*

Trading

- 7. The trading process on a regulated market should ensure the fair and orderly conduct of business. In particular, there should be rules and/or procedures that:*
 - provide a price formation process in which market users can have confidence;*

- *enable market users to obtain the best price available for a trade, taking into account the nature of the trading system and the size of the transaction and, in particular, ensure real time disclosure of the best bid and ask prices, and the size of possible transactions at those prices (pre trade transparency);*
- *ensure real time disclosure of the price and volume of all completed transactions, including 'off market' trades executed under the rules of the regulated market by member firms or firms admitted to the regulated market. The publication of prices and volumes should be delayed or suspended only in circumstances permitted in article 21, paragraph 2 of the ISD. The use of these kind of derogations of the transparency requirements should be periodically reviewed and the regulated market should be able to justify their use in the public interest (post trade transparency);*
- *are designed to prevent disorderly markets;*
- *ban practices that have the effect of unfairly disadvantaging other market users.*

Performance of transactions

8. *Arrangements must be in place for the performance of transactions executed via a regulated market's facilities. These should be designed to provide for:*
- *the timely settlement of transactions;*
 - *the minimization of settlement risk;*
 - *the provision of effective procedures for handling defaults, and other cases of non-performance, in an orderly manner.*

Systems used for the clearing and settlement of transactions executed on a regulated market should be subject to regulatory approval and oversight.

9. *Arrangements should be in place to ensure that transactions will be settled in as short a cycle as possible. In particular for immobilized or dematerialized bonds and shares (no physical delivery to investors), the target standard should be no more than T+3.*

Monitoring and enforcement

10. *Resources and procedures, including adequate data recording and audit trails, must be in place to ensure that a regulated market monitors compliance with its rules effectively. Where some of the data is not stored by the regulated market, the regulated market should have arrangements under the responsibility of the regulated market to obtain this information in a timely fashion. If a regulated market identifies serious breaches of its rules or breaches of other regulations or legislation relevant to the regulatory authority, it should notify its regulatory authority.*
11. *There should be arrangements for handling complaints and effective and impartial disciplinary arrangements for addressing breaches of a regulated market's rules or other behaviour by members or participants that is likely to damage the market. There must be provisions, in the case of serious rule breaches or other misconduct, for the expulsion of members and the termination of trading in securities it has admitted to trading. The regulatory authority should be informed beforehand of such an expulsion or termination.*

12. *A regulated market must be ready, to the best of its ability in accordance with its national law, to co-operate with other regulated markets and competent authorities and to provide such information to them as may be required for them to fulfil their obligations.*

CONDITIONS FOR ACCESS TO THE MARKET

Membership

13. *Admission and participation processes should ensure that a regulated market admits to membership, or participation, only firms and persons which:*
- *are fit and proper;*
 - *have a sufficient level of trading ability and competence, and the technical capability to meet the reporting requirements;*
 - *have sufficient capital for the role they are to perform as a member of the regulated market and over which the regulated market is confident that it can enforce its rules;*

Technical access arrangements

14. *Arrangements for providing technical access to members/participants should ensure:*
- *adequate protection to the integrity of the regulated market;*
 - *that the allocation of responsibilities for the proper functioning of the arrangements are clear and that there are procedures for resolving problems speedily should they arise.*
 - *Whether or not the connection from the market operator's computer to terminals of the member/ participant is provided by the market operator, the member/ participant or third party supplier, the regulated market retains responsibility for establishing standards that will safeguard the orderly conduct of business.*
15. *A regulated market should satisfy itself that member firms/ participants which provide clients with an electronic link to their computers for transmission of the clients' orders to the market, have proper safeguards in place. At a minimum, the safeguards which should be in place are that:*
- *the member firm/ participant is able to detect the input of orders that could be regarded as 'abnormal' in the current market conditions;*
 - *the member firm/ participant is able to halt any orders that would result in the client breaching any credit limits or any restriction on the order size or type it may place.*

In any event regulated markets should ensure that the member/ participant remains fully responsible for any order entered into the market from the member's trading computer.

CONDITIONS GOVERNING LISTING AND/OR ADMISSION TO TRADING

- 16. Only securities in which there is a proper market should be admitted to trading. A proper market means a market in which:***
 - investors have adequate information relevant to the security, on an equal basis with others, to be able to form a judgement as to its current value;***
 - the securities are properly constituted under the laws of the issuer.***
- 17. In the case of shares and debt securities, arrangements should exist so that market users can readily determine whether a security is admitted to official listing within the terms of the Directive 79/729/EEC and a prospectus has been published in the framework of this admission and if not, under what arrangements these securities have been admitted to trading.***
- 18. In the case of derivatives, the contracts should be designed so as to allow the orderly pricing in both the derivative and the cash market and should be appropriate to avoid the risk of disruption, including manipulation, in these markets.***
- 19. Regulated markets should have procedures to ensure that securities that no longer meet the admission requirements are removed from trading. When taking such a decision, the regulated market should consider the advantages and disadvantages of the withdrawal of securities, including investor protection, the cost and loss (for investors) in liquidity.***

THE STANDARDS

CONDITIONS FOR OPERATION OF THE MARKET

Governance

- 1. Ownership arrangements should be transparent. Holders of proprietary interests in a regulated market who are in a position to exercise effective control and the persons at director level who determine the day to day policy of the regulated market should be fit and proper. The manner by which the regulatory authority achieves this objective may vary. Where this is not achieved by a process of prior approval, regulatory authorities should have other ways of ensuring the objective is met.***
- 2. A regulated market should pay careful attention to conflicts of interest that may arise between its commercial objectives and its regulatory responsibilities. To ensure that the public interest in high regulatory standards is upheld, a market's constitutional arrangements must provide for it to be able to carry out its regulatory obligations effectively. Securities regulators should consider these arrangements not only in respect of the regulation of trading but also in respect of other regulatory responsibilities the operator of the regulated market may have.***

Of particular importance to securities regulators, especially in the context of 'for profit' and competing exchanges, is that there are proper regulatory arrangements that specially address such conflict of interest in respect of the approval of the prospectus to be published for the listing or admission to trading of securities and the responsibilities concerning the ongoing information to be disclosed by the companies whose securities are listed or admitted to trading.

1. It is important to overall market confidence that the service provided by a regulated market is delivered with proper regard to high standards and integrity. Just as a firm is expected to meet standards of fitness and propriety, so too should a regulated market.
2. The importance of ensuring the integrity of the service is such that those who are in a position to exercise effective control because they are responsible for the day to day policy of the regulated market or through a proprietary interest in the regulated market, should be fit and proper. The process by which a member state achieves this objective may vary. What is important is that those who license or recognize regulated markets should have the capability, directly or indirectly, to ensure that regulated markets remain outside the control of parties who are deemed to be unfit.
3. An issue of particular importance for bodies that carry self-regulatory responsibilities is that of managing any conflicts of interest that may arise between an operator's commercial interests and its regulatory responsibilities. Whatever its ownership structure, a regulated market should have in place governance arrangements that minimize such conflicts and ensure, where they do arise, that they are satisfactorily managed so that the public interest prevails. Regulatory authorities should keep under review the conflicts that may arise from the development of 'for profit' and competing markets and be ready to modify regulatory arrangements including those for the approval of the prospectus to be published for the listing or the admission to trading of securities and for the supervision of the ongoing information to be disclosed by companies whose securities have been listed or admitted to trading if they consider that to be necessary in the public interest.

Management, systems and resources

- 3. *Management structures and resources should be such as to enable a regulated market to deliver its service reliably and allow the operator to identify, assess and manage risk efficiently.***
 - 4. *The IT systems used by a regulated market should deliver high standards of reliability and minimize operational risks to the regulated market and market users.***
 - 5. *Financial resources should be sufficient to address the risks to which a regulated market may be exposed and to enable an orderly closure of a regulated market should that become necessary. Risk management procedures must be in place.***
 - 6. *Where a regulated market exercises regulatory responsibilities and is allowed to delegate a function for which it has regulatory responsibility, it should exercise due care and diligence in doing so. In any event it must retain full regulatory responsibility for the exercise of that function and should notify the regulator in advance of such arrangements.***
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4. Public confidence in regulated markets is likely to be best maintained when the operator of a market facility provides a service that is recognised to be efficient and reliable. The pivotal role of regulated markets in the trading of securities means that users need to be able to rely on the facilities they are using. This means that they should be able to depend on the operator's management competence, the quality of the I.T. and other systems employed and the adequacy of financial resources.
 5. A regulated market's technical systems need to be capable not only of providing a reliable and secure trading and information service to users, but also of delivering other regulatory objectives, including the recording of full trade details, the safe storage of relevant information and systems to enable information to be used in assisting in maintaining orderly markets and combating financial crime and market abuse.
 6. The level of financial resources that any individual regulated market should provide will depend on a variety of factors. These might include such considerations as the scale and complexity of the operation and the nature of any particular risks to which the regulated market may be exposed (e.g. whether or not it enters into market contracts with members and bears a counter party risk). The appropriate level of resources will also need to take into consideration the financial needs or liabilities of any other activity engaged in by the market operator, or any guarantor, and the way in the latter case in which the regulated market's regulatory capital is ring-fenced. Resources should also be sufficient for users to hold an expectation that when a market is recognised and assigned as a regulated market it will have a reasonable life expectation and that if the regulated market is to close, whatever the reason or circumstances, it should be able to do so in an orderly fashion and by limiting as much as possible the loss to users.
 7. Where a market operator is allowed to delegate any functions for which it has regulatory responsibility (e.g. the operation of the regulated market's systems), it cannot divest itself of its regulatory responsibility for these functions. It should take care to contract only with reputable and reliable third parties and notify the regulatory authority in advance.

Trading

7. ***The trading process on a regulated market should ensure the fair and orderly conduct of business. In particular, there should be rules and/or procedures that:***
 - ***provide a price formation process in which market users can have confidence;***
 - ***enable market users to obtain the best price available for a trade, taking into account the nature of the trading system and the size of the transaction and, in particular, ensure real time disclosure of the best bid and ask prices, and the size of possible transactions at those prices (pre trade transparency);***
 - ***ensure real time disclosure of the price and volume of all completed transactions, including 'off market' trades executed under the rules of the regulated market by member firms or firms admitted to the regulated market. The publication of prices and volumes should be delayed or suspended only in circumstances permitted in article 21, paragraph 2 of the ISD. The use of these kind of derogations of the transparency requirements should be periodically reviewed and the regulated market should be able to justify their use in the public interest (post trade transparency);***
 - ***are designed to prevent disorderly markets;***
 - ***ban practices that have the effect of unfairly disadvantaging other market users.***
8. Generally speaking, the characteristics investors look for when seeking to transact business are prices in which they can have confidence, liquidity and the ability to obtain the best price available at the time for their size and type of trade.
9. The way in which prices are determined reflects a number of factors. These include the transparency arrangements, the algorithms adopted for executing orders, any arrangements for the enhancement of natural liquidity, and the kind of trading strategies and practices that the regulated market permits or prohibits.
10. FESCO does not regard it as the role of the regulator to prescribe market design, which in any case may vary according to prevailing market practice for different securities. Rather, it considers that a regulated market's trading arrangements should seek to meet certain objectives. One of the most important functions of a regulated market is to have a price formation process which produces prices that reflect the free balance of supply and demand in a particular security and, where applicable, 'expected' pricing relationships with other securities.
11. Important considerations here are likely to be the amount of trading information - both pre and post trade - available to users of the regulated market, the order handling process and the algorithm for trade execution. Article 21 of the ISD sets out minimum requirements for the disclosure of post-trade information. These set standards for securities - which are exceeded in many jurisdictions - while also permitting member states to adopt different arrangements in respect of small markets, very large trades, highly illiquid securities, and bonds and other forms of securitised debt. While FESCO recognises that the appropriate transparency arrangements may need to differ according to the nature of the regulated market, it also considers that high levels of transparency are desirable, and should be achieved. Where a regulated market makes use of the derogations provided in article 21, paragraph 2 of the ISD, it should be able to demonstrate that this produces an overall benefit to market users. A regulated market should ensure that its publication arrangements cover all transactions conducted under its rules, whether or not those trades are executed by means of the market's facilities (e.g. its electronic order book).

12. Pre-trade transparency is also important. It provides for interest in trading to be widely advertised, broadening trading opportunity and increasing the likelihood of execution at the most competitive terms available. The arrangements under which this is achieved may vary according to the extent that the regulated market is a dealer market, an open outcry market or an electronic order-book market - or some mix of these. In any event, high levels of pre-trade transparency are likely to be conducive to users of the regulated market being able to execute at the best available price for their size of order.
13. In regulated markets operating market maker systems, or where special arrangements are in place for firms to enhance liquidity, the market operator should approve, and periodically review, any incentives or protections made available to dealers in return for providing a liquidity service.
14. Investor confidence is particularly likely to be harmed where markets become exceptionally volatile or the price behaviour of individual instruments is erratic. In the case of the former, market operators need to weigh the benefits of allowing continuous trading against the desirability of interposing processes which afford market users the opportunity to reassess a changed situation and to alter their orders accordingly. There should be procedures to suspend trading in fast markets where this is necessary to maintain an orderly market.
15. In respect of individual securities, erratic trade to trade pricing and market abuse is more likely to occur in the case of illiquid and relatively infrequently traded securities. Traded prices of less liquid securities are always likely to be inherently more volatile than those of liquid ones and market operators should consider in the first instance the most appropriate methods for trading such securities. Some regulated markets may prefer to concentrate supply and demand in periodic auctions, while others may prefer to offer a continuous liquidity service (albeit in small size) via contracted liquidity providers. The process employed by a regulated market will to some extent reflect investor preferences, but market operators should be encouraged to review, periodically, their approach to trading in less liquid securities. If an investor is trading in an illiquid security, he must be able to obtain the information to be aware of that fact.
16. Market abuse, in the form of trading practices that unreasonably disadvantage other users, will always serve to undermine confidence in markets, as well as harm those individuals who are victims of the abuse. In most jurisdictions, the major forms of market abuse – insider dealing and market manipulation – are criminal offences and are addressed by the regulatory authority or other governmental authorities. In addition, regulated markets need to have rules banning unfair practices by their members/ participants. Practical ways of doing this may include paying particular attention to the design of derivative contracts, the procedures adopted for setting key reference prices (such as daily closing prices and futures expiry prices) and by ensuring that any indices are constructed in ways that minimise their vulnerability to manipulation.

Performance of transactions

8. ***Arrangements must be in place for the performance of transactions executed via a regulated market's facilities. These should be designed to provide for:***
 - *the timely settlement of transactions;*
 - *the minimization of settlement risk;*
 - *the provision of effective procedures for handling defaults, and other cases of non-performance, in an orderly manner.*

Systems used for the clearing and settlement of transactions executed on a regulated market should be subject to regulatory approval and oversight.

- 9. *Arrangements should be in place to ensure that transactions will be settled in as short a cycle as possible. In particular for immobilized or dematerialized bonds and shares (no physical delivery to investors), the target standard should be no more than T+3.***
17. The formation of a bargain is only the first stage in a transaction. The transaction entered into still has to be performed in accordance with the terms of the contract and it is critical to investor confidence that users of the regulated market can rely on their transactions being honoured, and in a timely fashion. All regulated markets should therefore have robust arrangements to ensure the performance of transactions undertaken on their markets. Where clearing and settlement of the transactions effected on the regulated market are undertaken by third parties, the regulated market must be able to demonstrate that the overall arrangements enable that objective to be met. It is not enough for regulated markets to expect market participants to look after themselves.
18. In addressing the performance of transactions, regulated markets should have:
- ‘up front’ measures to reduce the risk of non-performance;
 - arrangements which deliver reliable clearing and settlement;
 - procedures to deal efficiently with cases of non-performance.
19. Important ‘up front measures’ are that members/ participants should have adequate capital for the trading they may undertake – these will already be provided for in the case of ISD firms in relation to the investment services performed. Regulated markets should also have prudent processes for assessing (and implementing) any limits on members’/participants’ trading activity. When trades are not guaranteed by a central counterparty, the market should have other arrangements in place – for example, a guarantee fund or insurance – to provide protection to users, taking into consideration the nature of the market and of the professional status of the users. These arrangements are especially important where trading takes place on an anonymous basis and parties therefore rely on the regulated market to provide a degree of protection.
20. The arrangements for clearing and settlement themselves should provide for as short a cycle as practicable. Initial matching and confirmation and, where applicable, novation and/or netting should take place as soon after execution as possible. T+3, the standard as agreed by the G 30 is still considered sufficient for transactions in immobilised or dematerialised shares and bonds (that is where there is no physical delivery to investors).
21. While central counterparty settlement is standard in derivatives markets, FESCO recognises that alternative arrangements can provide adequate risk minimisation in the case of other securities. What is important is that the approach adopted does reduce risk to a minimum level. Where central counterparty systems are used, they should have adequate financial resources whether in the form of clearing funds, insurance policies or other arrangements in order to be able to meet their potential liabilities. Their risk management procedures should be of high quality and should include efficient margining arrangements.
22. Settlement itself should always be on a delivery versus payment basis in the case of securities, thus ensuring that neither party is out of securities or funds, and should be final. In the case of derivatives, settlement should ensure the simultaneous exchange of credits and debits in the case of cash settled contracts, and robust arrangements for delivery in the case of deliverable contracts.

23. Non-delivery should be a breach of regulated market's rules. Where non-performance occurs for reasons other than default, the regulated market should ensure that there are procedures in place to resolve the position. These might include a buying-in facility or an arbitration process that requires the parties to reach a speedy cash settlement. In any event, the regulated market should have rules requiring timely settlement of trades, and procedures to enforce this.
24. Where a member/participant in the regulated market or, where relevant, a Clearing House defaults, default procedures should be in place which minimise market disruption and protect users' interests. These should ensure that completed transactions cannot be unwound. Default procedures should be transparent in order to provide certainty and predictability to market participants, to facilitate orderly handling in the case of a default and to enable market participants to make an informed assessment about markets.

Monitoring and enforcement

10. ***Resources and procedures, including adequate data recording and audit trails, must be in place to ensure that a regulated market monitors compliance with its rules effectively. Where some of the data is not stored by the regulated market, the regulated market should have arrangements under the responsibility of the regulated market to obtain this information in a timely fashion. If a regulated market identifies serious breaches of its rules, or breaches of other regulations or legislation relevant to the regulatory authority, it should notify its regulatory authority.***
11. ***There should be arrangements for handling complaints and effective and impartial disciplinary arrangements for addressing breaches of a regulated market's rules or other behaviour by members or participants that is likely to damage the market. There must be provisions, in the case of serious rule breaches or other misconduct, for the expulsion of members and the termination of trading in securities it has admitted to trading. The regulatory authority should be informed beforehand of such an expulsion or termination.***
12. ***A regulated market must be ready, to the best of its ability in accordance with its national law, to co-operate with other regulated markets and regulatory authorities and to provide such information to them as may be required for them to fulfil their obligations.***
25. Confidence in regulated markets rests not only on the quality of their organisation and procedures but on the way in which they enforce their rules. Markets which fail to monitor and enforce their rules, whether through lack of efficiency or as the result of governance arrangements that compromise their ability to do so, may harm users and deprive them of the fair treatment they are entitled to expect. In addition to serious breaches of its own rules, a regulated market should report to its regulatory authority regulatory or legislative breaches relevant to that authority.
26. A regulated market should have a dedicated regulatory department that has an appropriate management organisation and resource. A suitably qualified and senior manager should have operational charge of the department, and there should be arrangements in place to ensure that the Board (or those responsible for the governance of the regulated market) are in a position to ensure that the regulated market's regulatory obligations are fully discharged.

27. Fundamental to the regulated market's ability to discharge those responsibilities is the quality of the data collected and the processes used for recording it. However, it is not sufficient for a regulated market simply to collect and record data. It also needs to have processes that enable it to make use of the data, either for real-time monitoring or for post-event audit. The regulated market should in any event have processes which enable it to monitor the orderliness of trading in real-time, whether the trading takes place on an electronic order-book, on a floor, in a pit, or via telephone, fax or any other messaging system.
28. There should be strong and impartial disciplinary procedures. A good disciplinary arrangement is the establishment of an impartial disciplinary committee (or committees). Such committees must be empowered, in the case of serious breaches of trading or other membership rules, to suspend or expel members. Where the regulated market becomes aware of events that mean there may no longer be a proper or orderly market in specific securities, there should be adequate arrangements through which trading (on its market) in those securities can be suspended or permanently terminated. The regulatory authority must be informed beforehand of such an expulsion or termination. In some jurisdictions in these circumstances a prior authorisation by the regulatory authority will be needed.
29. In today's environment in which securities, derivatives on those securities and indices are often traded on different markets, co-operation between a regulated market's regulatory department and those of other markets and market supervisory bodies more generally is of critical importance. It is important that regulated markets are not only ready to co-operate, so far as the law makes this possible, but manage their business in a way that makes it possible for them to be able to respond quickly and fully to the kinds of requests they themselves would be likely to make of others. The need for co-operation becomes even more important because of the (trading) links which are being developed between (regulated) markets.

CONDITIONS FOR ACCESS TO THE MARKET

Membership

13. ***Admission and participation processes should ensure that a regulated market admits to membership, or participation, only firms and persons which:***
 - ***are fit and proper;***
 - ***have a sufficient level of trading ability and competence, and the technical capability to meet the reporting requirements;***
 - ***have sufficient capital for the role they are to perform as a member of the regulated market and over which the regulated market is confident that it can enforce its rules.***
30. It is of fundamental importance to all market participants that those with whom they trade on a regulated market abide by the rules of the market and are capable of fulfilling their transaction obligations.

31. Article 15 of the ISD stipulates (in summary) that membership or access to a regulated market shall be conditional in respect of investment firm's own compliance with:
 - investment firms' capital adequacy requirements and home member states supervising such compliance;
 - the rules of the regulated market in relation to the constitution and administration of the regulated market,
 - the rules relating to transactions on the market;
 - the professional standards imposed on staff operating on and in conjunction with the market,
 - the rules and procedures for clearing and settlement.
32. Member States' regulatory authorities are responsible for checking that firms and persons comply with those requirements which are imposed by the ISD (especially on fitness and propriety). Where the firm is established in the same Member State as the regulated market, the same regulatory authorities may be involved. In case of admittance or participation of firms situated in other EEA States (remote members), the regulated market can rely on the checking by the regulatory authority in the home EEA State so far as it is the responsibility of that regulatory authority as home country supervisor. For European Standards of Fitness and Propriety, we refer to FESCO document 99-Fesco-A.
33. With technology now making possible a much wider potential membership or participation in markets, the operators of regulated markets may wish to grant access to firms outside the EEA or to persons who may not require authorisation under the provisions of the ISD or laws of the Member States. Admission to regulated markets of such firms or persons may have considerable benefits for the regulated market. However such firms and persons should only be admitted where the regulated market is satisfied that:
 - it can contractually enforce its rules (including trading, settlement and default rules);
 - there are adequate means of co-operation and information sharing between its own regulatory authority and that of the participant;
 - any necessary modification to the general conditions of entry are not detrimental to the interests of other members, individually or collectively, or to the regulated market as a whole;
 - such persons and firms meet the commercial and legal criteria of membership including reporting requirements.
34. In general, firms which are allowed to be a member of a regulated market are authorised investment firms and credit institutions under the scope of the ISD (except for example locals as mentioned in article 2, paragraph 2, under j of the ISD). However, some regulated markets have not only broadened their traditional membership among firms authorised on the basis of other financial legislation, e.g. by admitting fund management groups, but also admitted non-authorised firms on condition that they engage only in 'own account' dealings. While until now it has remained uncommon for unauthorised firms or individuals to become member or participant, this is certainly possible technologically. Where this is contemplated, the regulated market will need to take extra care to ensure that satisfactory arrangements are in place which are fully consistent with the financial and operational integrity of the market. In the case of investors being member/participants of the market, this should always involve arrangements under which the market operator is able to restrict the participant's trading according to the funds and securities currently available, or, in the case of derivatives, the deposit of sufficient collateral.

Technical access arrangements

14. Arrangements for providing technical access to members/participants should ensure:

- *adequate protection to the integrity of the regulated market;*
- *that the allocation of responsibilities for the proper functioning of the arrangements are clear and that there are procedures for resolving problems speedily should they arise. Whether or not the connection from the market operator's computer to terminals of the member/ participant is provided by the market operator, the member/participant or a third party supplier, the regulated market retains responsibility for establishing standards that will safeguard the orderly conduct of business.*

A regulated market should satisfy itself that member firms/ participants which provide clients with an electronic link to their computers for transmission of the clients' orders to the market, have proper safeguards in place. At a minimum, the safeguards which should be in place are that:

- *the member firm/ participant is able to detect the input of orders that could be regarded as 'abnormal' in the current conditions;*
- *the member firm/ participant is able to halt any orders that would result in the client breaching any credit limits or any restriction on the order size or type it may place.*

In any event regulated markets should ensure that the member/ participant remains fully responsible for any order entered into the market from the member's trading computer.

35. Electronic trading platforms offer many benefits to market users provided that they are well designed and well constructed. An important part of the total system is the link between the trading system and the member/participant. In some cases the regulated market will provide this link, including the terminal on the trader's desk; at the other extreme, the regulated market leaves it to the member firm or some third party service provider to establish the link. Different markets favour different approaches. But whatever the choice, the onus remains on the market operator to ensure that the arrangements for access to its trading platform operate in a way that enables it to meet its obligations to ensure the orderly conduct of trading.

CONDITIONS GOVERNING LISTING AND/OR ADMISSION TO TRADING

16. Only securities in which there is a proper market should be admitted to trading. A proper market means a market in which:

- *investors have access to adequate information relevant to the security, on an equal basis with others, to be able to form a judgement as to its current value;*
- *the securities are properly constituted under the laws of the issuer.*

- 17. *In the case of shares and debt securities, arrangements should exist so that market users can readily determine whether a security is admitted to official listing within the terms of the Directive 79/729/EEC and a prospectus has been published in the framework of this admission and if not, under what arrangements these securities have been admitted to trading.***
- 18. *In the case of derivatives, the contracts should be designed so as to allow the orderly pricing in both the derivative and the cash market and should be appropriate to avoid the risk of disruption, including manipulation, in these markets.***
- 19. *Regulated markets should have procedures to ensure that securities that no longer meet the admission requirements are removed from trading. When taking such a decision, the regulated market should consider the advantages and disadvantages of the withdrawal of securities, including investor protection, the cost and loss (for investors) in liquidity.***
36. Investors use regulated markets to buy and sell interests in commercial and financial risk. Those are risks they assess for themselves: regulation is not intended to protect them in determining what risks to buy or to sell but to give them information as complete and accurate as possible in order that they will be in a position to form their own judgement. In addition investors need to know that a proper market exists in the instruments they trade on the regulated market.
37. The definition of a regulated market in Article 1 in the ISD stipulates, inter alia, that the regulations issued and approved by the competent authorities must, where Directive 79/279/EEC is applicable, define the conditions governing admission to listing in that Directive and, where the Directive is not applicable, the conditions that must be satisfied by a financial instrument before it can effectively be dealt in on the regulated market.
38. In the case of corporate securities investors need to have sufficient information, on a timely basis, to be able to form a view as to the current value of the security (or any other instrument priced in relation to that security). Where a security is 'officially listed', EC directives and national legislation, together with the rules of the competent authority for listing, already require full and timely publication of such information, not only at the point of listing but also on a continuing basis. In a number of EEA States, such requirements apply not only to the official list but to every security, listed or admitted to trading on a regulated market.
39. Where Directive 79/279/EEC is not applicable, the regulated market should have conditions governing the admission to trading on that market. These conditions should be issued or approved by competent authorities.
40. In respect of shares and debt securities admitted to trading on a regulated market which are not officially listed, the requirements for the publication of information differ in the EEA states. FESCO will work on the harmonisation of these information requirements.
41. The proper functioning of regulated markets also requires that securities that are traded on those markets do not have restrictions on transferability which would impede confidence in the market or its orderly operation. Therefore regulated markets should have requirements which do not allow such securities to be admitted.

42. In the case of derivatives, the regulated market should ensure that the contracts it trades have been soundly structured, taking into account:
- their economic utility, their correlation with the underlying instrument, which should itself be sufficiently liquid, and
 - the arrangements for arriving at expiry prices and, where applicable, delivery arrangements.³

³ See IOSCO paper on ‘The application of the Tokyo Communiqué to exchange-traded financial derivatives products, (September 1998).

Definitions

1. European Economic Area – the Member States of the European Union, Norway, Iceland and Liechtenstein.
2. Market operator – the entity which has operational responsibilities for a regulated market.
3. Regulatory authority – a Securities Commission within the European Economic Area, responsible for regulated markets.
4. Regulated markets – markets which are notified to the European Commission on the basis of article 16 of the ISD.
5. Securities – except where the context otherwise requires, the instruments as mentioned in section B of the annex to the ISD.