THE PARTICULARITIES OF COMPLIANCE AT A TRADING VENUE

We have asked Alpay Soytürk, Head of Compliance and Trading Surveillance at Spectrum Markets about the intricacies of compliance at a trading venue.

Mr. Soytürk, everybody has an at least vague idea of what Compliance comprises – can you please elaborate on the particularities of Compliance at a trading venue?

The operation of a trading venue constitutes an investment service under the regulatory terms of MiFID[1] and, respectively, WpHG[2]. Accordingly, the duties of the compliance function comprise the assessment of compliance risks, monitoring obligations, reporting obligations as well as performing advisory and support tasks. From a risk management perspective, Compliance forms the 2nd line of defence between business and audit. That's the standard composition of how the compliance function is integrated in an investment services provider's risk architecture.

The function specialises, however, with a view to its capital market compliance aspects, i.e., the obligation of enforcing the rules under the Market Abuse Regulation[3] – covering the prohibition of insider dealing, unlawful disclosure of inside information and provisions to prevent and detect market manipulation. The latter is obviously key for the compliance of a trading venue.

What kind of abusive acts are there and have they increased over the recent years?

Generally speaking, the prohibited activities are Insider Dealing and Market Manipulation. It is not just forbidden to engage in insider dealing, the attempt alone is already punishable as is to recommend or entice insider dealing to third parties or the unlawful disclosure of inside information. Prohibited behaviour that is referred to as Market Manipulation comprises trade-based manipulation, information-based manipulation, reference value related manipulation and other acts of deception. The compliance function's responsibility spans a much wider area of monitoring obligations but as far as the field of trading is concerned, these are the most relevant ones.

Clearly, manipulation techniques vary and are evolving over time, i.e. they get more sophisticated with technological progress. However, the core concepts, e.g., insider dealings, front running, wash trades, layering, spoofing – to name but a few – have remained widely unchanged. Consequently, any strategy aiming at the prevention of market manipulation must be considerate of the specific characteristics of an individual type of market abuse. Once these attributes are known, a certain pattern can be translated into indicators that allow for detecting possible cases of, e.g., market manipulation. Then again, simply breaking it down to observing alerts would be way too careless. It is as important to properly assess the risk management needs particular to a certain type of market or instrument.

With a view to the development of the volume of such fraudulent behaviour, it is true that there has been a significant increase of suspicious transactions observed in the market over the course of the past 5 years. But that is simply due to a much stricter regulatory regime rather than being an indicator for an increase in market manipulation overall.

What is at the heart of the changed legal environment?

I did already mention the core legal frameworks – aside from the much-increased monitoring and reporting obligations, the strongest impact of these concepts is that they are aligned on a European level, that single regulations are also aligned with one another and contain many cross-references and that their enforcement has also been exacerbated and harmonised.

How is order execution at Spectrum sheltered from abusive practices?

Spectrum Markets has been established as a Multilateral Trading Facility (MTF). That, in itself, is a substantial advantage over the alternative to having your orders executed over the counter, given the high transparency standards that are legally required. We have in place a number of pre-trade controls that automatically rejects orders which are unusual in their number, price or size both in terms of units and value. Mechanisms that have been set up to curtail extreme volatility such as circuit breakers, trading halts or suspensions indirectly also work as a shield against abusive tactics.

In addition, we do of course use tools to monitor trading activities in order to detect manipulative behaviour. For these, it is important that they can be incorporated complex rules, process loads of data in a performant manner and offer the necessary configuration flexibility to grow with increased business in terms of volume and diversification and to allow for adaption to changes in regulation. However, as mentioned earlier, there is more to a consistent approach to trade surveillance than just choosing the right monitoring software.

What would that be?

Experience, most importantly. But remember the regulatory element to compliance: There are not just the responsibilities that we have discussed. There are strict requirements to the compliance function such as to their effectiveness, skills, knowledge, expertise, authority, permanence, independence and others such as the prohibition of an outsourcing of the compliance function. A whole new reality has emerged with a view to the necessary centralisation of understanding, monitoring and steering capabilities.

As far as trading is concerned, by choosing on-venue execution you have thus yet contributed to the prevention of market manipulation to a much larger extent than you may imagine.

Thank you!

---

[1] Directive 2014/65/EU (the Markets in Financial Instruments Directive) [2] Gesetz über den Wertpapierhandel (Wertpapierhandelsgesetz)
[3] Regulation (EU) No 596/2014 (MAR)

Please don't hesitate to get in touch if you wish to receive further detail. spectrum-markets.com

Dr. Alpay Soytürk, LL.M.
Head of Compliance and Surveillance
+49 69 427 299 192
Alpay.Soyturk@spectrum-markets.com

Spectrum is the trading name of Spectrum MTF Operator GmbH. Headquartered in Frankfurt, Germany, we offer a new way of dealing in leveraged products for the European retail market; introducing a purpose built 24/5 lit trading venue, with complete transparency, increased choice and maximum control