FINMA Circular 2018/1
Organised trading facilities

Duties of operators of organised trading facilities (OTFs)

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	FMIA Articles 42–46
	FMIO Articles 38–43

Addressees

BankA			ISA			SESTA	FMIA						CISA									AMLA			Other	
Banks	Financial groups and congl.	Other intermediaries	Insurers	Insurance groups and congl.	Intermediaries	Securities dealers	Trading venue	Central counterparties	Central securities depositories	Trade repositories	Payment systems	Participants	Fund management companies	SICAVs	Limited partnerships for CISs	SICAFs	Custodian banks	Asset manager CISs	Distributors	Representatives of foreign CISs	Other intermediaries	SROs	DSFIs	SRO-supervised institutions	Audit firms	Rating agencies
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I. Purpose

This circular explains the term “organised trading facility” (OTF) as used in Article 42 of the Financial Market Infrastructure Act (FMIA; SR 958.1) as well as the duties of the operator of an OTF under Articles 43-46 FMIA and Articles 38-43 of the Financial Market Infrastructure Ordinance (FMIO; SR 958.11). 1

The term “OTF” is defined in Article 42 FMIA. The legal definition of an OTF sets it apart from a multilateral trading facility (MTF, Art. 26 let. c FMIA) and a stock exchange (Art. 26 let. b FMIA), collectively referred to as trading venues. Whereas OTFs can be used for multilateral trading in certain financial instruments on either a discretionary or a non-discretionary basis, multilateral trading in securities based on non-discretionary rules is only possible on an MTF or stock exchange. The rules for OTFs thus apply to all facilities that function in a similar way to trading venues but are either not used to trade securities or require contracts to be concluded on the basis of discretionary rules (Art. 42 let. a and b FMIA). Furthermore, certain facilities for bilateral trading in securities or other financial instruments qualify as OTFs (Art. 42 let. c FMIA). OTFs are not subject to a separate audit but are audited as part of the operator’s regulatory audit. 2

II. Scope of application

The FMIA does not treat OTFs as financial market infrastructures in their own right, stipulating instead that they must be operated by banks, securities dealers and trading venues (Art. 43 para. 1 FMIA). In addition, an OTF may be operated by a legal entity that is not authorised by FINMA but is controlled directly by a trading venue and subject to consolidated FINMA supervision (Art. 43 para. 2 FMIA). 3

Swiss banks, securities dealers and trading venues that operate an OTF in a branch or group company outside Switzerland must ensure that they can identify, limit and monitor the associated risks. 4

III. Definition of terms

A. Organised trading facility

An OTF exists when 5

- trading is governed by a set of rules that is standardised and binding for participants,
- contracts are concluded within the scope of application of these rules, and
- the initiative to trade comes or can come from the participants.

Trading facilities that fulfil the above criteria but are used exclusively for internal transactions in a group within the meaning of Article 115 lets. a and b FMIA are not covered by the OTF rules. 6

a) Standardised rules

A standardised and binding set of rules exists when the rules regarding the use of the facility, the admission of financial instruments to trading and trading between participants or between the operator and participants are the same for all participants. The rules include the principles for executing participants' orders, trading processes and trading hours. Both the operator and the participants must agree to comply with the rules, which must be binding on both. Trading must be planned in advance and conducted through recurring processes. A facility designed exclusively for spontaneous trading that is not planned in advance (ad-hoc trading) on the basis of rules that are not defined in advance is not covered by the OTF rules. 7

The terms used in the legislation were chosen to be technologically neutral and do not presuppose a particular technical system for operating an OTF. A trading facility may function solely on the basis of a set of rules. However, the presence of a technical system is an indicator of the existence of a trading facility. 8

b) Conclusion of contracts within the rules

Contracts must be concluded within the scope of application of the rules. It does not matter whether the contract is settled within or outside the rules. 9

Facilities within which no contracts are concluded thus do not qualify as trading facilities. These include, for example, the following: 10

- bulletin boards used to publish purchase and sale interests;
- other facilities that merely bundle potential purchase and sale interests and forward them through the system to the execution venue (e.g. order routing facilities);
- electronic post-trade confirmation services;
- portfolio compression facilities;
- facilities for providing indicative prices.

Where an offer is made and a contract can be concluded by accepting the offer within the rules, a trading facility exists. 11

An exchange of bids within the meaning of Article 42 FMIA can also be assumed to take place in a request-for-quote facility, which can thus be regarded as a trading facility. 12

In the case of bilateral OTFs under Article 42 let. c FMIA, contracts must also be concluded within the rules. If the exchange of bids cannot result in the conclusion of a contract within the rules, no (bilateral) trading facility exists. 13

c) Participants' initiative

It must also be possible for the initiative to trade to come from the participants. Internal trading facilities, e.g. those of asset managers, in which clients are unable to exert a direct influence on trading, therefore do not qualify as OTFs. 14

The purpose of the standardised and binding set of rules (see Margin no. 7) must be geared towards trading initiated by participants between participants or between the operator and participants. 15

B. Discretionary/non-discretionary trading

Trading rules are non-discretionary when they leave the trading value or the operator of an OTF no discretion in the matching of offers (Art. 23 FMIO). Offers are matched exclusively in accordance with the trading facility's rules or with the aid of the trading facility's protocols or internal operating processes. 16

In discretionary trading, the operator of an OTF may exercise discretion on a number of levels: 17

- by deciding whether to place a participant's order via an OTF or to withdraw it;
- and/or by deciding not to match a particular participant order at a particular time with orders present in the system, providing this is compatible with the user's instructions and the duty to ensure best execution;
- and additionally, in bilateral trading, by deciding whether to enter into a contract or reject it.

The operator must disclose to the participants the principles it uses to exercise discretion in discretionary trading. These should be based on objective criteria that do not result in the unequal treatment of participants or different types of participants (see Margin no. 34). 18

Measures under Article 40 in conjunction with Article 30 para. 2 FMIO to guarantee orderly trading (see Margin nos. 31-35) are not to be understood as use cases for exercising discretion in discretionary trading. These measures must be put in place by both trading venues (in non-discretionary trading) and operators of an OTF (in non-discretionary and discretionary trading). 19

C. Multilateral/bilateral trading

a) Multilateral trading

Multilateral trading brings together the interests of multiple participants in the acquisition and sale of securities or other financial instruments within the trading facility with a view to concluding a contract (Art. 22 FMIO). In order to ensure that the facility is neutral, executing particpants' orders against the operator's own book or that of a company belonging to the 20 same group is not permitted in principle. In contrast to bilateral trading, therefore, the operator in multilateral trading is in principle not a contracting party itself (see Margin nos. 21 and 22 for exceptions). The criterion of multiple participants is met when the facility has at least three active participants.

One exception to the principle set out in Margin no. 20 is the execution of orders from participants in matched principal trading. This is a type of transaction in which the operator intermediates between the buyer and seller in such a way as to be exposed to no market risk at any time during the execution, with both processes being executed at the same time and the transaction being settled at a price that produces no profit or loss for the operator apart from a previously disclosed commission, fee or other charge. 21

Another exception to the principle set out in Margin no. 20 applies to units separated from OTF operation through organisational measures and information barriers (see Margin nos. 26 and 27) within the legal entity that operates the facility. These units may act as market makers or participants on the operator's OTF, subject to the conditions outlined below. If a unit of the operator acts as a participant, it must be ensured that this unit is subject to the same rules as all other participants of the OTF and that the other participants benefit from equal opportunities. A unit of the operator may act as a market maker if the OTF's rules subject it to appropriate duties for parties that simultaneously provide liquidity and tradable volumes on both buy and sell sides. In both cases, the operator must disclose in a suitable manner that it uses the OTF to trade against ist own book. Furthermore, the operator must publish details at least once a month, broken down by product category, of the volumes traded via the OTF by participants and on its own account. The maximum daily volume of trading on own account must also be published for the previous month, again broken down by product category. 22

b) Bilateral trading

Whereas multilateral trading facilities normally involve a large number of participants acting on both buy and sell sides, bilateral trading via an OTF always involves the operator of the trading facility as a counterparty to the transactions concluded. In bilateral trading facilities, therefore, the operator itself is always a contracting party and is exposed to market risk on executing the transaction. 23

D. Traded financial instruments

Depending on their form, OTFs can be used to trade securities or other secondary-market financial instruments. The term "financial instruments" is to be understood as broadly defined, but it does not include currency and precious metals spot-transactions. In particular, liquidity plays no role whatsoever in determining what qualifies as a financial instrument. 24

Transactions on the primary market are not covered by the OTF rules, nor is the sale of financial instruments specially created for a client by the party that created them to the client 25 who ordered them if no repurchase prices are provided by the seller or in the seller's system during the term of the products.

IV. Duties of the OTF operator

A. Duties of operators of multilateral OTFs

Anyone operating a multilateral OTF must take appropriate and effective measures to separate it organisationally from their other business activities. The interaction of various OTFs with the same operator concerning the same securities or financial instruments must be excluded. Where there are various types of OTF within the meaning of Article 42 lets. a-c FMIA, these must be operated separately from each other. The various types of OTF must be separated using appropriate and effective measures such that, in particular, it is not possible to transfer orders between bilateral and multilateral functions (exceptions as described in Margin no. 22 are possible). To avoid conflicts of interest, own-account trading (bilateral OTF) and matched principal trading (multilateral OTF) must not be carried out on the same trading facility. In the case of transactions under discretionary rules, best execution must be guranteed, provided the participant has not expressly waived this right (see Art. 39 para. 3 FMIO). 26

Appropriate and effective measures in accordance with Margin no. 26 include measures involving the use of rooms, personnel, functions, organisation and information technology to identify, prevent, eliminate and monitor conflicts of interest and to create confidential spaces in which information can be isolated and controlled. The natural persons who trade in securities or financial instruments or decide on such trading must not be allowed to make any decisions regarding the ongoing operation of the OTF. 27

B. Duties of operators of bilateral OTFs

The operator of a bilateral OTF must ensure that each order is executed at the price valid when the order is received or at a better price for the participant. The operator must ensure, based on the prices it offers, that the best possible result is achieved for the participant financially as well as in terms of timing and quality. Exceptions to the requirement for best execution are permitted if the client concerned expressly waives the right to best execution for a specific transaction or issues clear instructions. 28

If an operator falls within the scope of application of the OTF rules by dint of creating financial instruments specially for clients and providing repurchase prices for these (see Margin no. 25), the operator must ensure that the repurchase prices are reasonable in relation to the products' underlying assets, where applicable. This requirement is considered to have been met in particular when bid and ask prices within a narrow spread are provided on an ongoing basis for a specific product category. Whether a spread is narrow or not is to be determined according to prevailing market conditions. 29

The operator must be able to prove to the participants on request that their orders have been executed in accordance with its rules. 30

C. Guarantee of orderly trading

The OTF operator issues regulations on the organisation of trading and monitors compliance with the statutory and regulatory provisions, as well as the trading process (Art. 39 para. 1 FMIO). To ensure that the facility is operated in accordance with the regulations, the operator must set up an efficient control function that is independent of trading and systematically records and evaluates trading data without interruption and must integrate this into its internal control system. This control function may be entrusted to persons who also perform other compliance functions. The person responsible for the control function ensures that market abuse is reported to FINMA. 31

The operator keeps a chronological record of all orders and transactions carried out through the OTF (Art. 39 para. 2 FMIO). This record-keeping duty serves to document transactions so that supervisory authorities can be provided with proof of the orderly execution of transactions in securities or other financial instruments. It must be possible to reconstruct all orders and transactions, including those for automated trading, at any time, in chronological order and with the necessary granularity. The operator must additionally put systemic measures in place to ensure that every change to records after the fact, together with the status before the change, can be tracked. Records must be protected against changes that do not reflect the facts. If the operator already fulfils this record-keeping duty in the context of another statutory duty, the records do not need to be duplicated. 32

The operator of an OTF must ensure that this guarantees orderly trading even in the event of intense trading activity. (Art. 45 para. 1 FMIA in conjunction with Art. 40 FMIO). This includes providing sufficient technical and human resources to prevent outages and faults as well as concepts for replacement capacity and measures to rectify technical faults quickly. 33

The operator of an OTF sets transparent rules and procedures for fair, efficient and orderly trading, as well as objective criteria for the effective execution of orders, and communicates these to participants. The criteria must not lead to an objectively unjustified unequal treatment of participants or different types of participants. 34

Rules on the introduction and implementation of measures in accordance with Margin nos. 22 and 26-34 must be contained in internal directives. Compliance must be monitored by a suitable party designated as responsible for this (see Margin no. 31). 35

D. Trading transparency

The provisions on pre-trade transparency relate to the financial instruments named in Article 27 para. 1 FMIO. 36

Bilateral OTFs can meet the pre-trade transparency requirements by publishing binding offers. If no liquid market exists for a particular financial instrument, price offers on request suffice. 37

The market for a financial instrument is regarded as being liquid within the meaning of Article 42 FMIO if the instrument was traded at least 100 times per trading day on average in the previous year (from January to December) on the trading venue to which it was first admitted. 38

The market for a financial instrument that is not admitted to trading on any trading venue is not regarded as being liquid within the meaning of Article 42 FMIO. 39

If the operator of an OTF refrains from publishing binding offers for financial instruments that are admitted to trading on a trading venue because no liquid market exists, it must document its analysis of the market's liquidity in such a way that knowledgeable third parties may make a reliable judgement of the marekt's liquidity. 40

In the case of OTFs that operate matched principal trading (see Margin no. 21), no allowance may be made for exceptions from the transparency provisions. 41

E. Reporting

OTF operators must report to FINMA if they operate an OTF or intend to do so in future (Art. 29 FINMASA). 42