Guidelines for Direct Market Access and Sponsored Access

Introduction

The Nasdaq Nordic Member Rules (“NMR”) and the Exchange Rules of Nasdaq Derivatives Markets (“ERDM”), both sets of rules collectively referred to as the Member Rules, are the governing texts regarding Direct Market Access (“DMA”) and Sponsored Access (“SA”). The purpose of this document is to give further guidance on the application of the applicable rules.

Under its Member Rules, the Nasdaq Nordic markets allow their members to, upon application, be granted a right to use DMA. Members who wish to offer DMA for trading in derivatives do not need to send in an application but will instead enter into a Direct Market Access Agreement with the exchange (“DMA Agreement”).

DMA is the process by which a member electronically and automatically directs a client’s orders to the trading system through the use of a nominated technical system or technical connection between the member and the client. DMA is governed by section 4.8 of NMR as well as section 2.2.22 of ERDM and the DMA agreement.

SA refers to arrangements where a member permits a client to transmit orders electronically in the member’s identity directly from the client’s trading infrastructure or through a third party vendor to the trading system, with no routing through the member’s internal electronic trading system. SA is governed by section 4.9 of NMR and sections 2.2.23 and 2.9 of ERDM.

Nasdaq Nordic’s rules as regards DMA/SA are aimed at ensuring that effective arrangements are in place to ensure fair and orderly trading and prevent and detect market manipulation. These guidelines are aimed at clarifying the requirements when a member provides DMA/SA to its clients and to provide guidance on measures to be taken by the member and its clients (and, in case of sub-delegated -DMA/SA, the client’s client) to ensure compliance with the Member Rules.

When a member in general wishes to start offering DMA/SA to its clients, a written request thereof shall be submitted to Nasdaq. As mentioned above, no application is needed when a member wants to offer DMA for trading in derivatives. In such case, a member does not need to submit a written request but should instead contact Nasdaq to discuss the way forward and the entering into of the DMA agreement. The request should include the information stated in the Member Rules and a general description of the system setup to be deployed. The key focus for the exchange is matters relating to the content of these guidelines, i.e. controls and procedures to ensure that the Member Rules on DMA/SA will be upheld, that the order submission will not cause disorderly trading and that monitoring is performed. When a member makes significant changes to its systems setup or

\[1\] Nasdaq Nordic refers, for the purposes of these Guidelines, either each individually or all together, to Nasdaq Copenhagen A/S, Nasdaq Helsinki Ltd, Nasdaq Stockholm AB, and Nasdaq Iceland hf.
performs material changes to the controls and procedures referred to above, the documentation submitted to Nasdaq shall be updated.

The material submitted to Nasdaq should contain information about the scale, nature and complexity of the order and trade flow expected, whether connections will be co-located and whether the connection will be used for automated trading. The material should also describe whether connectivity offered to clients can be used for offering electronic access to clients of such clients ("Sub-delegated access"). Descriptions of security measures in place, e.g. pre-trade controls, monitoring of trading and procedures for suspending access, should be detailed and should demonstrate the integrity of such controls. Any material submitted to Nasdaq in an application for DMA/SA or in connection with an update will be subject to review by Nasdaq. Nasdaq may request further material to validate information that has been submitted.

These guidelines are without prejudice to, and should be read in conjunction with, the Member Rules, applicable law and regulation and the ESMA guidelines on Systems and controls in an automated trading environment for trading platforms, investment firms and competent authorities\(^2\), as well as any other statute, regulation, rules, rulings, decisions or guidelines issued by a competent body with jurisdiction over the member and, where applicable, the DMA Agreement.

**Due diligence**

In its written routines for DMA/SA, the member shall describe the due diligence measures in place between the member and the clients with regard to the access arrangements.

The due diligence procedure should be appropriate to the risks posed by the nature of the client, the scale and complexity of its prospective trading activities and the service being provided.

For clients categorized as retail clients under Directive 2004/39/EC (as amended) article 4(12), the due diligence procedure shall ensure that statutory investor protection and know-your-client requirements are met, that the service provided is suitable for the client and that the client is reasonably informed of the terms of the services and the applicable rules and restrictions with regards to it.

The scope of the due diligence for non-retail clients or advanced DMA/SA arrangements should at least include ensuring that a client:

i) is considered fit and proper for the use of DMA/SA;

ii) has appropriate financial resources;

iii) has a sufficient number of employees with adequate knowledge, experience, training and competence for the activities the member undertakes on the exchange’s order books; and

iv) has adequate internal procedures and controls for these activities.

Member firms may, to ensure that criteria iii) above is met, wish to consider whether training should be provided to the clients’ key personnel involved in trading, compliance or signoff of trading algorithms. Where members provide clients with trading algorithms or other functionality to

\(^2\) ESMA/2012/122 (EN)
automate trading by use of DMA/SA, the member should ensure that the clients receive the adequate training to make safe and accurate use of such tools.

When assessing the level of due diligence to perform for non-retail clients or advanced DMA/SA arrangements, the following matters shall be given the appropriate consideration:

- Is the client regulated under any national, European or third country laws or regulations;
- does the client have sufficient financial resources and credit/clearing arrangements for the type of business outlined and the limits intended to be set up;
- does the client have sufficient personnel with the relevant training for trading the instruments covered by the access arrangement;
- do the users that will be provided access have documented experience from trading in relevant financial instruments especially when considering the types of strategies to be undertaken by the prospective client;
- does the client based upon information available to the Member, have a disciplinary history with competent authorities or trading venues;
- does the prospective DMA/SA client have some historical pattern of trading, on the relevant Nasdaq exchange or other relevant markets, that should be taken into account;
- what are the risks posed by the nature of the client, the scale and complexity of its prospective trading activities and the service to be provided; and
- will the client offer electronic access to clients in its turn

Where advanced DMA/SA is arranged so that a client connects to an electronic protocol provided by the member, as opposed to by use of a designated trading application provided by the member, the member should perform specific due diligence with regards to the risks associated with such arrangement. Such due diligence should include a certification of the use of the connectivity as well as an assessment of the relevance and effectiveness of controls implemented to uphold risk management procedures and pre-trade order validations. The certification procedures should be pre-defined and should have been signed off by the relevant compliance or risk management function within the firm. The validations performed to form the basis for certification should be documented.

**Security measures, risk limits**

Members should ensure that there are appropriate risk limits in place for each DMA/SA client. The determination of relevant risk limits should take into account the trading strategy, credit worthiness and financial strength of the client, the member’s knowledge about the client as well as the client’s track record. When determining appropriate risk limits, any relevant arrangement that the client can demonstrate regarding clearing services, prime brokerage or similar arrangement should be taken into account.

The pre-trade order validation of the member should ensure that the client’s individual risk limits are not exceeded as a consequence of order submission under the access arrangement.
Members offering DMA/SA to its clients should also be able to automatically block or cancel orders from a DMA/SA client where the member risks compromising its own risk management thresholds.

**Pre-trade order validation**

In order to protect the member and its DMA/SA clients, as well as to prevent that orders which would result in disorderly trading are entered into the trading system, a member offering DMA/SA should have in place pre-trade order validations.

Such order validations should check the DMA/SA client’s orders before submission to the trading system, in relation to at least:

i) price;

ii) order value;

For complex or highly automated order flows, or order flows that otherwise constitute significant risk for the member or the integrity of the market place, the order validations should in addition include the following types of checks:

iii) number of orders submitted in a certain time frame;

iv) price, both on an order-by-order basis and over a specified period of time.

The type and configuration of the pre-trade order validation checks, including when to perform checks iv) and v), should be carefully designed based on the nature of the transactions, where at least the following should be taken into account:

i) the degree of automation in the trading activities of the client;

ii) the complexity of aggregated trading patterns of the client;

iii) the risks involved in the trading activities of the client; and

iv) as regards price limits, their suitability with the instruments to which the placing of orders relates, i.e., market segment, liquidity and price level.

The member should carefully consider to what extent each control shall be possible to override or not, as well as what procedures shall apply if controls are overridden. Such procedures should be reviewed by compliance and risk management staff. Pre-trade controls may only be overridden in relation to a specific trade with the full knowledge of relevant staff responsible in the risk management function.

Pre-trade validation should be automated.

**Sub-delegated access**

A member offering DMA/SA to a client, including a right for the client to grant a similar form of direct access to a third party (the client’s client) should require the client to have arrangements in place to ensure that the client’s clients are fit and proper for the use of direct access, and that contractual arrangements are in place between the client and its clients to ensure that the client’s clients are subject to requirements and controls corresponding to those to which the client is subject under the Member Rules and these guidelines.
The member should further require that its DMA/SA clients keep the member informed about any sub-delegated access arrangements in place.

**User accounts and client identifiers**

Order submission by application of DMA shall be conducted by use of designated user accounts, whereby the order submission that relates to DMA can be clearly distinguished from other forms of order submission. On the derivatives market, the order submission by DMA does not have to be made by use of designated user accounts.

Order submission by application of SA shall for each client of the member be conducted by use of a designated participant id or user account, whereby the order submission that relates to an individual SA client can be clearly distinguished from other forms of order submission. When applying for such dedicated id or account, the identity, and other information as requested by Nasdaq, of the client shall be disclosed. Nasdaq will not perform due diligence with regards to the clients of the member but reserves the right to reject an application for an id or account to be used by a client.

**Monitoring**

Members providing DMA/SA should continuously monitor the orders sent through their system by their DMA/SA clients for the times that such order submission is enabled. The scope of such monitoring should be to ensure that risk limits are upheld and to identify orders which may, alone or in aggregation with other orders, constitute disorderly trading or otherwise a breach of the Member Rules.

The monitoring referred to above should be performed by knowledgeable staff that have the authority to take remedial action if needed, including suspension of a DMA/SA client’s access to submit orders to the market place. The staff should be accessible to Nasdaq during the times that orders are submitted to the market place and the member should ensure that Nasdaq has relevant contact details for each user id that is used for DMA/SA.