Regulatory requirements for operating an organised trading facility

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Key takeaways

- **Financial service providers offering facilities for the trade of securities and other financial instruments may be operating an organised trading facility.**
- **The operation of an organised trading facility requires authorisation or recognition as a bank, securities firm or trading venue. Anyone who operates or intends to operate an organised trading facility, including financial service providers already subject to prudential supervision by FINMA, must provide an adequate organisation and report to FINMA to get regulatory clearance.**
- **FINMA is contacting financial market participants who may be operating an organised trading facility without having the necessary authorisation or organisational measures in place as required by law.**

Overview

Although the regulatory rules for operating an organised trading facility (OTF) have been applicable since 1 January 2018, some operators of OTFs still do not have the necessary authorisation and/or organisation required by law. FINMA is aware of this issue and has started contacting financial market participants who are or might be operating an OTF.

What is an OTF and who may operate one?

An OTF is a type of establishment for the trade of securities and other financial instruments. There are in total three types of these establishments under Swiss law: (i) Stock exchanges, (ii) multilateral trading facilities (MTFs) (referred to collectively as trading venues), and (iii) OTFs (Art. 26 let. b and c and Art. 42 of the Financial Market Infrastructure Act, FMIA).

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Stock exchanges are institutions for multilateral securities trading where securities are listed. Their purpose is the simultaneous exchange of bids between several participants and the conclusion of contracts based on non-discretionary rules. The same applies for MTFs, but without listing of securities. An OTF is a facility operated in Switzerland for the (i) multilateral trading of securities on a discretionary basis, (ii) multilateral trading of financial instruments that are not securities on a non-discretionary basis or (iii) bilateral trading of securities and other financial instruments, which might constitute an OTF (Art. 42 FMIA). For further information on the definition of an OTF, also see FINMA Circular 18/1.

Unlike trading venues, OTFs are not financial market infrastructures in their own right and are not independently authorised by FINMA. However, the only financial market participants who are allowed to operate an OTF are licenced banks, licenced securities firms and authorised or recognised trading venues (Art. 43 para. 1 FMIA).

What rules apply for operators of an OTF?

As a first step, operators of an OTF need to ensure that they are sufficiently authorised by FINMA, and if not, apply for the necessary authorisation. Further, certain organisational measures need to be taken when operating an OTF.

Rules for OTF operators not yet subject to prudential supervision of FINMA

To operate an OTF, the operator must have a licence either as a bank according to the Banking Act (BA) or as a security firm according to Art. 41 of the Financial Institutions Act (FinIA), or be authorised as a trading venue according to Art. 4 para. 1 FMIA. The licence to operate as a bank also authorises the entity to operate as a securities firm (Art. 6 para. 1 FinIA).

The licencing requirements for banks and securities firms are stated in the BA and FinIA, respectively. Trading venues must meet the requirements as set out in the FMIA.

The FMIA provides for an exception from the requirement of authorisation: If the OTF is operated within a financial group via a legal entity that is controlled directly by a financial market infrastructure and is subject to consolidated FINMA supervision, the operator of the OTF does not need an authorisation (Art. 43 para. 2 let. a and b FMIA).

For further information on the authorisation process and requirements, or assistance when applying for a licence or authorisation, please contact Pestalozzi.

Rules for OTF operators who are already authorised as banks, securities firms or trading venues

Financial market participants with an authorisation or recognition as a bank, securities firm or trading venue may operate an OTF. However, they are further subject to certain regulatory duties. First, they must implement a standardised and binding set of rules. Such a 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 set of rules should include at least principles for executing the orders, trading processes and trading hours. The participant and the operator both have to agree to

comply with these rules. This set of rules does not need to be approved by FINMA.

Further duties relate to the organisation and prevention of conflicts of interest, the guarantee of orderly trading and the trading transparency (Art. 44-46 FMIA).

Organisation and prevention of conflict of interest

Anyone who operates a multilateral OTF must (i) do this separately from the other business activities, (ii) take effective organisational measures to identify, prevent, settle and monitor conflicts of interest and (iii) ensure that client interests are comprehensively protected when conducting proprietary transactions on the organised trading facility operated by him (Art. 44 FMIA).

In order for the separation of business activities to be effective, several measures may be taken, including the segregation of functions, both physically and in terms of personnel. These measures should allow for a confidential space in which information can be isolated and controlled.

Organisational measures to prevent a conflict of interest are specified in the Financial Market Infrastructure Ordinance (FMIO) and include the duty to issue regulations on the organisation of trading (Art. 39 para. 1 FMIO). As the OTF itself is not subject to prudential supervision, the regulations do not need to be approved by FINMA. However, the OTF must monitor compliance with statutory and regulatory provisions (Art. 39 para. 1 FMIO) and report any market abuse to FINMA.

The operator of an OTF is generally allowed to conduct proprietary transactions if the client's interests are protected. This is the case if the operator discloses in a sufficient manner that it executes participants' orders against its own book. This information may be disclosed directly in the set of rules, although there is no specific form prescribed for how disclosure shall be made.

The abovementioned duties do not apply to operators of bilateral OTFs. However, such operators must ensure that each order is executed at the price valid when the order is received or at a better price for the participant.

Guarantee of orderly trading

The operator of an OTF must take effective measures to guarantee orderly trading on the trading facility, even in the event of intense trading activity, and to prevent the disruption of the trading facility (Art. 45 para. 1 and 2 FMIA). Hence, the rules that apply to trading venues for orderly trading must in general also be observed by OTFs (Art. 40 and 41 FMIO). Further, the operator of an OTF must set transparent rules and procedures for fair, efficient and orderly trading, as well as objective criteria for the effective execution of orders (Art. 40 FMIA).

Trading transparency

To ensure trading transparency, the operator of an OTF must publish information on the transaction that is carried out on the OTF, in particular the price, volume and time of the transaction (Art. 46 para. 1 FMIA). This duty of post-trade transparency is applicable to all

kinds of transactions that are carried out on an OTF and traded multilaterally (Art. 43 para. 1 FMIO). The operator shall publish the relevant information in accordance with the standardised set of rules. For bilateral trading facilities that qualify as OTFs, an aggregated publication at the end of the trading day is sufficient (Art. 43 para. 2 FMIO).

In case of multilateral trading and bilateral trading where a liquid market exists, the operator of the OTF must provide for pre-trade transparency as well if shares are traded (Art. 46 para. 3 FMIA and Art. 42 FMIO). The operator of a multilateral OTF must publish the five best bid and offer prices as well as the volume of orders throughout normal trading hours (Art. 27 para. 1 and 2 FMIO). It is sufficient if the information is accessible via the operator's website. For the bilateral trading where a liquid market exists, it is sufficient to publish the binding offers. In the case of bilateral trading where no liquid market exists, price quotes on demand suffice (Art. 24 para. 2 FMIO).

Reporting

Anyone who operates or intends to operate an OTF must report to FINMA (Art. 29 Financial Market Supervision Act, FINMASA).

Further steps

The regulatory rules for operating an OTF have been in place for over two years and FINMA is starting to contact financial market participants who are or might be operating an OTF without fulfilling the necessary requirements. Therefore, financial service providers offering new trading facilities should review their business operations and get FINMA approval if they qualify as an OTF.

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No legal or tax advice

This legal update provides a high-level overview and does not claim to be comprehensive. It does not represent legal or tax advice. If you have any questions relating to this legal update or would like to have advice concerning your particular circumstances, please get in touch with your contact at Pestalozzi Attorneys at Law Ltd. or one of the contact persons mentioned in this Legal Update.

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