

## **DUE DILIGENCE ASSESSMENT OF PROSPECTIVE DEA CLIENTS**

With the implementation of MIFID II in January 2018, investment firms who provide their clients access to European trading venues via direct electronic access are required to conduct a due diligence assessment on the suitability of the client prior to providing access and review that due diligence on annual basis in line with the regulations.

### **What is direct electronic access?**

Direct Electronic Access (“DEA”) is defined in Directive 2014/65/EU as *“an arrangement where a member or participant or client of a trading venue permits a person to use its trading code so the person can electronically transmit orders relating to a financial instrument directly to the trading venue and includes arrangements which involve the use by a person of the infrastructure of the member or participant or client, or any connecting system provided by the member or participant or client, to transmit the orders (direct market access) and arrangements where such an infrastructure is not used by a person (sponsored access)”*

### **What is a European trading venue?**

Any regulated market or multilateral trading facility authorised under Title III of Directive 2014/65/EU. For example, the LME, ICE Futures Europe, Euronext, Eurex, EEX etc.

### **What is the due diligence assessment which an investment firm like SFL must conduct?**

MIFID II requires investment firms that provide DEA to a trading venue to have in place effective systems and controls which ensure a proper assessment and review of the suitability of clients using the service, that clients using the service are prevented from exceeding appropriate pre-set trading and credit thresholds, that trading by clients using the service is properly monitored and that appropriate risk controls prevent trading that may create risks to the investment firm itself or that could create or contribute to a disorderly market or could be contrary to Regulation (EU) No 596/2014 (Market Abuse Regulation) or the rules of the trading venue. Direct electronic access without such controls is prohibited. An investment firm that provides direct electronic access is responsible for ensuring that clients using that service comply with the requirements of MiFID II and the rules of the trading venue<sup>1</sup>.

Commission Delegated Regulation (EU) 2017/589 of 19 July 2016 supplementing Directive 2014/65/EU of the European Parliament and of the Council with regard to regulatory technical standards specifying the organisational requirements of investment firms engaged in algorithmic trading<sup>2</sup> (‘RTS 6’) further specifies DEA requirements, including the due diligence assessment requirements of prospective DEA Clients.<sup>3</sup> An investment firm offering DEA is required to carry out a due diligence assessment of its prospective DEA Clients to ensure that they meet the requirements set out in RTS 6 and the rules of the trading venue to which it offers access. A DEA Provider allowing sub-delegation shall ensure that a prospective DEA Client, before granting that client access, has a due diligence framework in place that is at least equivalent to the one that the DEA provider is subject to under RTS 6.<sup>4</sup> A DEA provider (and a DEA Client which provides sub-delegation) shall review its due diligence assessment processes annually.<sup>5</sup>

### **What is meant by a “DEA Client which provides Sub-delegation”?**

SFL as a DEA provider may allow its clients to sub-delegate their DEA onto their underlying clients. Where this occurs SFL must ensure that its direct DEA Client performs the same due diligence assessment of the underlying clients receiving sub-delegation access as SFL must conduct on the direct DEA Client.

**Thus StoneX Financial Ltd. as an investment firm providing DEA requires prospective DEA clients to complete the attached questionnaire at the outset the DEA arrangement and on an annual basis therein.**

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<sup>1</sup> See MiFID II, Article 17(5).

<sup>2</sup> Published in the Official Journal of the EU, OJ L 87, 31 March 2017. Available at: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32017R0589>

<sup>3</sup> See Article 22 of RTS 6 for details

<sup>4</sup> See Article 22(3) of RTS 6

<sup>5</sup> See Article 23 of RTS 6 for details

**Client Information**

Client Name:

LEI:

Account Number (if yet known):

**Trader Information**

First Name:

Middle Name:

Last Name:

Email Address:

Contact Phone Number:

Trading Address:

City:  Region:  Postal Code:

Country:

**Historic Trading Activity**

Describe your historical trading pattern and behaviour during normal course of business on relevant markets\* that will be accessed via the proposed DEA arrangement. Please answer with reference to asset classes traded during the last 2 years, in what capacities, and trading frequency.

**Operational Set-Up**

Please provide market/product specific detail as appropriate.

Click Trading or Programme Trading (or both)? Please describe any automated investment or execution strategies.

Markets to be accessed through this account and platform:

If using in-house trading systems, please describe operational set-up.

**Expected Order Flow/Trading Behaviour**

Hedging  Speculative

Types of Strategies (e.g., Arbitrage, intraday, high frequency):

Expected Order Volume, please be product specific:

Expected Trading Volume, please be product specific:

**Internal Risk Controls**

Please describe internal risk controls your firm applies in the following areas:

Pre-trade controls applied to trading strategies on the Relevant Markets to be accessed via the DEA arrangement:

Post-trade controls applied to trading strategies on the Relevant Markets to be accessed via the DEA arrangement:

Real time monitoring applied to trading strategies on the Relevant Markets to be accessed via the DEA arrangement:

### Sub-Delegation of DEA Service

Are you providing sub-delegation (i.e. will you be providing DEA to your clients via this connection)?

Yes       No

*If Yes, please complete the following questions:*

Do you comply with the requirements set out in Article 22(3) of RTS 6? (See definitions and relevant regulations appendix.)

Do you carry out an annual due diligence assessment (as per Article 23 of RTS 6)?

Are you using a due diligence framework which covers substantively the same topics as this questionnaire?

### Responsible Parties

Please provide information regarding the person within your firm responsible for dealing with actions and errors:

Name:

Position:

Email Address:

Contact Phone:

DEA Due Diligence Questionnaire submitted by:

Name:

Position:

Date Submitted:

**APPENDIX 1: DEFINITIONS AND RELEVANT REGULATIONS**

\*Relevant Markets are defined as any regulated market or multilateral trading facility authorised under Title III of Directive 2014/65/EU to which the prospective DEA Client wishes to access through the DEA Provider.

[http://ec.europa.eu/finance/securities/docs/isd/mifid/rts/160719-rts-6\\_en.pdf](http://ec.europa.eu/finance/securities/docs/isd/mifid/rts/160719-rts-6_en.pdf)

**Article 22 (Article 17(5) of Directive 2014/65/EU) Due diligence assessment of prospective DEA clients**

1. A DEA provider shall conduct a due diligence assessment of its prospective DEA clients to ensure that they meet the requirements set out in this Regulation and the rules of the trading venue to which it offers access.
2. The due diligence assessment referred to in paragraph 1 shall cover:
  - (a) the governance and ownership structure of the prospective DEA client;
  - (b) the types of strategies to be undertaken by the prospective DEA client;
  - (c) the operational set-up, the systems, the pre-trade and post-trade controls and the real-time monitoring of the prospective DEA client. The investment firm offering DEA allowing DEA clients to use third-party trading software for accessing trading venues shall ensure that the software includes pre-trade controls that are equivalent to the pre-trade controls set out in this Regulation.
  - (d) the responsibilities within the prospective DEA client for dealing with actions and errors;
  - (e) the historical trading pattern and behaviour of the prospective DEA client;
  - (f) the level of expected trading and order volume of the prospective DEA client;
  - (g) the ability of the prospective DEA client to meet its financial obligations to the DEA provider;
  - (h) the disciplinary history of the prospective DEA client, where available.
3. A DEA provider allowing sub-delegation shall ensure that a prospective DEA client, before granting that client access, has a due diligence framework in place that is at least equivalent to the one described in paragraphs 1 and 2.

**Article 23 (Article 17(5) of Directive 2014/65/EU) Periodic review of DEA clients**

1. A DEA provider shall review its due diligence assessment processes annually.
2. A DEA provider shall carry out an annual risk-based reassessment of the adequacy of its clients' systems and controls, in particular taking into account changes to the scale, nature or complexity of their trading activities or strategies, changes to their staffing, ownership structure, trading or bank account, regulatory status, financial position and whether a DEA client has expressed an intention to sub-delegate the access it receives from the DEA provider.