

### ***Interview with a senior manager #8***

- SPEAKER1 00:02 Recording OK, so the recording has started, so could you just begin by just describing your investment firm's subsector, what it does, what it trades?
- SPEAKER2 00:21 OK, well, we're in the financial services sector. We're a broker. So, we have clients, and we also trade on a proprietary basis. So, we trade for ourselves as well. We deal primarily in commodities. So that would be metals, soft commodities, some energy products. We also do a lot of foreign exchange business. That's pretty much the products that we deal with. The clients that we deal with are mainly. Corporates, they're professional clients. We very...we're not permission to deal with retail clients, although we do have some individuals that we deal with, but they are always professional individuals in terms of their experience of trading the products that we offer.
- SPEAKER1 01:27 And I mean, how would you describe the sort of goals of the firm what's the firm trying to do? You know.
- SPEAKER2 01:33 Ultimately, ultimately the firm is about making money for the shareholders, but we're doing it in such a way that we ensure that our relationships with our clients are of paramount importance to us...so .We have to get out , the aim of the firm is basically to make money, but not at the expense of our clients.
- SPEAKER1 02:16 Ok and... what... how would you describe your role in the firm?
- SPEAKER2 02:21 I'm Head of the Documentation Team which looks after the onboarding of clients. So, we carry out due diligence on all our clients and provide them with their terms of business. We also do well that we do a lot of stuff that in relation to the money laundering regulations, which is basically monitoring the transactions, doing ongoing due diligence...Just keeping information up to date with regards to our clients. What else what else do we do Mainly that maybe that's what we do, is we look after the documentation of the clients and they due diligence on the clients.
- SPEAKER1 03:12 So... MiFID II described three types of trading algorithm. So, the simplest trading algorithm are order routing algorithms. So typically, these are used by firms or investors who maybe they're trading in fragmented markets. So, it might be possible, for example, to trade British Airways stock on London Stock Exchange, but it might also be possible to trade it on the Frankfurt exchange or something. So, in order to determine where the best price was and send the order there accordingly. The second type of algorithm would be sort of execution enhancement tools. So, you'd have a trading platform, and it would have tools in which a user of that platform could then calibrate to help them make more effective trading decisions. So, it could be iceberg order. That would be a type of algorithm, stop losses are actually, the type

of algorithm, those types of things. And then you have the sort of what a lot of people on the street would think of as being trading algorithms, the sort of more black box type stuff...So...you know , somebody actually designing something which will take in a large amount of data , possibly using machine learning and using that data could be Twitter information, maybe, you know , the President's tweets or something, and then try to determine investment decisions and will seek to then execute those autonomously. Does, to your knowledge, your firm support any of those types of algorithms?

SPEAKER2 04:44 OK, well, ordering routing absolutely. Execution enhancement. I would say to some extent, yeah. We have our own in-house electronic trading platform that would have the ability to do things like iceberg stop losses. We do offer options, trading facilities mainly for our FX business but we're expanding that into other products. Say you've got...you've got that the ability to basically do complex option trading in terms of algos, we don't actually we don't offer in terms of trading algorithms, we don't actually offer any of that. We may have the odd client that is actually using an algorithm to trade through our systems, but we don't actually do that ourselves.

SPEAKER1 05:41 And are you guys offering API access? And not just sort of platforms, but...

SPEAKER2 05:47 Yeah, we do offer API access, yes.

SPEAKER1 05:48 Yes, OK. And conduct risk. What would your understanding be of conduct risk and your firm's sort of framework to manage that?

SPEAKER2 06:07 Well, ok, we do have a framework , conduct risk is... Partly to do with how we behave ourselves and also... Partly and ensuring that our clients behave that they trade within that, but everything that goes through us is done correct, and that there's no there's no abuse of our firm in terms of market abuse or any other type of activity that..that would sort of, well, basically market abuse and all that, all the sort of related types of abuse that you can do when you're trading in electronically or on the markets that we offer. Well, what else would I say? It's about ensuring that all staff were aware of all the rules that we have to abide by...from not just a regulatory perspective, but also from... it's mainly from energy perspective, but also. I guess from a sort of a and a legal and also an ethical standpoint, so that we want to have a culture that is not...it is stands up to scrutiny.

SPEAKER1 08:08 What would you say the main conduct risks associated with the algorithmic trading that you might support in particular?

SPEAKER2 08:17 Uh...I would say it would be market abuse, so that various types of market abuse in terms of trading, for example, frontrunning or collusion or...so there are various things like that.

SPEAKER1 08:44 In terms of...just in terms of where you sit in the food chain, because I'm quite interested in this particular point on the onboarding front. RTS 6 from MiFID II... I don't know if you've heard of that?

Yeah.

They...that brought in some specific due diligence requirements that firms are sort of required to do on their clients, which are doing electronic trading through direct electronic access. In your view ...do you think that that's working effectively in terms of helping firms to identify...you know, actual conduct risks that that kind might be engaged in?

SPEAKER2 09:32 I would say...I mean, yeah, the regulations obviously help firms in following the regulations, obviously, we then have an understanding of why they're trading with us, what their trading patterns are, what their expected activity is. We have a transaction monitoring system; our compliance team has a transaction monitoring system that looks at ... probably about 20 types of market risk. So, again, anything that we don't see, obviously...a lot of these things are dependent upon how the system is calibrated, but we would get anything that any alerts or anything that is highlighted by the system...would basically that... that would tell us anything where the client is not trading in a manner that we would expect or if there's anything potentially suspicious about what clients are doing and all that... all the information that comes out of those systems is then reviewed by the compliance team and a governance committee to basically determine whether further action is required, such as reporting to the regulator.

SPEAKER1 11:12 Is your team doing the sort of RTS 6 due diligence?

SPEAKER2 11:18 That doesn't actually fall within our team, we do due diligence from other perspectives, but not in relation to MiFID II.

SPEAKER1 11:27 OK and or is your team responsible for doing the sort of the background screening on client? So, looking at adversely news.

SPEAKER2 11:38 So, we carry out screening on all clients in any case. But in terms of when clients are trading electronically, we also carry out screening on and all the individual traders that are authorized by our clients to trade electronically with us. So, we do carry out screening. The screening on clients is ongoing. So, we do it. Account opening, but also it is carried out on a daily basis, screening on individual traders is only done when they sat with them while sitting down, when they set up with access to trade electronically. But there is also a requirement to refresh the manual refresh of our due diligence for anyone that's trading electronically.

- SPEAKER1 12:27 And that screening does not just look at sort of money laundering, terrorist financing, or does it also look at, say, fine by the CME?
- SPEAKER2 12:39 It looks at market abuse. It looks at money laundering. It looks at pretty much everything else that we would get hit if they if someone had basically. Get involved in market abuse or anything that might not even be relevant to that particular area.
- SPEAKER1 12:59 So have there been any situations where, you know, for example, you've got a client in the Far East who, you know, they might want some sort of D.A. access and they may be intending to put their own algorithms through that access. Have there been any occasions where, for example, you've picked up that that client or one of their traders has had a fine say from C.M.A for lying and spoofing or something?
- SPEAKER2 13:28 That does happen occasionally. Not very often in those cases. We probably wouldn't offer them electronic access or certainly not the individual, but we would certainly have to contact the client and ask them about obviously the fine or whatever it is that's come up, what they've done about it, how they change their controls since the fine. And then our compliance team would probably would then make a judgment as to whether we can try electronically with any of these individuals or these firms. So, there's also, again, an escalation process where we would escalate any hits that we had to the compliance thing.
- SPEAKER1 14:16 OK, and does the firm routinely offer any training to the client, so if you've got clients that are out and again in the Far East, they might not be that familiar with what the rules are on the European markets for electronic or algorithmic trading. Does the firm sort of seek to educate them about that? Or is their view that it's not really the firm's responsibility?
- SPEAKER2 14:42 I'm not aware that the firm does actually provide training. I mean, there is so for our in-house electronic trading platform, I believe that there is a training module at that is part of that system, but I'm not aware that we would necessarily do it for any other trading platform that wasn't in-house. In terms of whether concentrating on the markets they trade on, we do get as part of the due diligence on firms we actually ask them what their experience is so we wouldn't really be offering electronic trading to clients that we wouldn't really be dealing with clients that hadn't got the required experience before us to invest for them. They would have to be we'd have to classify them as a as a professional client in order to do business with him. So, from that context, we would therefore expect that they have got experience trading on these markets. So, they shouldn't really require any training from us.
- SPEAKER1 16:08 OK, would you say I mean, how would you say that the knowledge of people in the firm and maybe in your team is I mean, how would you rate

their knowledge of the sort of conduct risks that are associated with algorithmic trading so that they are able to spot, you know, it could be potential money laundering, which is associated with both the trading attacks.

SPEAKER2 16:44 In terms of the money laundering risk? Yeah, I would say very high. We actually do carry out automated transaction monitoring from a money laundering perspective. We do that on a daily basis. So, all transactions and all settlements go through an automated transaction monitoring system and off the shelf system that we that we've purchased, that there will be license that I think my team are very aware of. Money laundering obviously is a type of market abuse in terms of the other types. So, for things like frontrunning. And I think we the team and the Fed have had training, there's always ongoing training about money laundering and market abuse risks. So, every year there's an automated e-learning package that we have to complete. So, I think the team are very aware of the different types of market abuse and they're very, very aware of money laundering risks, particularly money laundering, because obviously we have our own transaction monitoring system that specifically looks at money laundering type of risk. So multiple settlements, trading, changes in trading activity, that sort of stuff.

SPEAKER1 18:18 In terms of I mean, one of the things I've sort of picked up and I've been speaking to other participants in this whole process is they're saying, you know, one of the most difficult things on a sort of DEA or sub delegated to is picking up an. You know, people that are engaged in abuse, for example, you might face an intermediary broker or something, and, you know, there might be a particular trader who's calibrated now given to behave in a certain way, which is not acceptable in European markets. And, you know, you might ordinarily the broker might speak to that client and say, look, you got to switch this trader off or something. One of the challenges that some of the other participants have said is that can be very difficult to see when that person is popped up somewhere else. And so, it's almost like going down to Brighton Beach and playing the head popper thing where your head pops up over here, you knock it down, it appears there again. Is that something which, you know, you see yourselves, you know, people that are doing certain types of activity are just sort of reappearing.

SPEAKER2 19:33 And it's very difficult to. Well, it's impossible for any organization to know what. A client might be doing in with their other broker relationship, so I would say, yeah, no, we don't have the ability to know whether someone whose is whose activity or doing something else, but I think part of the onus for that really lies on at the at the regulator level, because we do a lot of as other firms, these sort of things would you would hope, would be picked up by the transaction reporting that we have to do so. We report all our transactions to a trade repository and all the other brokers will also be

reporting all their transactions. So, and position and transaction reporting, so you would see that the rate at the regulated level, they should be able to determine if there is any sort of market abuse across the market, because it's all based. They have that ultimately. It's all based on the client and their ownership, the beneficial ownership of the client. So, I would say that that sort of control is probably at the regulated level rather than at the firm level.

- SPEAKER1 21:22 Do you think I mean, there's enough collaboration between. I mean, you know what I mean? What, if any, collaboration is that between different brokers, maybe to help the sector? Identify potential.
- SPEAKER2 21:43 Yeah, I would say in my experience, there's no collaboration between brokers, I know that the rules have been changing in the last year, certainly from a money laundering perspective, that that would allow brokers to get together to potentially discuss suspicious activity. But in my experience, that hasn't happened yet.
- SPEAKER1 22:13 What about support from sort of industry associations and the regulator itself? I mean, do you think that there is enough support to help again firms because firms are in a difficult place, right, because of some delegation stuff. Do you sense this is there's enough sort of support there or do you think more could be done? Uh.
- SPEAKER2 22:44 It's difficult to comment on how effective the regulator is from a money laundering perspective. That I think they provide guidance. Now, when rules change, they update their rule book and you know, I think. You know, they do provide guidance, but in terms of their effectiveness, I mean. I'm sure that I don't think they're particularly effective. Certainly, from you know, from a money laundering perspective, you know, you all you hear are stories about the amount of money that's laundered through the U.K. each year. But then when you look at actually. Who they like, the amount of people that the regulator or the national pride that we caught up with and find. It seems to be a bit, but to be fair, I hope they're helpful, but maybe not that effective.
- SPEAKER1 24:14 Finally, what would your principal concern for the future be?
- SPEAKER2 24:20 Well, the biggest risk at the moment is all around cyber security type of risks and fraud. So, you know that the phishing or you know the DDOS attacks and that those sorts of risks, that they would be definitely my biggest concern.
- SPEAKER1 24:46 Do you think algorithmic trading amplifies those risks or is it really are they really separate from....?
- SPEAKER2 24:55 Well, yeah, I think the biggest risk are the fraud related risks and the algorithmic trading. That that I wouldn't necessarily say that amplifies it. It's

probably that's more of a market abuse type area rather than a fraud area. I think it does amplify. It certainly increases.

SPEAKER1 25:34 OK, that concludes the interview, so I'm going to switch off the recording now.