

DLT Provider Guidance Notes

# Market Integrity

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## Introduction

The purpose of this guidance note is to provide a DLT Provider, as defined in the Financial Services (Distributed Ledger Technology Providers) Regulations 2020 (the DLT Regulations), with guidance as to the operational, technical and organisational standards expected and in some circumstances required by the GFSC.

This guidance note is specifically in respect of regulatory principle 10 of the DLT Regulations (the Regulatory Principle).

The Regulatory Principle states that ***“A DLT Provider must conduct itself in a manner which maintains or enhances the integrity of any markets in which it participates”***.

This document should be read as interpretative guidance for a DLT Provider and the examples contained in this document should be noted as indicative of good practice by a DLT Provider in connection with the Regulatory Principle.

A DLT Provider should note that the GFSC will take this document into account when reviewing a DLT Provider’s practices. The operational standards expected and required by the GFSC of a DLT Provider will vary depending on the size, particular nature, scale or complexity of the DLT Provider’s business.

It is also important to note that the GFSC has published separate guidance notes in respect of each of the other nine regulatory principles. It is important that DLT Providers (both actual and prospective) read and understand each guidance note within the context of the wider DLT Framework, and consider the interrelation between the expectations or requirements these documents set out when devising their processes, policies and procedures.

## Market Integrity

Market integrity is essential to the fair, orderly and efficient functioning of a given market as well as of the overall marketplace more generally. It encompasses a number of key responsibilities, such as monitoring for manipulative trading and other forms of market abuse, and fostering non-discriminatory market access, transparency in price formation, fair trading practices, high disclosure standards and robust consumer protection.

DLT Providers all have an obligation to maintain and enhance market integrity in every market in which they participate, although the precise contours of each DLT Provider’s responsibilities will depend on the nature of its business and of its participation in a given market.

This Regulatory Principle seeks to recognise the diversity of the assets and activities within the virtual asset marketplace. It is important that DLT Providers are aware of the fact that the functions and features of virtual assets, and the manner in which they are traded, can differ. Consequently, firms will need to be cognizant of such differences when designing and amending their controls in this context in order to ensure that they are appropriate and effective.

When determining how best to comply with this Regulatory Principle, a DLT Provider should consider its role in a particular market and in the marketplace overall. For example, a DLT Provider that operates a trading platform will need to make certain considerations that may not be relevant to one that acts solely as a custodian and does not otherwise participate in any market.

## Responsibilities of a DLT Provider

DLT Providers are expected to recognise and consider market integrity issues at both the level of the individual market and that of the virtual asset marketplace overall. Without strong market integrity, there cannot be free and fair pricing of assets for trading, lending or collateralisation, maintenance of good liquidity, or, most importantly, trust among market participants. DLT Providers should conduct themselves in a manner that fosters transparency, efficiency, fairness, liquidity and resilience within the markets in which they operate on an ongoing basis. They should establish, implement, and regularly update policies and procedures related to compliance with this Principle.

Market integrity is continuous in nature and generally cannot be judged by isolated events, although such events, and/or patterns of events can indicate the existence of issues that need to be addressed. DLT Providers are expected to act in the interests of market integrity on a sustained and ongoing basis and to set an example for all other market participants and stakeholders. While GFSC does not expect DLT Providers to be guarantors of others' conduct, they should assist in rooting out conduct inimical to market integrity to the extent reasonably possible. For example, DLT Providers are expected to report nonconforming conduct to the appropriate regulatory authorities and/or to the operators of the particular markets affected, terminate account access where appropriate, share information about bad actors and activities detrimental to market integrity, and make suitable changes to their controls and procedures in order to better protect against such conduct.

## Market Integrity Requirements and Considerations

A DLT Provider must apply its best endeavours to preventing and mitigating the effects of all types of misconduct in the context of market integrity.

### Market Manipulation

A DLT Provider will need to implement measures commensurate with its activities in order to prevent, or mitigate the effects of, any type of manipulation or improper influencing of prices, liquidity or market information, or any other behaviour which is inimical to market integrity.

For the purposes of this Regulatory Principle, the GFSC considers market manipulation to include any of the following activities and behaviours:

- Unless established to have been done for legitimate reasons, placing an order to trade or any other behaviour which:
  - gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of, a virtual asset; or
  - sets, or is likely to set, the price of one or several virtual assets at an abnormal or artificial level.
- Entering into a transaction, placing an order to trade or any other activity or behaviour which affects or is likely to affect the price of one or more virtual assets, while employing a fictitious device or any other form of deception or contrivance;
- Disseminating information through the media, including the internet, or by any other means, which gives, or is likely to give, false or misleading signals as to the supply of, demand for, or price of a virtual asset, or is likely to secure the price of one or several virtual assets at an abnormal or artificial level, including the dissemination of rumours, where the person who made the dissemination knew, or ought to have known, that the information was false or misleading.

- Securing a dominant position over the supply of, or demand for, a virtual asset, which has, or is likely to have, the effect of fixing, directly or indirectly, purchase or sale prices, or creates, or is likely to create, other unfair trading conditions;
- The placing, cancelling or modifying of orders to a virtual asset trading platform, which has one of the effects referred to under the first bullet point, by:
  - Disrupting or delaying the functioning of the trading platform for virtual assets or engaging into any activities that are likely to have that effect;
  - Making it more difficult for others to identify genuine orders on the virtual asset trading platform or engaging into any activities that are likely to have that effect, including by entering orders which result in the destabilization of the normal functioning of the trading platform;
  - Creating a false or misleading signal about the supply of, demand for, or price of, a virtual asset, in particular by entering orders to initiate or exacerbate a trend, or engaging into activities that are likely to have that effect; and
- Taking advantage of occasional or regular access to the traditional or electronic media by voicing an opinion about a virtual asset, while having previously taken positions on that virtual asset, and profiting subsequently from the impact of the opinions voiced on the price of that virtual asset, without having simultaneously disclosed that conflict of interest to the public in a proper and effective way.

DLT Providers should identify and adopt best practices relating to identifying, monitoring and controlling market manipulation. For example, a DLT Provider might consider, where reasonably practicable:

- Monitoring how accounts that enter orders which initiate or exacerbate a trend react to subsequent price movements, when assessing whether these orders have been placed for legitimate reasons.
- Investigating whether algorithmic based systems are being used to generate deceptive data around transaction volumes (sometimes referred to as wash trading).
- Monitoring the movements of any significant or centralised holdings of particular virtual assets. In the majority of cases, DLT Providers will only be expected to monitor the movement of assets within their environment or systems, in a manner proportionate to their activities and resources. However, firms should exercise discretion and consider whether it may be appropriate to monitor the movements of particularly large holdings of specific virtual assets in certain circumstances.
- Monitoring the publication of information through public channels which might be aimed at generating false or misleading signals. In this context, the GFSC expects a DLT Provider to ensure that it is aware of information published through major broadcasters, widely read DLT-focused publications, and widely subscribed social media channels, for example. A firm will generally not be expected to commit resources to monitoring the content of more obscure media outlets, or of comments threads on social media platforms (unless there are good reasons to do so in specific circumstances).

## Insider Trading

A DLT Provider should not use inside information about virtual assets to acquire or dispose of those virtual assets, either directly or indirectly and either for its own benefit or that of a third party.

A DLT Provider that possesses inside information about virtual assets should not recommend that a third party acquires or disposes of those virtual assets, or that they cancel or amend an order concerning those virtual assets on the basis of that inside information. Neither should they induce a third party to make any such acquisition, disposal, cancellation or amendment concerning those virtual assets.

For the purposes of this Regulatory Principle, ‘inside information’ means any information of a precise nature that has not been made public, relating, directly or indirectly, to one or more DLT Providers or issuers of

virtual assets or to one of more virtual asset, and which, if it was made public, would be likely to have a significant effect on the prices of those virtual assets.

DLT Providers should consider the following factors when designing policies and controls relating to insider trading:

- How best to assess the rationale for the disclosure or non-disclosure of inside information;
- How best to ensure employees and associated third parties are able to identify inside information and understand how to comply with the DLT Provider's obligations around insider trading and the disclosure of conflicts of interest;
- How best to monitor the trading activity of employees and, to the extent that it is reasonably practicable, third parties that have access to inside information, in order to ensure that they are not engaged in insider trading; and
- How best to conduct market surveillance in order to identify trading patterns or activities that may be indicative of insider trading or market manipulation.

## Disclosure

DLT Providers should create and, to the extent that it is reasonably practicable, enforce disclosure requirements with respect to their employees, the markets which they operate and the particular virtual asset(s) trading on these markets, with a view to creating and maintaining an appropriate level of transparency. To the extent reasonably practicable:

- DLT Providers should be required to inform the public as soon as possible of inside information which concerns them, in a manner that enables the public to access that information in an easy manner and to assess that information in a complete, correct and timely manner.
  - Such disclosure may be delayed on the DLT Provider's own responsibility provided that immediate disclosure is likely to prejudice the legitimate interests of the DLT Provider, delay of disclosure is not likely to mislead the public and the DLT Provider is able to ensure the confidentiality of that information. It will be for the DLT Provider to evidence this.
- Employees of a DLT Provider that possess inside information should be prohibited from disclosing it to any other person, except where such disclosure is made in the normal exercise of their employment, profession or duties.
- DLT Providers should disclose the following in a manner that enables the public to access that information easily and to assess that information in a complete, correct and timely manner:
  - the functions and features of any market which they operate, the types of virtual assets that may trade on these markets, the basic functional rules that govern trading on these markets and any ability to access other markets;
  - the rules and requirements governing the admission of virtual assets for trading on any market which they operate, as well as those governing the de-listing of virtual assets;
  - the nature of their participation in the market(s) which they operate and in any other market(s), as well as that of any individuals or entities connected with the DLT Provider; and
  - any interests the DLT Provider has that may conflict with the interests of its clients, counterparties or any other relevant stakeholders.

## Trading Standards

A DLT Provider should also consider the following, in the interests of promoting high trading standards:

- Providing accurate and prompt market data to all stakeholders, such as information about bids, offers and last prices as well as any other data relevant to achieving fairness and transparency;
- Putting measures in place to prevent or reduce the ability of liquidity providers and market makers to significantly alter their prices after orders are received during ordinary market conditions;
- Putting measures in place to prevent any subset of participants in the market(s) that it operates from receiving preferential treatment when placing or executing their orders;
- Evaluating the execution quality of trades that take place within the market(s) that it operates and comparing it to industry best practice;
- Ensuring that there are appropriate policies and procedures in place governing the distribution of client assets between hot and cold storage;
- Ensuring that clients have timely access to their assets;
- Providing clear and timely communication to clients and all relevant stakeholders regarding any planned or unplanned market downtime, and how it will impact any open positions or trades;
- Training employees in relevant roles how to detect and respond to patterns or activities within the market(s) that it operates which may be indicative of market manipulation;
- Assessing the existence and extent of market fragmentation within the virtual asset marketplace and understanding its impact;
- Monitoring the marketplace and working to mitigate the effects of any violations of this Regulatory Principle and reporting bad actors to the GFSC or any other relevant authority; and
- Being cognizant of its role within the marketplace overall and of any potential systemic risk that its actions may impact.

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