

# SWX Europe *compliance*

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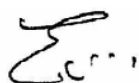
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We hope you will find this issue of SWX Europe *compliance* useful. We welcome your comments and suggestions.



Emma Vick  
Director of Regulation and Compliance

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## Market Notices

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Since the last *compliance*, Market Notices 32/2008 to 33/2008 inclusive have been issued:

Market Notice	Date	Content
32/2008	30.09.2008	The creation or increase of net short positions, either naked or covered, in Swiss financial stocks is not permitted on SWX Europe
33/2008	06.10.2008	Updated list of UK incorporated financial stocks to which the FSA Code of Market Conduct net short selling provisions apply

All Market Notices are available at [www.swxeurope.com](http://www.swxeurope.com) in the Regulation section.

## Updates to Rules and Directives

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There have been no changes to the Rules and Directives since *compliance* 22.

## Membership Notices

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Membership Notices published since *compliance* 22 have been:

Membership Notice	Date	Content
17/2008	25.09.2008	Additional Member ID – Banque Cantonale de Geneve
18/2008	26.09.2008	De-activation of a member ID – Rahn & Bodmer Banquiers
19/2008	30.09.2008	De-activation of a member ID – UBS AG
20/2008	09.10.2008	Additional Member ID – Citigroup Global Markets Limited
21/2008	13.10.2008	Additional Member ID – J P Morgan Securities Ltd
22/2008	30.10.2008	Additional Member ID – Deutsche Bank AG, London Branch
23/2008	07.11.2008	Change of Settlement Agent – J P Morgan Cazenove Limited

All Membership Notices are available at [www.swxeurope.com](http://www.swxeurope.com) in the Regulation section.

## FSA statement on the 30 day review of short selling measures

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On 22 October the UK Financial Services Authority (FSA) issued a statement on the 30 day review of its short selling measures for UK incorporated financial stocks. The FSA has concluded that, with one exception, that it should not make any changes to the measures at this time.

The one change relates to the requirements for disclosing significant net short positions in UK financial sector stocks. The FSA accepts that it is not proportionate to require daily disclosures of short positions where there has been no change in a short position. Consequently, the Code of Market Conduct has been changed so that from 31 October, once disclosure of a short position has been made, additional disclosures will only be required when that short position changes. The FSA will publish its Consultation Paper on short selling in January.

A list of UK incorporated financial stocks traded on SWX Europe to which these provisions apply has been provided in the appendix to Market Notice 31/2008. Disclosure to SWX Europe is not required.

The SWX Europe provisions relating to the short selling of Swiss financial stocks detailed in Market Notice 32/2008 remain unchanged.

## Market Integrity

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Members should have appropriate controls and take reasonable care to avoid unnecessary volatility during auction periods. The practice note to Rule 2.10 refers to inputting and deleting orders during auctions in a manner which gives or is likely to give a false or misleading impression of the value or probable opening state of the market in that security. Members should also pay due regard to the impact that the entry of significantly large orders during auction periods can have on other participants and the market in general. This applies particularly at times when volatility is likely to be high, for example on days of options and futures expiries.

The practice note also refers to times other than during auctions in which the inputting or deletion of orders gives or is likely to give a false or misleading impression of the value or price of the security or the order flow in a security.

Low volume orders or transactions may also be unacceptable and could amount to market abuse, for example where there is no legitimate commercial rationale for a transaction or where a misleading impression of the market could be created.

Entering orders to seek to affect the price of a derivative instrument is clearly unacceptable.

## Controls over order entry systems

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Members are encouraged to review their order entry system controls periodically to ensure that they remain appropriate. Members are responsible for the genuineness and accuracy of orders directed to SWX Europe and must have sufficient order management systems, procedures and controls to prevent errors in the entry of orders to the order book.

This also applies to orders entered or deleted by an automated system, for example where an algorithm enters orders in reaction to its own previous order entry or deletion or where an algorithm does not recognise pre-opening phases (i.e. auction periods and five minute trading halts).

The SWX Europe rules and directives of most relevance to controls over order entry and order management are as follows:

Rule 1.1:

"A member must at all times:

[...]

b) in the view of SWX Europe, have sufficient competence, systems, procedures, controls and resources to fulfil its trading, reporting, clearing, settlement and compliance responsibilities under the rules"

Rule 2.2:

"A member shall at all times maintain adequate control and security over orders entered into the system."

Rule 2.3:

"A member is responsible for the genuineness and accuracy of orders directed to SWX Europe in the name of, or by, the member."

Rule 2.10

"A member shall not:

a) act in a way that gives or is likely to give a false or misleading impression of the value or price of a security or its order flow or volume traded

Directive 15 - Order Routing and other Automated Systems

[http://www.swxeurope.com/download/regulation/directives/directive\\_15.pdf](http://www.swxeurope.com/download/regulation/directives/directive_15.pdf)

## **Guidance regarding the prevention of erroneous trades**

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SWX Europe has prepared the following guidance for SWX Europe members on the prevention of erroneous trades. The guidance supplements the requirements set forth in the SWX Europe rules and any associated practice notes.

The “first line of defence” in the prevention of erroneous trades is to prevent erroneous orders reaching the order book in the first place. Members should have adequate systems and procedures in place to prevent erroneous orders from being sent to the order book. Members should also ensure that traders receive adequate training on the use of trading systems and that order book and off-order book activity is appropriately supervised. The following is guidance only and is not an exhaustive list.

### **1. Price controls**

Prior to sending an order to the order book, the member’s internal systems should compare the price of the order against the current reference price. A tolerance should be set within the system so that prices exceeding this tolerance are not sent automatically to the order book. Market practice is generally for the system to warn the trader that the trade exceeds the tolerance and to require the trader to override the system in order to proceed.

Different tolerance levels may be appropriate depending on the security and the condition of the market. In some cases, the tolerance may be configurable by the trader, though we recommend that in such cases the Head of Trading, or other person in a similar position, should set maximum tolerances to prevent traders from setting tolerances so wide as to effectively disable the controls.

### **2. Volume controls**

Automated volume controls work in essentially the same manner as price controls and should be implemented in order to prevent errors in the size of the order.

### **3. Value Controls**

Though price and volume controls should be considered as necessary measures, some members supplement them with controls based on the total value of the order. As is the case with price and volume controls, these should be compared against a configurable tolerance and should prevent an order reaching the order book.

### **4. Matching own trade**

In order to prevent situations in which a member matches its own trade, it is desirable that the system checks executable orders from the same trading entity on the opposite side of the market. SWX Europe accepts that a member may match its own trades on an occasional and incidental basis, but where such matching occurred regularly it could be symptomatic of a lack of appropriate controls within the member firm.

### **5. Multiple orders**

For those members whose trading system includes the ability to resubmit orders quickly (such as by hitting the Enter key multiple times), the system should check that the total volume/value of the string of orders does not exceed the configured tolerance. This aim of this control is to prevent “fat finger” trades in which a large number of small orders are inadvertently sent to the market.

For order routing and the use of other automated systems, please see SWX Europe’s Directive 15 which covers routing of third party orders by a member via electronic means without manual intervention.

SWX Europe accepts that the setting of tolerances is often difficult, since there may be legitimate reasons for placing an order at a price outside of the tolerance level (such as limit orders of very long duration). Our view is that automated system controls are nonetheless necessary, as they can be overridden by the trader on those occasions in which the tolerance is inappropriate. The goal of these controls is to alert the trader to potential erroneous trades rather than to restrict the level of flexibility appropriate for legitimate trading activities.

## Reported Trades

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In line with Practice Note (d) of SWX Europe's Rule 3.1, Reported Trades ("RTs") should be input as follows:

- a transaction between two non-SWX Europe members, with the SWX Europe member acting in a riskless principal or intermediary capacity must be reported as 'SELL' with the trading capacity code 'CU'
- a principal purchase of shares by an SWX Europe member from a non-SWX Europe member must be reported as 'BUY' with the trading capacity code 'PR'
- a principal sale of shares by an SWX Europe member to a non-SWX Europe member must be reported as 'SELL' with the trading capacity code 'PR'

Please note that Reported Trades should not be flagged as 'BUY' with the trading capacity code 'CU'. When an SWX Europe member buys shares from a customer, this will be regarded as a principal 'PR' purchase.

Please go to Compliance Newsletter dated 7 September 2008 to view a summary of the MiFID pre and post-trade transparency requirements:

[http://www.swxeurope.com/download/regulation/newsletters/compliance\\_newsletter\\_18.pdf](http://www.swxeurope.com/download/regulation/newsletters/compliance_newsletter_18.pdf)

## Registered personnel

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Members are kindly requested to inform SWX Europe of any changes in registered personnel or those personnel who wish to receive e-mail notices.

Members are directed to Rule 1.5 and Directive 2 governing the registration of individuals:

[http://www.swxeurope.com/download/regulation/rules/swxeurope\\_rules.pdf](http://www.swxeurope.com/download/regulation/rules/swxeurope_rules.pdf)

[http://www.swxeurope.com/download/regulation/directives/directive\\_02.pdf](http://www.swxeurope.com/download/regulation/directives/directive_02.pdf)

## FSA Market Watch

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FSA Market Watch no. 29 can be found by following the attached link. Subjects covered in this issue include:

- Unauthorised trading at Societe Generale: update
- Market abuse controls: follow-up visits to hedge fund managers

[http://www.fsa.gov.uk/pubs/newsletters/mw\\_newsletter29.pdf](http://www.fsa.gov.uk/pubs/newsletters/mw_newsletter29.pdf)

Please address any comments/questions/suggestions to  
[regulation@swx.com](mailto:regulation@swx.com)

Tel: +44 (0) 20 7074 4545 - Fax: +44 (0) 20 7074 4532