

Intercontinental Exchange



Disruptive Trading Practices

January 14, 2015

Background – U.S.

- › The U.S. Commodity Exchange Act, section 4c(a)(5), states that it shall be unlawful for any person to engage in any trading, practice, or conduct on or subject to the rules of a registered entity that:
 - (A) Violates bids or offers;
 - (B) Demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or
 - (C) Is, is of the character of, or is commonly known to the trade as, ‘spoofing’ (bidding or offering with the intent to cancel the bid or offer before execution).

- › In May 2013, the CFTC published interpretive guidance regarding spoofing, which stated *inter alia* the following:
 - “Spoofing” includes, but is not limited to:
 - (i) submitting or cancelling bids or offers to overload the quotation system of a registered entity,
 - (ii) submitting or cancelling bids or offers to delay another person’s execution of trades,
 - (iii) submitting or cancelling multiple bids or offers to create an appearance of false market depth, and
 - (iv) submitting or canceling bids or offers with intent to create artificial price movements upwards or downwards.

Background - Canada

- › In 2013, the Investment Industry Regulatory Organization of Canada (“IIROC”) issued guidance on manipulative and deceptive practices, in Canadian **equities** markets, and included behaviors such as layering, quote-stuffing, and spoofing.
- › In 2014, Canadian provincial securities regulators addressed the usage of automated order systems and algorithms in National Instrument 23-103, which relates to **equity** markets, noting that automated systems must not “*interfere with fair and orderly markets.*”

ICE Futures U.S. and ICE Futures Canada

- › Rules coming into effect on January 14, 2015, which clarify the prohibitions on disruptive trading practices.

- › The updated rules expand on existing rules, and specifically make it a violation to:
 - Enter an order or market message, or cause an order or market message to be entered, with:
 - (a) The intent to cancel the order before execution, or modify the order to avoid execution;
 - (b) The intent to mislead other market participants;
 - (c) The intent to overload, delay, or disrupt the systems of the Exchange or other market participants;
 - (d) The intent to disrupt the orderly conduct of trading, the fair execution of transactions or mislead other market participants, or
 - (e) Reckless disregard for the adverse impact of the order or market message.

 - Knowingly entering any bid or offer for the purpose of making a market price which does not reflect the true state of the market, or knowingly entering, or causing to be entered, bids or offers other than in good faith for the purpose of executing bona fide Transactions.

Frequently Asked Questions

- › Information provided in IFUS and IFCA notices:
 - https://www.theice.com/publicdocs/futures_us/exchange_notices/IFUS_Disruptive_Practices_Notice.pdf
 - https://www.theice.com/publicdocs/futures_canada/member_notices/2014_12_29_Disruptive_Trading_Practice_rule.pdf

- › Rules can be found in Rule 4 (ICE Futures U.S.) and Rule 8 (ICE Futures Canada)
 - https://www.theice.com/publicdocs/rulebooks/futures_us/4_Trading.pdf
 - https://www.theice.com/publicdocs/futures_canada/rules/Rule8_Trading.pdf

- › FAQs will be permanently linked in the Market Resource page of each exchange:
 - <https://www.theice.com/futures-us/market-resources>
 - <https://www.theice.com/futures-canada/market-resources>

General assessment factors – partial list

- › Intent to induce others to trade when they otherwise would not;
- › Intent to affect a price rather than trade, or otherwise create misleading market conditions;
- › Market conditions at the time of the conduct;
- › Effect on other market participants;
- › Historical patterns of activity by the market participant;
- › Order entry and cancellation activity;
- › Size of orders relative to market conditions at the time the orders are placed, and relative to the market participant's position and/or capitalization;
- › Duration for which the orders are exposed to the market;
- › Queue position / priority of the order(s) in question
- › Change in the best offer price, best bid price, last sale price, or other price that results from the entry of the order;
- › Market participant's activity in related markets.

Intent, and reckless disregard

- › Intent may be ascertained through various factors, such as those listed on the previous slide.
- › Intent does not require the market participant to admit their state of mind.
- › Recklessness has been commonly defined as conduct that “departs so far from the standards of ordinary care that it is very difficult to believe the actor was not aware of what he or she was doing.”
- › Ignorance of the rules, or lack of general knowledge, are not defenses.

Timing of orders, and order withdrawal

- › Rapid entry and deletion of orders may be a factor when determining if a rule violation occurred.
- › However, there is no prescribed “minimum” time for orders to be considered valid.
- › It is not a violation to withdraw, cancel, or modify an order, if there was genuine intent to execute a bona fide transaction at the time of entry.

Errors

- › Legitimate errors are not a violation of disruptive trading rules.
- › However, errors may violate other rules, if market participants have not taken sufficient steps to mitigate their occurrence.
- › Operators of algorithmic trading systems must take particular care to ensure there are safeguards and risk controls for their order-entry activity.

Iceberg / Hidden Quantity orders

- › Usage of Hidden Quantity (“iceberg”) orders is not a violation.
- › However, patterns of activity where iceberg orders are used on one side of the market, while fully-displayed orders are used at the same time on the opposite side of the market, may be factors in evaluating the purpose of market participant’s activity.

Orderly conduct and fair execution

- › Intent to disrupt orderly conduct of trading, or the fair execution of transactions, is a violation.
- › Reckless disregard for the adverse impact of an order is a violation.
- › Factors taken into consideration may include:
 - Is there a rational relationship between consecutive prices?
 - What is the correlation between price changes and volume of trade?
 - What is the relationship between the price of derivative and underlying?
 - What are spreads between contract months?
- › It is a market participant's obligation to understand the market he/she is trading in, and what may be disruptive in that market.

Algorithms

- › Algorithm operators have an obligation to understand the behavior of their algorithms, and test them to ensure proper and compliant operation in a variety of relevant market circumstances.

Questions and Contact Information

- › Questions?

- › Key contacts:
 - ICE Futures U.S. compliance
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