NYSE Euronext

Powering the exchanging world.

Market Surveillance

NYSE Euronext and European perspective

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European regulatory structure - 1/2

European Directives

- MAD (2003)
- Transparency Directive
- MiFID

National Law and Regulation

- In all countries

Requirements of regulated exchanges

- Protect investors
- Fair and orderly markets
- Promote and maintain integrity

Regulatory functions of regulated markets

- Establish market rules
- Vet membership applications
- Monitor compliance with Rules
- Investigate Rule breaches
- Enforcement actions

European regulatory structure - 2/2

European cross-border monitoring and enforcement

Exchanges/Exchange groups

- Breaches of Rulebook
- Impose sanctions
- Contractual (cross border) relationship - e.g. NYSE Euronext members

National and European regulators

- Differing national laws on privacy of information
- No client identifiers
- Markets highly fragmentized
- Rudimentary cross border coordination (ESMA)

European cross-border enforcement - 1/2

MiFID today: highly fragmented market

- Thesis: national regulators / ESMA almost blind to cross border or multi-venue market abuse
  - Regulated Markets: 40 to 60 % of listed products traded on exchange
  - Inefficient use of market & trading data
    - Regulated Markets: monitor, survey, order **and** transaction details
    - MTF's: transaction detail only

NYSE Euronext

European cross-border enforcement - 2/2

Market Abuse Regulation (MAR): Improved cross border enforcement

- Extended scope of market abuse framework:
  - Includes RM’s, MTF, OTC, OTF, etc.
- Includes:
  - Attempts to engage in Insider dealing
  - Attempts of market manipulation
- Level playing field among all trading venues
- Coordination by ESMA
- Introduction of minimum rules for administrative measures, sanctions and fines
  - Disgorgement of profits
  - Fines to exceed profit gained or loss avoided
  - Member states to introduce effective, proportionate and dissuasive criminal sanctions

NYSE Euronext – Regulatory structure - 1/4

NYSE Euronext Regulatory functions

- Establish market rules
- Vet membership applications
- Monitor compliance with Rules
- Investigate Rule breaches
- Enforcement actions

- Identify and investigate market abuse and insider trading
  - forward to national competent authority

Overall objective: ascertain compliance with Euronext Rules, MAD, MiFID, MAR

- ➢ Real-time monitoring and preventive supervision
  - Daily operational management of the market
- ➢ T+1 surveillance
  - Detection of Rulebook breaches, market abuse and insider dealing
  - Investigate, audit members

NYSE Euronext – Regulatory structure - 2/4

NYSE Euronext

- contractual relationship with Members (brokers, dealers)
- Rule breaches

Competent authority

- Market abuse and insider trading

In case of a violation of the Rules, Euronext may (Rule 9301/1):

- Require the Member to fulfil its obligations under the Rules (letter)
- Impose a penalty (€ 500 – € 250.000)
- Claim compensation for actual damages caused to Euronext interest
- Suspend some of the Member's trading or membership rights (max. 6 months)
- Suspend the Member's Euronext membership (max. 6 months)
- Terminate the Member's membership
- Publish all or a part of the decision taken by Euronext management

NYSE Euronext – Regulatory structure - 3/4

When trading on the Euronext Markets, a Member shall

- Observe high standards of integrity, market conduct and fair dealing
- Act with due care, skill and diligence
- Refrain from any act or course of conduct which is likely to harm the reputation of Euronext or any Euronext Market

NYSE Euronext – Regulatory structure - 4/4

A Member must not engage in

- Artificially and/or abnormally move the price of a financial instrument
- Entering artificial orders or causing artificial transactions
- Reporting a fictitious transaction or any other false data
- Creating a false or misleading impression
- Any other action that may damage the integrity and transparency of the market
- Agreeing or acting in concert with or providing assistance to any person with a view to or in connection with breaching the rules

Market manipulation – examples

Pre-auction manipulation

- A manipulator enters a buy order (sell order) giving the impression that there are buyers (sellers) in the market
- …and also enters an opposite order
- Shortly before the opening auction or closing auction he cancels or modifies his buy order (sell order)
- … and trades at a better price on the opposite side in the auction

Market manipulation – examples

Quote stuffing

- A tactic of quickly entering and withdrawing large orders in an attempt to flood the market with quotes that competitors have to process…
- …thus causing them to lose their competitive edge in high frequency trading. (Investopedia)
- The May 6, 2010 flash crash was said to be caused by quote stuffing, but after investigating the SEC came to another conclusion.
- What about entering many orders in shares before the opening auction or entering many quotes in option before the opening?

Market manipulation – examples

Momentum ignition

- The proprietary firm may initiate a series of orders and trades (along with perhaps spreading false rumours in the marketplace) in an attempt to ignite a rapid price move either up or down
- This will "spoof" the algorithms of other traders into action and cause them to buy (sell) more aggressively
- By establishing a position early, the proprietary firm will attempt to profit by subsequently liquidating the position if successful in igniting a price movement (SEC)

➢ **NYSE Euronext position in HFT ESMA Response:**

  - Ping orders and momentum ignition strategies are not necessarily abusive in nature.
  - Each such case must be assessed against a range of factors when determining whether the actual behaviour constitutes market manipulation. For ping orders, one needs to consider what the real intention is to trade or to create a print.

Market manipulation – examples

It is important to consider:

(1) whether the activity leads to significant changes in the price of the financial instrument, particularly compared to the “normal” trading range of the financial instrument

(2) whether the transactions lead to a change in beneficial ownership or risk

(3) whether the activity is concentrated within a short time period and leads to a price change which is subsequently reversed and

(4) whether the activity is conducted at around a specific time when reference prices and settlement prices are calculated with that activity having an effect on the prices

Market manipulation – examples

Other forms of market manipulation

- Marking the close
- Painting the tape
- Manipulation of settlement prices

Case study: Order Book Layering 1/3

- A manipulator enters multiple orders on the bid (offer)
  … giving the impression that there are buyers (sellers)
  and narrowing the spread …

- … forcing other Members to improve their bids or offers if they want to trade and possibly triggering other algorithms

- The manipulator's true intention is to trade on the other side of the order book

- Often the manipulator then flips to the other side of the
  order book

Case study: Order Book Layering 2/3

- In July 2010 GCD noticed a case of OBL in a Dutch stock by a Member
- Upon further investigation GCD noticed similar behavior in a French and a Portuguese stock in June and July 2010
- However, in the case of the Portuguese stock it was noted that several traders entered orders independent of each other so GCD concluded that this was not OBL

Case study: Order Book Layering 3/3

- GCD imposed a penalty of 50,000 in accordance with Euronext Notice N9-01 (“penalty notice”)
- GCD took into consideration that the behaviour stopped after GCD announced the start of the investigation
- Ongoing discussion with the Member and the business on how to judge a situation where several traders of one Member firm enter orders in the same financial instrument.