

Attachment 1

DEFINITIONS

member authorised connection a direct technical connection that enables a non **member firm** to access **TradElect®** directly under a **member firm's** trading codes. Orders submitted in this manner do not pass through the usual order management systems of the **member firm**.

order routing a facility provided by a **member firm** through which a **customer** is able to submit orders to **TradElect®** under the **member firm's** trading codes and via the **member firm's** usual order management systems, but without manual intervention by the **member firm**.

Order entry

Access to TradElect® and the responsibility of member firms [2100-21095]

2100	Each order submitted to TradElect® shall be:
2100.1	firm; and
2100.2	subject only to the terms relating to benefit entitlements prevailing at the time of execution.
G 2101	A member firm that submits Any obligations and liabilities arising from the submission of electronic messages and orders to TradElect® , including those directly routed through it for customers, is responsible for all obligations and liabilities arising and <u>under a member firm's trading codes are the responsibility of that member firm.</u> The member firm shall, at all times, have sufficient order management systems, procedures and controls designed to prevent the entry of erroneous orders to TradElect® .

Guidance to Rule:

*A **member firm** is at all times bound by suitability rule 1020.*

*In determining whether a **member firm** has met the requirements of rules 1020 and 2101, the **Exchange** will consider the level of training and qualifications of individual traders, including the taking of any relevant examinations.*

*A **member firm** submitting an order to **TradElect®** is responsible for that order. If the order has been submitted by or automatically routed from a third party (whether another **member firm** or not), then the **member firm** should consider how it is going to control the order flow.*

~~The **member firm** is expected to adopt a regime where similar checks are made to those that would be made by reasonable human intervention. Consideration should be given to:~~

- ~~• the training that has been given to the people entering orders;~~
- ~~• the access controls over order entry that the originating third party applies;~~
- ~~• security controls over any network link between the originating third party and the **member firm**. These should be sufficient such that the **member firm** can be sure that an order purporting to come from a particular third party actually has done so (e.g. by use of authentication codes in a similar manner to the secure interactive interface linking the **member firm** to the **Exchange**);~~

- ~~the need for order acknowledgements from the originating third party;~~
- ~~controls over maximum order sizes that can be submitted by different originating third parties;~~
- ~~controls over prices of orders and having system parameters that would generate an alert if the order would execute at a price that the **member firm** would not be satisfied with;~~
- ~~monitoring and controls over the total exposure of the **member firm** to orders routed for a particular third party; and~~
- ~~clear allocation of responsibility for dealing with actions and errors (e.g. it should be clear how, when and by whom orders on the book would be deleted).~~

~~All of these matters should be dealt with in formal agreements between the **member firm** providing the order routing service and any relevant third party (whether **member firm** or non-member).~~

[Note: The guidance deleted above is now under paragraph 2103, with minor amendments]

Erroneous orders

An erroneous order is an order entered mistakenly where there was no intention to trade in the security or an order where the terms entered, mistakenly, did not represent the intended transaction. For the avoidance of doubt the terms of an order include both price and size.

In determining whether an order is erroneous, the **Exchange** will ask the **member firm** for details of the background to the order. Below is a non-exhaustive list of scenarios where the **Exchange** may query an order with a **member firm**:

- orders that exceed the **Exchange's** price monitoring thresholds;
- an aggressively priced limit order that executes against a significant number of orders on one side of the order book, which could take place, for example, if price and size have been entered in the wrong fields;
- an order that creates multiple executions e.g. a tranching facility that divides orders into an order size either not intended by the **member firm** or which is of a size so small as to be inappropriate; or
- a very high priced buy order or a very low priced sell order entered into the auction period when it might be more appropriate to use a **market order** to guarantee execution.

Member firms should ensure that their systems are designed to identify and prevent the entry of erroneous orders to TradElect[®]. In determining whether a **member firm's** systems are adequate in this regard, **member firms** should consider the use of controls and system alerts, which may be based on some or all of the following:

- the last order book traded price (from the previous day if appropriate);
- the current spread in the market;
- trader, security-specific or firm-wide size and price limits;
- the likely movement in the price of the security if the order is submitted;
- a minimum order size of a certain financial consideration per order; and
- controls on the price of limit orders submitted during an auction, to avoid aggressively priced limit orders being used instead of market orders.

The above list is not exhaustive and **member firms** are likely to wish to develop their own bespoke controls and system alerts to prevent the entry of orders which, because of their price, size and nature, could impact on the smooth running of the market.

Member firms should aim to prevent the entry of all erroneous orders, and system alerts should be able to prevent the entry of orders containing errors which, because of their size and nature, may impact on the smooth running of the market.

The parameters for any such alerts should be determined by each **member firm**, with reference to the nature of its business. Parameters should be set at levels such that, if no alert is generated in relation to any particular order, then the **member firm** should be satisfied with the execution price(s) achieved.

Member firms' procedures and controls should be designed to ensure that orders are entered correctly and that any alerts generated are responded to appropriately.

Member firms should be aware that in deciding what action to take against a **member firm** for the submission of any apparently erroneous order, the **Exchange** will consider both the potential and the actual market impact. It will also have regard to the relative frequency with which the **member firm** submits such orders.

Order routing

~~The **Exchange** is aware that **member firms** may have contractual arrangements with their order routing **customers**, which mean that the **customer** bears the financial risks of entering erroneous orders. However, under the **Exchange's** Rules, the responsibility for such orders rests wholly with the **member firm** in whose name the order is entered. Whilst ongoing education, training and guidance for a **member firm's** order routing **customer** is to be encouraged, this cannot entirely replace the safeguards that internal system controls and alerting functionality can provide.~~

~~In order to prevent the submission of erroneous orders by a **customer**, a **member firm** may wish to consider the following controls and system alerts:~~

- ~~• prevention of submission of an order if the **customer** has overridden alerts and/or notification to the **member firm** that the **customer** has attempted to over-ride the alert;~~
- ~~• training given to those **customer** entering orders.~~

~~The **Exchange** expects a **member firm** to be able to delete a **customer's** order from TradElect™ or, if necessary, restrict the **customer's** ability to enter orders, without having the express consent of the **customer**. Such action by the **member firm** may be instigated by the **member firm** because of its own concerns regarding the **customer's** behaviour or at the specific request of the **Exchange**.~~

[Note: The guidance deleted above is now under paragraph 2103, with some amendments and reordering]

GT	2102 5	A member firm should use the correct dealing capacity indicator, as described in the Guide to TradElect ®, when submitting orders to TradElect®.
G	2103	A member firm may allow a customer to submit orders to TradElect® under the member firm's trading codes, either by way of order routing or by providing a member authorised connection , subject to the member firm having in place adequate systems and controls.

Guidance to Rule:

Order routing and member authorised connection

Submission of **customer** orders may be facilitated by either an **order routing** facility provided by the **member firm** or via a **member authorised connection** to TradElect®

Order routing is a facility through which a **member firm** allows a **customer** to submit orders to TradElect® under the **member firm's** trading codes and via the **member firm's** usual order management systems, but without manual intervention by the **member firm**. These order management systems may be housed within the **member firm's** facilities or hosted within the **Exchange's** Primary Data Centre but, importantly, are the same systems through which the **member firm** submits at least some of its own order flow to TradElect®.

A **member authorised connection** is a direct technical connection provided so that a **customer** is able to access TradElect® under a **member firm's** trading codes. As the connection is direct, orders submitted by the **customer** to TradElect® do not pass through the usual order management systems of the **member firm**. To ensure that appropriate controls are in place, the **member firm** and its **customer** may decide to implement a version of the **member firm's** controls within the **customer's** systems. Alternatively, the **member firm** may use the 'hosting' service at the **Exchange's** Primary Data Centre to implement specific controls for order flow submitted through **member authorised connections**, or employ another control structure (such as using controls provided by an independent software vendor).

Responsibility for **customers'** order flow (whether submitted to the **Exchange** via an **order routing** facility or a **member authorised connection**)

The **Exchange** is aware that **member firms** may have contractual arrangements with their **customers** that mean the **customer** bears the financial risks of entering erroneous orders. However, under the **Exchange's** Rules the responsibility for such orders rests wholly with the **member firm** under whose trading codes the order is entered.

The **Exchange** requires a **member firm** to be able to delete a **customer's** orders from TradElect® or, if necessary, restrict the **customer's** ability to enter orders, without having the express consent of the **customer**. Such action by the **member firm** may be instigated unilaterally by the **member firm** because of its own concerns regarding the **customer's** behaviour or at the specific instruction of the **Exchange**.

The **member firm** is expected to adopt a regime where similar checks are made to those that would be made by reasonable human intervention. Consideration should be given to:

- the training that has been given to the individuals entering orders;
- the access controls over order entry that the originating third party applies;
- security controls over any network link between the originating third party and the **member firm**. These should be sufficient such that the **member firm** can be sure that an order purporting to come from a particular third party actually has done so (e.g. by use of authentication codes in a similar manner to the secure interactive interface linking the **member firm** to the **Exchange**);
- the need for order acknowledgements from the originating third party;
- controls over maximum order sizes that can be submitted by different originating third parties;
- controls over prices of orders and having system parameters that would generate an alert if the order would execute at a price with which the **member firm** would not be satisfied;
- monitoring and controls over the total exposure of the **member firm** to orders routed for a particular third party; and
- clear allocation of responsibility for dealing with actions and errors (e.g. it should be clear how, when and by whom orders on the book would be deleted).

All of these matters should be dealt with in formal agreements between the **member firm** providing the **order routing** service or **member authorised connection** and any relevant third party (whether **member firm** or non-member).

Order routing

Whilst ongoing education, training and guidance for a **member firm's** customers that route orders through the **member firm** to TradElect® are to be encouraged, this cannot entirely replace the safeguards that internal system controls and alerting functionality can provide.

In order to prevent the submission of erroneous orders by a **customer**, a **member firm** may wish to consider the following controls and system alerts:

- prevention of submission of an order if the **customer** has overridden alerts and/or notification to the **member firm** that the **customer** has attempted to over-ride the alert;
- the segregation of this order flow by the use of the Trader Group facility within TradElect[®]; and
- appropriate training, education and guidance provided to those **customers** entering orders.

Member authorised connection

Member firms providing customers with a member authorised connection to TradElect[®] are entirely responsible for all obligations and liabilities arising from the entry, deletion and execution of all orders submitted by that customer.

A member firm that provides this facility for a customer must:

- ensure that relevant staff at the **customer** are conversant with the Rules and, in particular, those relating to order book trading. Relevant staff include the Head of Trading, the Head of Compliance and person(s) who sign off trading algorithms at the **customer**;
- segregate each **customer's** order flow from the **member firm's** order flow using the Trader Group facility within TradElect[®]. This is necessary to assist the Exchange in maintaining fair and orderly markets;
- restrict **customer** access to central counterparty order books only;
- use the Copy To functionality within TradElect[®];
- provide the **Exchange** with the name, head office address and country of incorporation of the **member firm's customer** for regulatory purposes. This information will be treated as confidential and will not be subject to commercial use;
- ensure it maintains appropriate management of **customers'** order flow, including having in place order entry controls. The **Exchange** is aware of a number of independent software vendors that may be able to provide software solutions to satisfy this requirement. **Member firms** may wish to consult the list of these independent software vendors on the **Exchange's** website or, alternatively, discuss this with their current software provider; and
- inform the **Exchange** and take appropriate action if it loses either its connectivity with the **Exchange** or its connection to its **customer(s)** where that connection allows the **member firm** to maintain order management controls over the **customer(s)** order flow.

G 2104

A member firm must undertake due diligence on any customer to which it provides or intends to provide a member authorised connection, in order to assess the suitability of any such customer to have a member authorised connection. The member firm must confirm to the Exchange that such due diligence has been undertaken and provide a systems diagram indicating how the customer will connect to TradElect[®] and the controls the member firm will have in place with respect to the customer's order flow.

A member firm must have undertaken due diligence to confirm that any customer to which it provides a member authorised connection:

- is considered fit and proper to have a direct technical connection to TradElect[®]
- has sufficient staff with adequate knowledge, experience, training and competence for the activities the customer undertakes on the Exchange's order books. Member firms may wish to consider whether training should be provided to the Head of Trading, the Head of Compliance and person(s) who sign off trading algorithms at the customer; and

- has adequate internal procedures and controls for these activities (which may include a version of the **member firm's** own order management controls being implemented within the **customer's** systems that the member firm is able to control remotely, or the **customer's** order flow being subject to order management controls via an independent software vendor.)

This assessment may fit within the **member firm's** existing due diligence framework or, if considered necessary, involve new due diligence processes that are specific to the provision of a **member authorised connection**. It is for **member firms** to judge what due diligence is necessary given the business, trading strategies and order flow of the **customer** or prospective **customer** to which the **member firm** wishes to provide a **member authorised connection**.

Member firms are required to submit a declaration to the **Exchange** confirming that they have undertaken appropriate due diligence to be satisfied on each of the above points. A template letter is provided on the **Exchange's** website. **Member firms** should attach to the declaration letter a clear and concise systems diagram indicating the technical connectivity arrangements through which the **customer** will connect to the **Exchange** and where within this connection the **member firm's** controls will be placed. In addition, a clear and concise explanation must be provided of how the controls will operate and how they will be maintained by the **member firm**.

Prior to agreeing to a **member authorised connection** being provided to a **customer**, the **Exchange** will meet the **member firm** to discuss the controls the **member firm** intends to put in place and the due diligence it has undertaken. This process is aimed at giving the **Exchange** sufficient comfort regarding the overall adequacy of the **member firm's** controls. However, **member firms** will retain responsibility for ensuring that their due diligence and controls are appropriate and sufficiently robust for their **customer's** business. The **Exchange** will not provide a specific endorsement of a **member firm's** due diligence or the controls it proposes to put in place but it will, nevertheless, exercise its right under rule 2105 to refuse a **member authorised connection** if it believes that the **member firm's** controls or its due diligence are inadequate.

Furthermore, **member firms** are required to satisfy themselves and, when requested, the **Exchange** that the **customers** to which they have provided **member authorised connections** continue to meet these requirements. For instance, if a customer to which a **member firm** has provided a **member authorised connection** has a significant change in trading volumes or its trading model, the **member firm** may consider it appropriate to refresh its due diligence on that **customer** to ensure that its systems, controls, training and staffing are adequate for its changed business. Otherwise, due diligence should be periodically reviewed according to the **member firm's** normal timetable, and the **Exchange** may require the **member firm** to share this reviewed due diligence with it. A **member firm** that becomes aware that a **customer** no longer meets the requirements must notify the **Exchange** immediately and cooperate with the **Exchange** to halt the **customer's** **member authorised connection**.

D G	2105	The Exchange reserves the right to refuse a member firm's request that a customer be provided with a member authorised connection to TradElect [®] .
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Guidance to Rule:

The **Exchange** may refuse a request to provide a **member firm's** customer with a **member authorised connection** where the **Exchange** is not satisfied in any respect with the due diligence undertaken by the **member firm** or where, in the **Exchange's** view, provision of the connection would present a risk to the orderly functioning of the **Exchange's** markets. Whilst the **Exchange** does not conduct due diligence on **member firms' prospective customers**, it may refuse a request to provide a **member firm's** customer with a **member authorised connection** where it is aware of adverse information about the prospective **customer** which may not have been detected by a **member firm's** due diligence;

The **Exchange** may also, at its own discretion, take other factors into account in applying this rule. The **Exchange's** view of the risks that may be posed by the provision of a **member authorised connection** to a **member firm's** customer overrides any contrary view taken by the **member firm**.

D	2106	The Exchange reserves the right to terminate or suspend a customer's member
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authorised connection without notice or consultation with the **member firm** or its **customer** where the **Exchange** believes this is necessary to preserve the orderly functioning of the **Exchange's** markets.

D 21072 The **Exchange** reserves the right to restrict or segregate a **member firm's** access to and use of **TradElect**[®] as it sees fit.
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Guidance to Rule:

The **Exchange** may decide to segregate a **member firm's** access to and use of **TradElect**[®] in order to protect market orderliness or for other regulatory reasons.

*Whilst the **Exchange** does not mandate how a **member firm** should segregate its **order book** business at **trader group** level, the **Exchange** reserves the right to do this as it sees fit. ~~including~~ Typically, this would be where it ~~considers~~ suspects a **member firm's** controls ~~may to be~~ inadequate or inappropriate, or, more generally, where it considers this to be in the interest of maintaining a fair and orderly market.*

*For instance, where a **member firm** chooses to use only one or a limited number of **trader groups** for its order flow, and the **member firm** has repeated problems in relation to erroneous orders being entered by an **order routing customer**, the **Exchange** may require that ~~such~~ all orders from that **customer** are assigned to a specific **trader group**.*

D 21083 The **Exchange** reserves the right to delete any order submitted to **TradElect**[®] where the **Exchange** believes it necessary in order to preserve market orderliness.

21094 When using **TradElect**[®] a **member firm** shall comply with the procedural, operational and technical requirements of the **Exchange's** systems and networks as specified by the **Exchange** from time to time.