System testing [1420]

G	1420		A **member firm** shall not submit orders, quotes or **trade reports** to **TradElect®** for the purpose of testing any systems or controls.

Guidance to Rule:
…

*This rule is not intended to preclude a **member firm** from:*
…

*(b) using algorithms ("black boxes") to submit orders, quotes or **trade reports** to **TradElect®**. The **Exchange** recognises that to mitigate risk, **member firms** using algorithms may wish to check those trading strategies by submitting trial orders or quotes to the appropriate trading service. In these circumstances the **Exchange** will not generally consider the orders or quotes submitted to **TradElect®** as prohibited testing under this rule. **Member firms** using algorithms are however reminded of their obligations under rules 1020 (adequate systems and controls), 1400 (misleading acts, conduct and prohibited practices) and 2101 (erroneous orders and **quotes**) to maintain the integrity of the market.*
…

ORDER BOOK TRADING RULES

Order entry

Access to TradElect ® and the responsibility of member firms [2100-2109]

	2100		Each order or **quote** 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		Any obligations and liabilities arising from the submission of electronic messages and orders to **TradElect ®** under a **member firm's** trading codes are the responsibility of that **member firm**. The **member firm** shall, at all times, have sufficient order management systems, procedures and controls designed to prevent the entry of erroneous orders and **quotes** 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 or a **quote** to **TradElect ®** is responsible for that order or **quote**. If ~~the~~ an 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.*

*Erroneous orders and **quotes***

*An erroneous order or **quote** is an order or **quote** entered mistakenly where there was no intention to trade in the security or an order or **quote** where the terms entered, mistakenly, did not represent the intended transaction. For the avoidance of doubt the terms of an order* *or **quote** include but are not limited to ~~both~~ price, ~~and~~ size and buy or sell (direction of trade).*

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

- *orders or **quotes** 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;*
- *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;*
- *an order that ~~creates multiple executions e.g. a tranching facility that divides orders~~ is divided into ~~an order~~ sizes either not intended by the **member firm** or which ~~is of a size~~ are so small or so large as to be inappropriate.*

***Member firms** should aim to prevent the entry of all erroneous orders and **quotes** to **TradElect ®** and~~.~~ ~~**Member firms**~~ should ensure that their systems are designed to identify and prevent the entry of ~~erroneous~~ such orders and **quotes**. 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 or **quote** is submitted;*
- *a minimum and maximum ~~order size of a certain~~ financial consideration per order or **quote**; ~~and~~*
- *controls on limit orders and market orders submitted during an auction. When entering limit and market orders in auctions **member firms** must have sufficient systems and controls in place so that the type of order they submit does not have an inappropriate affect on the uncrossing price of the security in question. For instance, a **member firm** may wish to submit a market order to an auction to maximise its probability of execution but should have regard to the possible impact of a large market order on the auction uncrossing price;*

*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 and **quotes** which, because of their price, size and/or nature, could 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 and **quotes** 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 orders or **quotes** 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 or **quotes**.*

(Amended N09/09 – effective 23 February 2009)

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