Violation of Market Conduct Rules of SIX Swiss Exchange and Scoach Switzerland

Decision:

In its findings, the Sanction Commission of SIX Swiss Exchange and Scoach Switzerland stated that the trader X systematically breached section 9.2, para. 1 and 2 lit. a of the SIX Swiss Exchange Rule Book, by taking the following actions in relation to the indicated shares on the representative dates mentioned in the considerations: In each case, in less than one minute, he placed several orders of varying sizes at various price levels in the order book on the sell or the buy side, entered several orders at the same price levels and thus caused an overhang in buy and sell orders respectively. With the opposing orders on the buy and sell sides respectively, he used the price difference, promptly cancelled his other entries and immediately changed to the other side by reentering orders of varying sizes at various price levels. He thus caused price and liquidity distortions and created the appearance of market activity.

Furthermore, the Sanction Commission stated that trader X systematically breached section 9.2, para. 1 and para. 2 lit a of the Scoach Switzerland Rule Book by conducting up to 12 transactions in the indicated warrants within one minute on the sample dates mentioned in the considerations, for which there was a lack of any economic basis, and thus created the appearance of market activity.

X will be suspended from the SIX Swiss Exchange and Scoach Switzerland exchanges for six months from the date of entry into effect of this decision. Furthermore, X is ordered to pay the costs of the proceeding in the amount of CHF 20,000.

Considerations:

1. In a sanction decision, the Surveillance & Enforcement (SVE) department of SIX Exchange Regulation suspended X on [date 1] from admission by X to trading on the SIX Swiss Exchange and Scoach Switzerland exchanges for six months because he breached section 9.2, para. 1 and para. 2 lit a of SIX Swiss Exchange Rule Book and section 9.2, para. 1 and para. 2 lit a of Scoach Switzerland Rule Book as well as margin nos. 23, 24, 27 and 29 of FINMA Circular 2008/38. X filed an appeal against this to the Sanction Commission in time. He applied to have the sanction decision lifted, in the alternative, to have a reprimand issued, in the further alternative, to have the period of suspension substantially reduced and to have the suspension of trading activity by X since [date 2] taken into account in any period of suspension.

2. The sanction proceeding against X was consolidated with a sanction proceeding against another trader of the same participant who is accused of the same breach of rules and regulations based on the same pattern of trading.

A. <u>General</u>

3. In 2011, SVE commenced a sanction proceeding against X, a nostro trader at participant Z, because he was suspected of breaching the Rule Books of SIX Swiss Exchange and Scoach Switzerland as well as FINMA Circular 2008/38 ("Market Conduct Rules"). The proceeding was limited to the trading activity of X in seven different securities within short time sequences on various days. These incidents represent examples of a variety of order entries and transactions observed by SVE. The analyses showed that the trading pattern detected was repeatedly carried out by X and also used in other securities. For reasons of procedural efficiency, however, only the order entries, cancellations and transactions in the following seven securities and time sequences were fully included in the proceeding:
    a. Registered share A, on [date 3] in the period from 15:25:12 to 15:28:41
    b. Call warrant with underlying / on share B, on [date 4] in the period from 15:22:13 to 15:23:10
    c. Call warrant with underlying / on share C, on [date 5] in the period from 09:50:31 to 09:51:38
    d. Registered share D, on [date 6] in the period from 16:21:07 to 16:24:40
    e. Registered share E, on [date 7] in the period from 16:53:30 to 16:55:31
    f. Registered share F, on [date 8] in the period from 14:21:38 to 14:25:21
    g. Registered share G, on [date 9] in the period from 10:52:02 to 10:53:27.

4. The facts in these cases were not disputed. Also not disputed was that X used this trading pattern in other securities as well. This follows explicitly, among other things, from the fact that he claimed that SVE tolerates trading machines that exhibit the same market conduct as he himself (see below). This is however also reflected in the argument that he had no doubts about the legality of his trading activity because no doubts were expressed by the auditors either. As a result, as already seen in the SVE investigation, a steady pattern of conduct can be assumed. However, in order to avoid superfluous elaborate repetitions and presentations of fact, only the two cases from [date 3] and [date 4] will be dealt with below as examples (registered share A and call warrant on underlying B respectively). The arguments put forth by X will be addressed provided they are of relevance for this decision.

5. X argues that he was not treated equally, that SVE tolerates trading machines which carry out the same trading activities as he himself. However, he did not offer any specific evidence in this regard. SVE said that, to date, the same market conduct has not been detected in the case of other exchange participants. If such had been detected (by a trading machine or trader), SVE would have also taken action against this. There is no reason to doubt this statement. It is not enough to rely on non-specific statements in the media about problems in high-frequency trading. Furthermore, it should be noted that there is no entitlement on the exchange either to "equal treatment in the case of a wrong". There are no indications that SVE firstly fosters any practice that is contrary to the rules and regulations and secondly moreover has any intention of doing otherwise in future. Both must be met for an exceptional "equal treatment in the case of a wrong".

6. In the appeal, X argues that the terms in FINMA Circular 2008/38 (FINMA Circular), which SVE accuses him of breaching, are unclear and non-specific and are not a sufficiently precise basis for a sanction. A sanction would therefore violate the principle of legality.

7. Pursuant to section 9.2, para. 1 of the SIX Swiss Exchange Rule Book, participants and their traders are required to comply with the applicable market conduct rules, in particular those in accordance with the FINMA Circular "Market Conduct Rules" (FINMA Circular 08/38), to preserve the integrity of the market at all times and to refrain from any unfair trading practices. Securities transactions must have an economic basis and correspond to genuine bid and ask behaviour. Para. 2 refers to the trading practices that are not permitted.

8. The FINMA Circular stipulates, in Section IV (Genuine bid and ask behaviour):

   - *Securities transactions must be founded on an economic basis and be in accordance with genuine bid and ask behaviour.* *Margin no. 22*
   - *Securities transactions or orders placed for the express purpose of creating the appearance of market activity or distorting the liquidity, market price or valuation of securities, as well as engaging in bogus trades and orders, are not permissible (market manipulation).* *Margin no. 23*
   - *The following behaviours are deemed to be specific indications of market manipulation (stock exchanges may regulate further details, where necessary):*
     - *Selling and repurchasing the same securities in quick succession for the account of one and the same beneficial owner (wash trades).* *Margin no. 24*
     - *Simultaneous buying and selling in the same security for the securities dealer's own trading account (nostro-nostro in-house cross trades).* *Margin no. 25*
     - *Pre-arranged entries of equal but opposite buy and sell orders in the same security subsequent to prior mutual agreement with the intent to distort liquidity or market prices (improper matched orders, daisy chains, whose coordination involves several parties).* *Margin no. 26*
     - *Liquidity and price distortion by deliberately creating an overhang of buy or sell orders (ramping, capping, pegging the market).* *Margin no. 27*
     - *Creating large positions with the intent to constrict the market (squeezing or cornering the market).* *Margin no. 28*
     - *Placement of bogus orders for large blocks in the trading system with the intention of immediately cancelling them (spoofing).* *Margin no. 29*

9. In particular, X submits that SVE (respectively the Exchange) should have defined in advance what an "overhang" is and when precisely there can be said to be a "price or liquidity distortion" (margin no. 27) and what is meant by "large blocks" and "bogus orders" (margin no. 29).

10. This submission cannot be accepted. Both stock exchange rules and regulations themselves and the FINMA circular can only provide general definitions. When the borderline in terms of manipulation has been reached can generally not be defined either in percentage terms or in absolute figures. Individual cases or a recognized pattern of behaviour will show whether an overhang or price and liquidity distortion is the result of genuine bid or ask behaviour or the result of a multitude of buy or sell orders without any traceable economic basis that are entered by the same trader. The same applies for the terms "large blocks" and "bogus orders".

11. As will be demonstrated, any person who enters a multitude of orders at various levels and of various volumes within one minute such they are not intended to reach execution and then immediately cancels them, cannot rely on having complied with any genuine ask and bid behaviour. The introduction of a regulated minimum holding period discussed in EU law, as it is presented, is then from the start of no significance if the multitude of various orders on the same side and prices taken from the inside market are cancelled regularly and early enough prior to potential execution. Any person who enters and cancels many orders within a few seconds so that their execution cannot be expected exposes themselves to the suspicion that the orders are bogus.

    Any large block is also only to be understood in connection with the specific order book situation. It is patently wrong to attempt to use the term of "block transaction" in this case pursuant to reporting requirement provision, as X submits.

    The same applies for the term "overhang". X argued that the definition in the FINMA Circular should be understood as being the same as when there is a suspension of trading. This argument cannot be accepted either. The non-opening in point 7, para. 3, lit b of SIX Swiss Exchange Directive No. 3 and the suspension of trading pursuant to point 10 of the same directive, are technical bases of the Exchange platform and have nothing to do with the specific trading pattern of a trader.

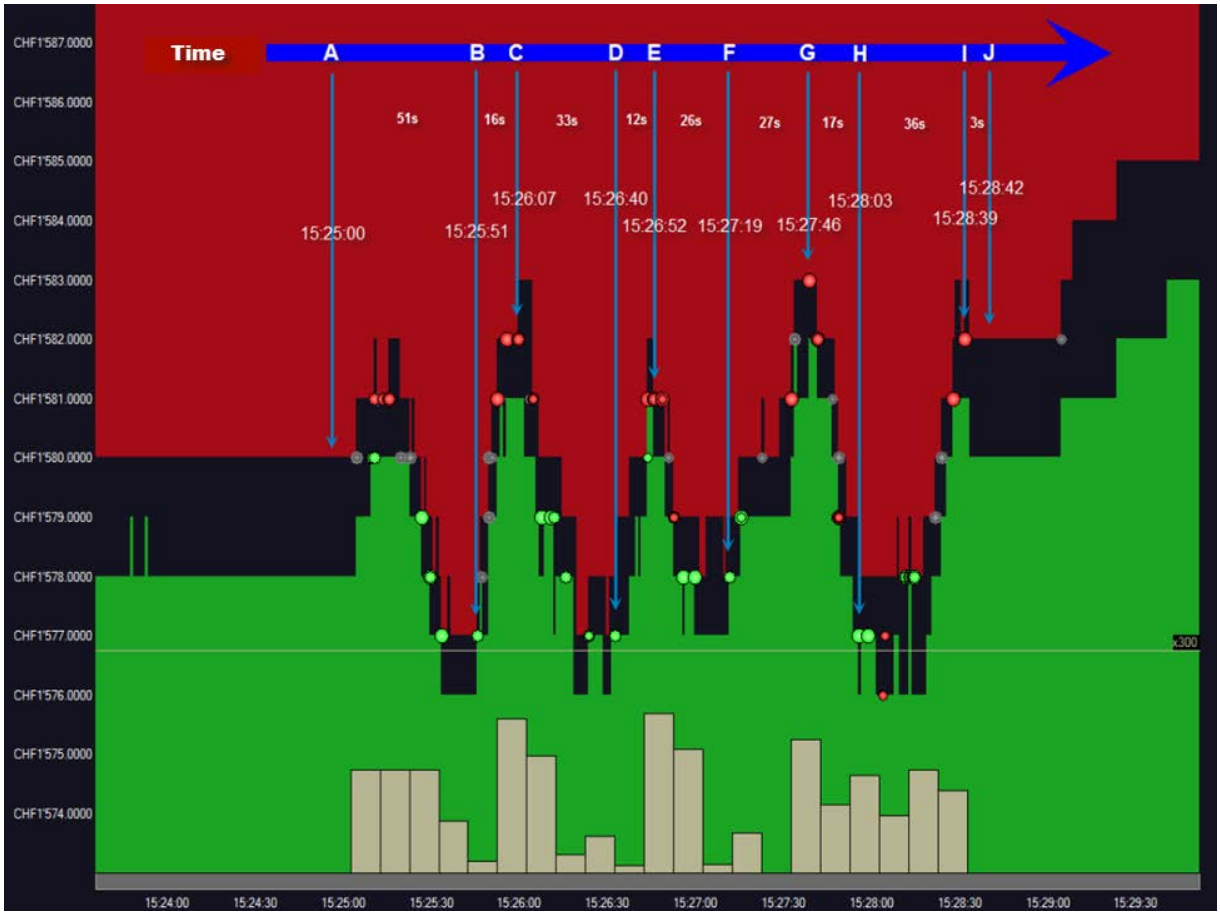
    Mention is made, for purposes of completeness, that in the consultation process on the FINMA Circular, the terms described here as being imprecise were not questioned by anyone (although other points were criticised). They are therefore regarded as generally understandable in the world of stock exchange trading.

12. X submits that no objection was made by SVE to the trading strategy of participant Z and that the auditors did not come across any facts to indicate that the rules and regulations were not complied with. It must also be stated that the presence of a formulated, permissible strategy of a bank does not mean per se that individual traders then act accordingly. The present proceeding concerns the behaviour of X himself, as revealed by the analyses conducted by SVE. He can thus not rely on the fact that the auditors did not find any facts which would indicate non-compliance with rules and regulations.

B. Considerations in relation to the facts

a) Trading in registered shares A (and in the other shares mentioned in the investigation)

13. On [date 3], in the three and a half minutes from 15:25:12 to 15:28:41, X made the entries set out by SVE in detail in Attachment 1 to the Sanction Decision in relation to registered share A. The following chart shows the course of bid and ask as well as the trades for this time period in graph form.



The green area of the diagram shows the course of the bid price and the red area, the course of the ask price. Each point stands for a trade and the larger the point, the greater the volume per trade. Green points mean that X was the buyer in the particular trade, red points stand for trades in which X was the seller. The gray bars visualise the entire volume traded by X in a 10-second interval. There are six intervals each minute, starting on the full minute, thus e.g. 15:25:00 – 15:25:09, 15:25:10 – 15:25:19, etc. According to his own information, when entering orders, X used the functions of software "ABC" that was used, which allowed him to enter and cancel so many individual orders in the time intervals.

The letters (A to J) in the horizontal blue arrow mark the times that are commented on individually in the mentioned Attachment 1.

14. *Time A* shows the order book prior to the activities of X. At 15:25:00, there were no orders by X in the order book for registered share A either on the bid or the ask side. The order volumes of the 10 best price levels on the bid and ask side amounted to 537 registered shares of A and 466 registered shares of A respectively; there were 36 buy orders against 46 sell orders. The bid-ask spread was CHF 2 (CHF 1,578 – CHF 1,580). The orders of the 10 best price levels on the bid side were between CHF 1,578 and CHF 1,567 and on the ask side, between CHF 1,580 and CHF 1,591.

15. At 15:25:51.981 (*time B1)* the situation was as follows: Since time A, the order volume of the ten best price levels on the ask side increased from 466 registered shares of A to 3,689 registered shares of A, the number of sell orders rose from 46 to 81. The spread is now at CHF 1,

the inside market at CHF 1,576 – CHF 1,577; the 10 best price levels on the bid side are between CHF 1,567 and CHF 1,576, on the ask side, between CHF 1,577 and CHF 1,586. With his volume of orders, X is present on the ask side on nine of the ten price levels with a share of between 75% to 96%. He carried out his order entries at various price levels and in addition, entered several orders on one price level. An outside investor or an electronic trading program would have to assume that the supply overhang must be attributable to several different investors willing to sell. The statement made by X that from a liquidity perspective, it is not important whether 10 orders for 5 or 1 order for 50 are entered, is therefore not correct. In actual fact, the multitude of orders at the same price level created an incorrect impression of liquidity. This type of order entry suggests to the market, which has only the publicly accessible view of the order book, that several sellers want to sell at the same price level, whereas it was actually primarily X, with his numerous orders at the same price level, who was creating the appearance of liquidity.

16. At this time, X has only one buy order for 69 registered shares of A at a price of CHF 1,576 (best price level) on the bid side in the order book.

17. At 15:25:53.077 (*time B2)*, X enters a buy order for 69 registered shares of A at the best ask price of CHF 1,577. At this price level, there is one single sell order for 15 registered shares of A, entered at 15:25:51.806 by another participant. This consequently resulted in the execution of 15 registered shares of A at a price of CHF 1,577. As a result of his order entries on the ask side, which created the impression of an ask overhang and as a result pushed the price downwards, X was therefore able to buy at CHF 1,577, thus CHF 3.00 more advantageously than at starting point A (CHF 1,578 – CHF 1,580). The price was changed through simple entries made by X.

18. Following the partial execution of the buy order (15 registered shares of A at CHF 1,577) by X at 15:25:53.077 *(time B3*), 54 registered shares of A remained on the bid side at a price of CHF 1,577 (best price level). X is now present on the ask side at every price level with a share of no less than 75%, on the tenth price level (CHF 1,587) with even 100%. The cumulative ask volume in 53 orders from him on the best ten price levels on the ask side reached, at time B3, with 3,657 registered shares of A, the highest value of all displayed order book situations.

19. By 15:26:07.499 (*time C1)* – 14 seconds after time B3 – X then cancelled 50 sell orders and changed the side. He has now placed numerous buy orders in the order book for registered share A. On the best 10 price levels on the bid side, between 62% and 100% of the order volumes are from X alone. While the cumulative volumes of the ten best price levels on the ask side declined in relation to time B3 from 3,950 registered shares of A to 631 registered shares of A, the cumulative volume of the best ten price levels on the bid side rose from 533 registered shares of A to 3,221 registered shares of A. The inside market is now at CHF 1,581 – CHF 1,582 (as compared with CHF 1,577 – CHF 1,578 at time B3).

20. At 15:26:07.512 (*time C2)*, another participant enters a buy order for 83 registered shares of A at a price of CHF 1,582. This buy order is executed with the two sell orders from X available at this price level (cumulative volume corresponds to exactly 83 registered shares of A). X was thus now able to sell his registered shares of A for a higher price due to his previous numerous buy orders. Following this sale at a price of CHF 1,582, the inside market rose from CHF 1,581 – CHF 1,582 to CHF 1,581 – CHF 1,583. On the ask side, X is only present on the price level CHF 1,584 with one order. His presence on the bid side is unchanged (*time C3*).

21. In the seconds following time C3, X cancelled all his buy orders once again and filled the order book on the ask side with sell orders. Up until 15:26:40.209 (*time D1)* he had a volume share of 82% – 98% on the best eight price levels. The cumulative sell volume of the ten best price levels on the ask side was at 3,627 registered shares of A compared with 614 registered shares of A at time C3. The inside market fell again to CHF 1,577 – CHF 1,578 compared with CHF 1,581 – CHF 1,583 at time C3. X placed only one order on the bid side, namely 69 registered shares of A at a price of CHF 1,577. This order was entered by X at 15:26:39.811, and at time D1, is at the best price level (CHF 1,577) together with an order by another market participant. However, the order from X was entered earlier whereby, in accordance with price-time priority, his orders were executed before all other buy orders in the order book at time D1. X was present on the ask side at the price level of CHF 1,581 and CHF 1,580 at times D1/D2/D3 with a high number of altogether 9 individual sell orders.

22. At 15:26:40.210 (*time D2)*, another participant entered a sell order for 10 registered shares of A at CHF 1,577. Consequently, there was an execution and X bought these 10 registered shares of A at the price of CHF 1,577.

23. Due to the partial execution (10 registered shares of A at CHF 1,577) at time D2, the order volume of the buy order of X fell from 69 registered shares of A to 59 registered shares of A. Execution priority continued to be the same *(time D3)*.

24. In the seconds following time D3, X changed again from the ask side to the bid side in the order book by 15:26:52.834 (*time E1)* and cancelled all of his sell orders that were still in the order book at time D3. Instead, he entered buy orders whereby he became very dominant at various price levels, at CHF 1,578 being even represented with 98%. Since time D3, the inside market rose from CHF 1,577 – CHF 1,578 to CHF 1,581 – CHF 1,582. At this time, X did not have any sell order in the order book. The cumulative ask volume on the best ten price levels fell, compared to time D3, from 3,647 registered shares of A to 363 registered shares of A. The cumulative bid volume on the best ten price levels rose, compared to time D3, from 522 registered shares of A to 2,654 registered shares of A. On the bid side, X was present on every price level except the first (CHF 1,581) and tenth price level (CHF 1,571). At 15:26:51.600, on the bid side, another participant entered a buy order for 10 registered shares of A at CHF 1,581 and at 15:26:51.903, a further participant entered a buy order for 10 registered shares of A at CHF 1,581.

25. At 15:26:53.430 (*time E2),* X entered a sell order in the order book for 69 registered shares of A at a price of CHF 1,581. As a result, there was a direct partial execution of 20 registered shares of A at CHF 1,581 with the two mentioned orders on the bid side.

26. Immediately following the partial execution (20 registered shares of A at CHF 1,581) of the sell order by X, 49 registered shares of A from his order remained on the best price level (CHF 1,581) on the ask side. On the bid side, he is subsequently to the transaction also present on the best price level (CHF 1,580) – and with 95% of the order volume (*time E3)*.

27. In the seconds following time E3 (*time F1)*, X cancelled all his buy orders in the order book and entered sell orders. On the seven best price levels, he gained a share of between 48% and 99% of the ask volume. On the best price level (CHF 1,579) on the ask side, X even had a 99% share of the order volume. The inside market in turn came under pressure and fell to CHF 1,578 – CHF 1,579 compared with CHF 1,580 – CHF 1,581 at time E3. The cumulative ask volumes of the best ten price levels rose in comparison to time E3, from 406 registered shares of A to 2,709 registered shares of A. In addition, X placed one single buy order for 69 registered shares of A at a price of CHF 1,578 (best price level on the bid side) at 15:27:19.155. This buy order from X also had the best time priority.

28. At 15:27:19.321 (*time F2),* a sell order for 11 registered shares of A at CHF 1,578 was entered by another participant and was consequently partially executed with the buy order from X already contained in the order book. After this purchase of 11 registered shares of A at the price of CHF 1,578, 58 registered shares of A from X remained on the bid side in the order book. In relation to time F1, the ask side remained unchanged (*time F3).*

29. In the seconds following time F3, X again cancelled all sell orders in the order book and changed sides. At 15:27:46.371 *(time G1)*, the cumulative ask volume of the best ten price levels was 498 registered shares of A, where at time F3, it was still at 2,709 registered shares of A. X was present on the bid side on the best ten price levels, on the best price level (CHF 1,582) with even 100%. The inside market at time G1 was at CHF 1,582 – CHF 1,583 compared to CHF 1,578 – CHF 1,579 at time F3. There was an order from X on the ask side for 92 registered shares of A at a price of CHF 1,583, which was entered at 15:27:45.051. With 2,926 registered shares of A, the cumulative bid volume of X on the ten best price levels reached, at time G1/G2/G3, the highest value of all order book situations described in this example.

30. At 15:27:46.372 *(time G2)*, another participant entered a buy order for 107 registered shares of A at a price of CHF 1,583. This was executed on the ask side of this price level against a total of 5 orders. X had a sell order for 92 registered shares of A at the price level of CHF 1,583 in the order book. There was a total of 6 sell orders at this price level, the order of X standing in fifth place in time priority. The cumulative volumes at this price level, that were before the sell order of X, resulted in 27 registered shares of A. Therefore, subsequent to these 27 registered shares of A, a further 80 registered shares of A of the sell order from X were executed (27 registered shares of A + 80 registered shares of A = 107 registered shares of A). At

15:27:46:372, there were only 12 registered shares of A from X remaining on the price level of CHF 1,583 *(time G3).*

31. In the seconds following 15:27:46:372 *(time G3)*, X cancelled all his buy orders in the order book and entered sell orders, as a result of which, at 15:28:03:027, he gained a share in the order volume of between 66% – 100% on the ask side of the first nine price levels *(time H1).* On the best price level (CHF 1,578) on the ask side, X had even a 100% share in the order volume, on the second best level (CHF 1,579), 99%. The inside market in turn came under pressure and fell to CHF 1,577 – CHF 1,578 compared to CHF 1,582 – CHF 1,583 at time G3. The cumulative ask volumes of the best ten price levels rose in comparison with time G3 from 391 registered shares of A to 3,648 registered shares of A. In addition, X placed one single buy order at 15:27:52.683 for 92 registered shares of A at a price of CHF 1,577 (best price level on the bid side).

32. At 15:28:03.038 (*time H2),* another participant entered a sell order in the order book for 119 registered shares of A at a price of CHF 1,577. Since the quantity of this order corresponded exactly to the available bid volume at this price level, all three orders at the price level of CHF 1,577 were executed, including that of X (purchase of 92 registered shares of A at CHF 1,577). Immediately following execution of this buy order by X *(time H3),* the best price level on the bid side was now CHF 1,576. At this time, X no longer had any more orders on the bid side. His strong presence on the ask side was unchanged.

33. In the seconds following time H3, X cancelled all sell orders that he still had in the order book at time H3, and changed sides. At 15:28:38:883 *(time I1)*, the cumulative ask volume on the best ten price levels was 471 registered shares of A, whereas this was still 3,648 registered shares of A at time H3. On the bid side, X is present at all price levels except the first one (CHF 1,581), at the tenth price level (CHF 1,572) with actually 100%. At time I1/I2/I3, he was present at price level CHF 1,578 with a total of 11 individual buy orders. The inside market at time I1 was at CHF 1,581 – CHF 1,582 compared to CHF 1,576 – CHF 1,578 at time H3. He entered an order on the ask side at 15:28:38.781 for 41 registered shares of A at a price of CHF 1,582.

34. At 15:28:39.041 (*time I2)*, another participant entered a buy order for 41 registered shares of A at a price of CHF 1,582. This was consequently executed with the sell order from X already contained in the order book (sale of 41 registered shares of A at CHF 1,582). Immediately following execution of this sell order (41 registered shares of A at a price of CHF 1,582), the best price level on the ask side was now CHF 1,583. At this time, X no longer had any order on the ask side. He continued with a strong presence on the bid side *(time I3)*, but cancelled these in the seconds prior to 15:28:42 *(time J).*

35. Time J shows the order book of registered shares of A following the activities of X on this trading day. X placed no order either on the bid side or the ask side. Compared with time I3, the cumulated bid volume of the best ten price levels on the bid side fell from 3,363 registered shares of A to 466 registered shares of A. The cumulative ask volume of the best ten price levels changed only slightly compared to time I3, it fell from 453 registered shares of A to 440 registered shares of A. For the first time since the projection of the order book prior to the activities of X (see time A), the cumulative bid and ask volume is in balance.

36. On this trading day, X did not carry out any further transactions in registered shares of A. Within 3 minutes 29 seconds, he thus bought 1,059 registered shares of A and sold 1,059 registered shares of A. In these minutes, neither the general market and sector situation nor that of A Ltd. changed in any way.

37. The records of the entries made by X show that between the times A and J, thus within 3 minutes and 29 seconds, he dominated the order book in the registered shares of A a total of 4 times on the bid side and 4 times on the ask side for some seconds at a time, and that just a few seconds later, he then cancelled his orders. Thus the order volumes in the order book at time A (15:25:00), prior to the activities of X, at the 10 best price levels, were 537 registered shares of A and 466 registered shares of A on the bid and ask sides respectively; there were 36 buy orders against 46 sell orders. At time B1 (15:25:51.981), the order volume of the ten best price levels on the ask side rose from 466 registered shares of A to 3,689 registered shares of A, the number of sell orders rose from 46 to 81. With his volume of orders, X was present on the ask side on nine of the ten price levels with a share of between 75% to 96%. The same happened in the other times C to I after the respective changes of sides. There is no doubt that he, by making these entries, deliberately created an overhang either on the buy

side or the sell side in the order book and thus influenced the price level of the share (level of inside market).

38. X entered the orders at various price levels and furthermore, entered various orders at one price level. An outside investor or an electronic trading program would have to assume that the supply overhang in the registered shares of A must be attributable to several different investors. A false impression arose in relation to liquidity and suggested to the market that several sellers respectively buyers wanted to take action at the same price level. In fact, however, there was no such great activity. It was X who, with his orders, created the appearance of liquidity. There is no question of him, as he submits, being a liquidity provider like a market maker.

39. There is no doubt that the overhang on the ask and bid side was deliberately created by X in order to be able to subsequently buy and sell advantageously. This is also evident from the fact that X shortly afterwards cancelled all sell and buy orders, completely changed sides and produced an overhang there in order to then profit from the artificially increased demand that he created. X did not enter the majority of the buy or sell orders at the best price level, but distributed them over several price levels. Several orders regularly qualified, in relation to the others contained in the order book, as large blocks. In addition, he cancelled his orders again already a short time later, once the price had been driven in the desired direction because of the multitude of orders, in order to effect a trade in his favour on the opposite side. It is inconceivable to talk about any genuine bid and ask behaviour when there are repeated changes of sides within a period measured in seconds. No market signals were present. Rather, X deliberately created an overhang and thus both artificially raised liquidity and distorted the price in the direction he wanted. X then immediately cancelled 93.15% of his buy order volume and 93.76% of his sell order volume respectively. It is obvious that the majority of the orders were placed in the order book only in pretence and were not intended to reach the execution stage at all. They must thus be qualified as bogus orders.

40. Within the good three minutes, X changed with his orders the sides of the order books 8 times. This leads to the conclusion that he did not have any actual trading strategy for the purchase or sale of registered shares of A, but wanted to mislead other participants / investors with his trading conduct in order to thus move the inside market on a short-terms basis in a direction favourable to him.

41. The same result follows from the actions of X found in the investigation in the other shares mentioned in point 3 and does not need to be elaborated any further.

42. X thus breached section 9.2, para. 1 and para. 2 lit a of SIX Swiss Exchange Rule Book

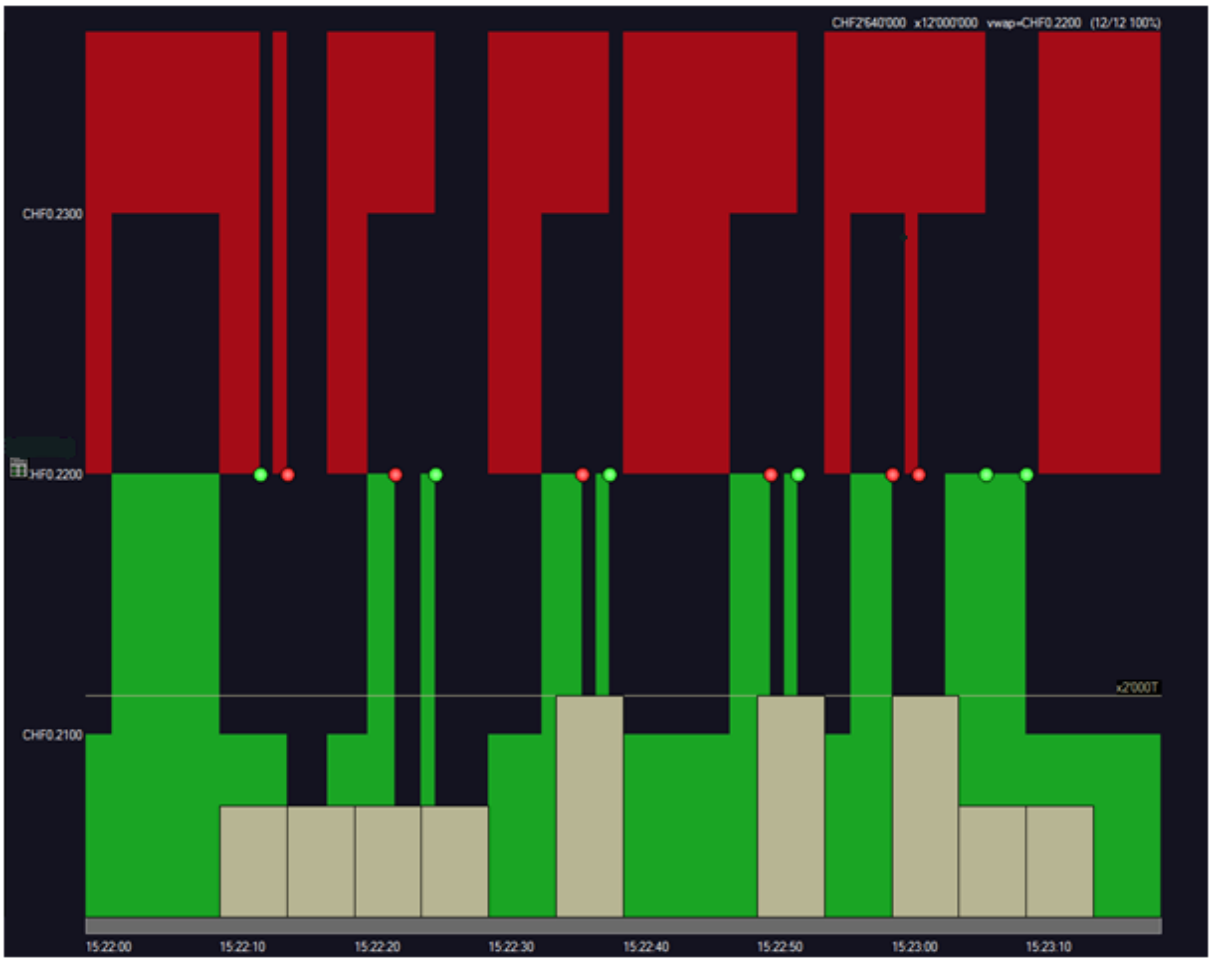
    a. by repeatedly causing an overhang on an alternating basis on the bid and on the ask side, he caused a manipulation pursuant to margin no. 27 of FINMA Circular 2008/38 (liquidity and price distortion by deliberately creating an overhang of buy and sell orders);

    b. by repeatedly placing orders on various price levels and several orders on one price level, he caused a manipulation pursuant to margin no. 23 of FINMA Circular 2008/38 (distortion of liquidity as well as creating the appearance of market activity);

    c. by repeatedly placing bogus orders for large blocks in the trading system with the intention of immediately cancelling them, he caused a manipulation pursuant to margin no. 29 of FINMA Circulars 2008/38 (spoofing).

b) <u>Trading in call warrants with underlying B and the call warrant with underlying C mentioned in point 3</u>

43. On [date 4] at 15:22:13, X bought 1 million call warrants on B. In the time from 15:22:15 to 15:23:10, X conducted 11 further trades in this call warrant. The following chart shows the course of bid and ask as well as the trades for this period of time in graph form.



The diagram shows that within 57 seconds, the same number of call warrants on B were traded back and forth at the same price. The counterparty of X was always the same counterparty (the market maker).

44. X claimed that in this time period, he not only traded the derivative but also placed orders in the underlying. When he started to trade in the derivative with underlying B, he had a long position of 8,000 of the underlying B. Since it was not possible in the indicated period to trade these 8,000 of the underlying B at CHF 137.50, he traded the derivative. It was possible to trade more than 8,000 shares in the call warrant on B (1 million call warrants on B x ratio 0.025 x delta 0.505 = 12,625 shares). Trading in the derivative thus served hedging purposes and to neutralise market risk. In the period of time, he changed his assessment of the market in relation to the hedge several times due to the market development. These assessments of the market resulted accordingly in the purchases and in the sales of the warrants.

45. This argument cannot be accepted. There are no indications that the 57 seconds from 15:22:13 to 15:23:10 involved any hedging of the long position in share B mentioned by him because by buying the call warrant with underlying B, he acquired the right to buy additional shares. To hedge his long position in the underlying of the call warrant with underlying B, he would have had to buy a put warrant or open a short position in call warrants (e.g. call warrants on B).

46. Attachment 2 to the SVE sanction decision shows details of the activity of X in the underlying B on SIX Swiss Exchange: On the buy side on [date 4] in the period of time from 15:22:13 to

15:23:10, he both entered 21 buy orders for a total of 84,000 shares B and also cancelled 21 buy orders for a total of 84,000 shares B. There were no sell orders from X in the underlying B within this period of time.

However, at 15:21:57, X entered a sell order for 4,000 shares at a price of CHF 137.50. At 15:23:18, thus *after* he very actively traded in the warrant with underlying B, he cancelled this sell order and at the same time placed a new sell order in the order book for 4,000 shares at a price of CHF 137.40. This sell order was immediately concluded in its entirety with several counterparties.

47. No indications can be detected between 15:21:57 and 15:23:10 which would objectively be a reason for the market development claimed by X, which would have resulted in several new assessments of the market in this short time. His activities in the underlying B and in the call warrant on B on SIX Swiss Exchange and on Scoach Switzerland do not give any indications that he wanted to undertake a hedging strategy for his long position of 8,000 shares B. These transactions lack any economic basis and furthermore, they convey the appearance of market activity.

48. In summary, X, in this period, with 12 trades in the call warrant on B, breached section 9.2., para. 2 lit. a of Scoach Switzerland Rule Book by causing a manipulation within the meaning of margin no. 23 of FINMA Circular 2008/38 through making trades to convey the appearance of market activity. The selling and repurchasing of the same securities in quick succession for the account of one and the same beneficial owner was also a manipulation within the meaning of margin no. 24 of FINMA Circular 2008/38 (wash trades).

49. The same applies to the actions of X discovered in the investigation in respect of the warrant on C mentioned in point 3.

C. Considerations in relation to the rules and regulations breached

50. It has been established that X systematically breached the following rules and regulations:

51. In the registered shares A ([date 3], 15:25:12 – 15:28:41), the registered shares D ([date 6], 16:21:07 – 16:24:40), the registered shares E ([date 7], 16:53:30 – 16:55:31), the registered shares F ([date 8], 14:21:39 – 14:25:21) and the registered shares G ([date 9], 10:52:02 – 10:53:27), he placed a large number of orders in the order book at various price levels a number of times within only a few minutes, thereby causing an overhang of buy respectively sell orders which led to the corresponding price and liquidity distortions. He thus breached section 9.2, para. 1 and para. 2 lit a SIX Swiss Exchange Rule Book and margin no. 27 of FINMA Circular 2008/38.

52. In the registered shares A ([date 3], 15:25:12 – 15:28:41), the registered shares D ([date 6], 16:21:07 – 16:24:40), the registered shares E ([date 7], 16:53:30 – 16:55:31), the registered shares F ([date 8], 14:21:39 – 14:25:21) and the registered shares G ([date 9], 10:52:02 – 10:53:27), he placed multiple orders on the same price level and as a result, to outside third parties, created the appearance of liquidity. Furthermore, by entering a myriad of orders at various price levels, he created the appearance of market activity. He thus breached section 9.2, para. 1 and para. 2 lit a SIX Swiss Exchange Rule Book and margin no. 23 of FINMA Circular 2008/38.

53. In the registered shares A ([date 3], 15:25:12 – 15:28:41), the registered shares D ([date 6], 16:21:07 – 16:24:40), the registered shares E ([date 7], 16:53:30 – 16:55:31), the registered shares F ([date 8], 14:21:39 – 14:25:21) and the registered shares G ([date 9], 10:52:02 – 10:53:27), he placed multiple bogus orders for large blocks in the trading system and then immediately cancelled them. He thus breached section 9.2, para. 1 and para. 2 lit a SIX Swiss Exchange Rule Book and margin no. 29 of FINMA Circular 2008/38.

54. In the case of the transactions by X in the warrants on B ([date 4], 15:22:13 – 15:23:10) and in call warrant on C ([date 5], 09:50:31 – 09:51:38), there was a lack of any economic basis. Through selling and repurchasing the same securities in quick succession for the account of one and the same beneficial owner, he breached section 9.2, para. 1 Scoach Switzerland Rule Book and margin no. 24 of FINMA Circular 2008/38 (wash trades). In addition to this, these transactions created the appearance of market activity, which is why X breached section 9.2, para. 2 lit a Scoach Switzerland Rule Book and margin no. 23 of FINMA Circular 2008/38.

D. Considerations in relation to the determination of penalty

55. Pursuant to section 18 lit. a SIX Swiss Exchange Rule Book, where provisions of the Rule Book have been breached, the Exchange may impose sanctions on participants and/or traders; specifically when there is a breach of the rules and regulations of the Exchange. If the breach is committed by a trader, the sanction consists of a reprimand, suspension or revocation of registration, pursuant to section 19, para. 1 of the Rule Book. When a sanction is imposed, the gravity of the breach, the degree of fault and any previous sanctions imposed on the trader will be taken into account. The same applies under the Scoach Switzerland Rule Book.

56. X systematically breached the above-mentioned provisions of SIX Swiss Exchange and Scoach Switzerland Rule Books, which is why a sanction must be issued against him.

57. It is not disputed that a sanction never had to be imposed against X to date. It is also not disputed that X carried out the activities deliberately and not due to negligence.

58. In the contested sanction decision, SVE described a suspension of six months as being appropriate. SVE held that X placed the great majority of the share orders with no intention of concluding them in the order book. In fact, with the numerous orders on multiple price levels on one side of the order book, he deliberately created a false view of the order situation. The true purpose of these orders, which were entered within a very short time alternatively on the bid or on ask side of the order book, was solely to change the price (inside market) so that he could profit from such price movements.

59. SVE held that in the case of these orders, it was foreseeable to X that he, with his entries that produced an order overhang, would not complete any trades. SVE also took into account that the majority of the orders and also the volume were not placed by X at the best bid or ask prices in the order book and that these orders were only available for execution in the order book for a very short time. On the other side, in the questionable periods of time, the orders had an enormous influence on the order book, which is publicly accessible. In these moments, the order book of the Exchange did not show the real situation in terms of supply and demand for these shares, the orders were instead “artificial and manipulated”.

60. In determining the penalty, SVE noted that "exchanges offer a pricing process that is based on bid and ask in the order book of individual securities. Market participants rely on pricing to be fair and on market forces (bid and ask) alone being determinative of prices. Investors rely on fairness being ensured at all times and on no manipulative practices interfering with this process, causing prices on the Exchange to be not the result of the real order situation in the order book. Market participants have the expectation and assume, when making their decisions, that the orders placed in the order book were always entered with the intention of buying or selling the particular share in the exchange system."

61. As mentioned, this case involves action with intent. X however claimed that he at no time had any awareness of wrongdoing. The reasons he gave for this were that the terms used in the FINMA Circular were vague and would first need to be defined in detail by the Exchange before they could be the basis of a sanction.

62. As already mentioned under point 10 f, that is not correct. The rules of conduct are clear. Furthermore, the facts investigated do not involve a borderline case in which one could be of a different view in good faith. SVE correctly pointed out that X was a skilled trader who knew the exact effect of his entries in the exchange system. As well, his statement that the Exchange permits trading machines that act exactly as he did, only much faster (which is not true), is not understandable either. It is obvious that X, with his entries and cancellations, knowingly affected the price level for some seconds in such a way that he achieved a price that did not correspond with any genuine supply and demand, thus deliberately manipulating. X did not dispute that the purpose of the FINMA Circular was clear to him. But its purpose is precisely to prevent market manipulation. X cannot rely on a lack of awareness.

63. X claimed that SVE condoned behaviour such as his for years. SVE would have to issue a publication indicating that such behaviour is unacceptable prior to imposing a sanction. However, there is no evidence that SVE condoned such behaviour in other cases. On the contrary, the case at hand is exemplary in showing how complex investigations are in order to be able to determine certain breaches of rules and regulations.

64. X also claimed that there has never been a suspension ordered in connection with market manipulation. If behaviour such as his is now labelled as contrary to the rules and regulations, a reprimand would first have to be issued and published to notify market participants as to what behaviour is deemed unacceptable. The argument does not hold true. Sanctions must be meted out in accordance with the gravity of the breach and the degree of fault in each specific case.

65. X argued that in 2003, a trader was merely issued a reprimand as a result of prohibited snake trading although the SFBC, already in a newsletter dated 11 December 1998, explicitly prohibited snake trading and for this reason provided a warning. It is to be noted furthermore, that on [date 10], the former Disciplinary Commission of the Exchange issued reprimands to various participants because they had allowed some of their traders, in the year previous, to engage in the snake trading mentioned. It was thus first the sanctioning authority (which could and can only take action for the Exchange participants) that sanctioned the snake trading. Only afterwards did the SFBC issue the generally applicable rule. It is thus not correct in the case of the prohibition against snake trading that a general rule was issued first prior to any sanctioning. One cannot derive from the issue of a reprimand due to snake trading against a trader in 2003 that in other cases a reprimand must be ordered first before any more grave sanction is allowed to be taken.

66. X submitted in the alternative that a reprimand or a suspension of merely one month should be issued and the period of the suspension set starting from [date 2] since he no longer traded as of this date (service of the SVE sanction decision).

67. A reprimand is only issued in mild cases where the fault is minor and/or the breach is not so grave. However, there is no entitlement to first have a reprimand issued for each first breach or first-time discovery of a breach of the rules and regulations. In the case dealt with here, there is not just one single instance of conduct contrary to the rules and regulations. In fact an extensive investigation discovered systematic conduct contrary to the rules and regulations. There is no question that X basically conducted nostro trading over and over again in the manner alleged. That is not to be taken lightly. The Exchange must not only ensure that there is no elaborate manipulation. It must also ensure, as mentioned by the SVE, that pricing is always fair, even in the case of small price movements and volumes, and that no manipulative practices interfere with the pricing process. It must also punish small but systematically committed breaches. This is precisely what X is accused of. However, where there is no mild and in addition systematic case, a mere reprimand is insufficient as a sanction and at the least, a suspension must be imposed.

68. X requested in the further alternative that the suspension be reduced to one month because six months would have a draconian effect. To what extent this actually holds true for suspensions of six months cannot be generalised. X argued that he no longer traded as of [date 2]. He therefore imposed a draconian period of time upon himself or else there is no such effect. He would have been free to act on behalf of his employer without the clearly visible manipulative actions. The nature of a penalty for breach of contract borders on being criminal law based on discretion, to a certain degree. Sanctioning bodies should neither set unduly severe penalties, nor merely symbolic ones. There are no apparent reasons to essentially make any other judgment than the one made by SVE. In particular, there are no signs that SVE was arbitrary in its choice of the extent of penalty. Furthermore, it in fact corresponds to the most recent practice of the Sanction Commission which is to generally issue stronger sanctions to promote compliance with rules and regulations through their preventative effect. The suspension of six months already ordered by SVE is appropriate in this case.

69. In the further alternative, X requested that the start of any suspension be retroactive to [date 2]. If such dating were used in practice, the person in breach of rules and regulations would be able to more or less reverse the sanctioning effect of a suspension, depending on the length of a sanction proceeding, which depends not only on the responsible bodies of SIX Swiss Exchange, but also on the steps taken by the person themselves. Accordingly, the suspension must start once the sanction decision enters into legal effect.

70. Pursuant to section 6.3 of the Rules of Procedure, the Sanction Commission as a general rule makes its legally enforceable decisions available in anonymous form on the SIX Exchange Regulation website. This will notify participants and traders of the practice. In the within case, SVE will be able to make abridgements for easier reading. In established practice, the Sanc-

tion Commission has not published sanctions against traders with any particular publication and naming names. This measure in this case is also not imposed.

71. With this outcome of the proceeding, X is required to pay the costs of the proceeding as well as for both the investigation and the Sanction Commission (SVE CHF 10,000, Sanction Commission CHF 10,000). The costs for legal counsel shall be paid by X himself (section 2.9 of the Rules of Procedure).

28 August 2012

(Translation)