Violation of Market Conduct Rules of SIX Swiss Exchange

Decision:

In its findings, the Sanction Commission of SIX Swiss Exchange stated that trader Y systematically breached section 9.2, para. 1 and 2 lit. a SIX Swiss Exchange Rule Book, in that he did the following to the indicated shares in the sample 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.

Y will be suspended from SIX Swiss Exchange for six months from the date of entry into effect of this decision. Furthermore, Y 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 Y, a nostro trader with participant Z, on [date 1] from admission to trading on SIX Swiss Exchange for six months because he breached section 9.2, para. 1 and para. 2 lit a SIX Swiss Exchange Rule Book as well as margin nos. 23, 27 and 29 of FINMA Circular 2008/38. Y 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 Y since [date 2] taken into account in any period of suspension.
2. The sanction proceeding against Y 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 in shares.

A. General

3. In 2011, SVE commenced a sanction proceeding against Y because he was suspected of breaching the Rule Book of SIX Swiss Exchange as well as FINMA Circular 2008/38 ("Market Conduct Rules"). The proceeding was limited to the trading activity of Y in three 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 Y and also used in other securities. For reasons of procedural efficiency, however, only the order entries, cancellations and transactions in the following three securities and time sequences were fully included in the proceeding:
   a. Registered share A, on [date 3] in the period from 10:46:05 to 10:55:07,
   b. Registered share B, on [date 4] in the period from 09:01:56 to 09:06:46,
   c. Registered share C, on [date 5] in the period from 11:43:08 to 11:47:36.
4. The facts in these cases were not disputed. Also not disputed was that Y 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 case from [date 3] will be dealt with as an example (registered share A). Besides, it is unnecessary to have SVE deal with additional cases. The arguments put forth by Y will be addressed provided they are of relevance for this decision.
5. Y 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, Y 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 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):*
     - o *Selling and repurchasing the same securities in quick succession for the account of one and the same beneficial owner (wash trades). Margin no. 24*
     - o *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*
     - o *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*
     - o *Liquidity and price distortion by deliberately creating an overhang of buy or sell orders (ramping, capping, pegging the market). Margin no. 27*
     - o *Creating large positions with the intent to constrict the market (squeezing or cornering the market). Margin no. 28*
     - o *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, Y 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 Y submits.

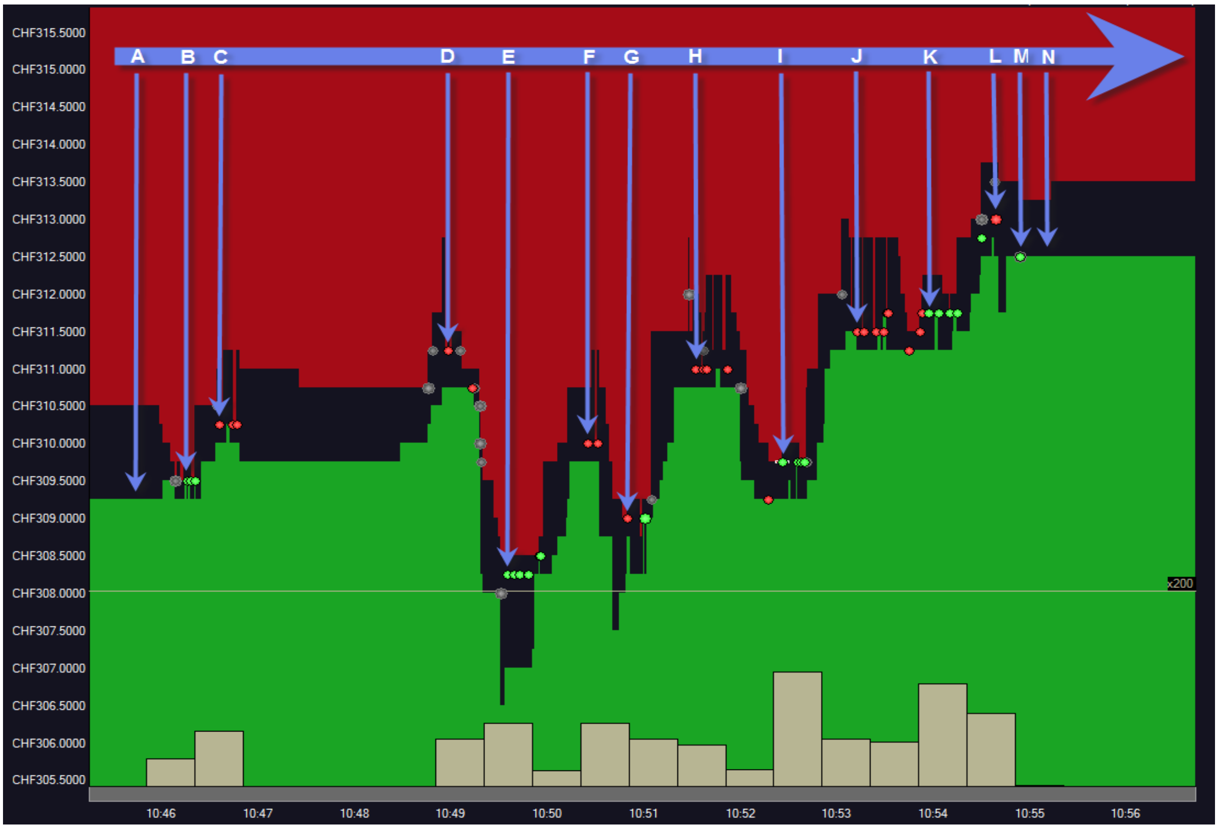
The same applies for the term "overhang". Y argued that the definition in the FINMA Circular should be understood as being the same as when there is a suspension of trading. This argument cannot be accepted either. The non-opening in point 7, para. 3, lit b of SIX Swiss Exchange Directive No. 3 and the 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. Y submits that no objection was made by SVE to the trading strategy of participant Y 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 Y, as revealed by the analyses conducted by SVE. Y 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. <u>Considerations in relation to the facts</u>

13. On [date 3], in the nine minutes from 10:46:05 to 10:55:07, Y 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 Y was the buyer in the particular trade, red points stand for trades in which Y was the seller. The gray bars visualise the entire volume traded by Y in a 30-second interval. There are two intervals each minute, starting on the full minute, thus e.g. 10:46:00 – 10:46:29, 10:46:30 – 10:47:59, etc. Pursuant to his own information, when entering *orders Y 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 – N) 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 in relation to registered share A prior to the activities of Y, i.e. at 10:45:40:343, there were no orders from Y in the order book for registered share A either on the bid or the ask side. The order volumes of the ten best price levels on the bid and ask side amounted to 987 registered shares of A and 1,188 registered shares of A respectively; there were 11 buy orders against 17 sell orders. The bid-ask spread was CHF 1.25 (CHF 309.25 – CHF 310.50), whereas the orders on the ten best price levels on the bid side were between CHF 306.00 and CHF 309.25, and on the ask side, between CHF 310.50 and CHF 316.00.

15. At 10:46:24:228 (*time B1)*, the situation was as follows: Since time A, the order volume of the ten best price levels on the ask side increased only slightly from 1,188 registered shares of A to 1,202 registered shares of A, but these 1,202 registered shares of A are now in the price spread of CHF 309.75 to CHF 312.00 in the order book. This is in contrast to time A, when the price spread was CHF 310.50 – CHF 316.00. The number of sell orders rose from 17 to 53. The inside market is now at CHF 309.50 – CHF 309.75. With his volume of orders, Y is now present on the ask side on all ten price levels with a share of between 10% – 100%. It can be seen that Y had a volume share of 100% on five price levels. Since his order entries were made at different price levels and he also enters several orders at one price level, an outside investor or an electronic trading program would assume that the supply overhang in registered share A must be attributable to several different investors willing to sell. The statement made by Y 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 a false impression with respect to liquidity. This type of order entry suggests to the market that several sellers want to sell at the same price level, whereas in actual fact, there is no such great liquidity in the market, but rather primarily Y, with his numerous orders at the same price level, creating the appearance of liquidity.

16. On the bid side, Y had placed only one order in the order book at time B at the best price level of the demand side (CHF 309.50) for 14 registered shares of A.

17. At 10:45:25:369 (*time B2)*, another participant entered a sell order in the order book for 14 registered shares of A at a price of CHF 309.50. This is consequently fully executed with the buy order from Y, already there, for 14 registered shares of A at CHF 309.50.

18. *Time B3* shows the order book immediately following execution (14 registered shares of A at CHF 309.50) of the buy order from Y. In relation to time B2, the ask side remained unchanged in respect of the sell orders from Y.

19. By 10:46:45:812 (*time C1)* – 20 seconds after time B3 – Y had cancelled all of his sell orders in the order book and entered buy orders, as a result of which he was present on the bid side on all price levels. He had a volume share of 100% on five of ten price levels. As a result of this demand overhang, the inside market rose to CHF 310.00 – CHF 310.25 compared to CHF 309.25 – CHF 309.75 at time B3. The cumulative number of orders rose from ten orders at time B3 to 63 orders. The price spread on the bid side narrowed to CHF 307.75 – CHF 310.00 (CHF 2.25) compared to CHF 305.00 – CHF 309.25 (CHF 4.25) at time B3.

20. On the ask side, Y was in the order book with a sell order for 14 registered shares of A at the best price level (CHF 310.25), which he transmitted precisely at time C1, 10:46:45:812.

21. At 10:46:45:962 (*time C2),* another participant entered a buy order in the order book for 14 registered shares of A at a price of CHF 310.25, which was consequently executed with the sell order from Y (for 14 registered shares of A at CHF 310.25) already contained in the order book. As a result of his previous numerous buy orders, which suggested to third parties that there was a high demand, Y was now able to sell his registered shares of A at a higher price.

22. *Time C3* shows the order book immediately following execution (14 registered shares of A at CHF 310.25) of the sell order from Y. The bid side remained unchanged in respect of the volume from Y as compared to *time C1*. Following this transaction, Y completely cancelled from the order book all orders entered on the bid side. At 10:46:58, there were no more orders from Y on either the bid side or the ask side.

23. Following a break of 1 minute and 52 seconds, at 10:48:50:063 (*time D1)* Y entered new buy orders. At 10:49:06:994, he again dominated the bid side of the order book. With his volume of orders, Y is now present on all ten price levels on the bid side with a share of between 23% – 100%. He has a volume share of 100% on four price levels. As a result of this renewed pressure to buy, the inside market rose to CHF 310.75 – CHF 311.25 compared to CHF 310.00 – CHF 311.00 at time C3. On the ask side, Y entered only one sell order in the order book for 16 registered shares of A at a price of CHF 311.25 (best price level).

24. At 10:49:07:010 (*time D2)*, another participant entered a buy order in the order book for 16 registered shares of A at the best bid price of CHF 311.25. This resulted in a transaction with the sell order from Y at CHF 311.25 for the entire 16 shares of registered shares of A already contained in the order book.

25. Following this transaction at 10:49:07:010 (*time D3)*, there are no longer any orders from Y on the ask side, and the demand side is unchanged in terms of volume from Y as compared to time D1.

26. By 10:49:44:138 (*time E1)* Y had cancelled all of his buy orders in the order book and entered sell orders, as a result of which he was strongly dominant on all ten price levels on the sell side with volume shares of between 28% – 100%. He was present on six of ten price levels with a 100% volume share. The inside market thus came under pressure and fell to CHF 308.25 – CHF 308.50 as compared to CHF 310.75 – CHF 312.25 at time D3. The price spread of the ten best levels on the ask side fell to CHF 308.50 – CHF 310.75 in comparison to time D3*,* when this was at CHF 312.25 – CHF 319.00. The number of cumulative orders rose from 21 to 59 orders.

    He placed a buy order for 16 registered shares of A at CHF 308.25 in the order book on the bid side at 10:49:44:138 *(time E1)*. With this order, he held a share of 100% of the order volume on this first price level (CHF 308.25) on the bid side.

27. At 10:49:44:165 (*time E2)*, another participant entered a sell order in the order book for 16 registered shares of A at a price of CHF 308.25. This was fully executed with the buy order from Y for 16 registered shares of A at CHF 308.25 already contained in the order book.

28. *Time E3* shows the order book immediately following full execution of these two orders. In terms of sell orders from Y, the ask side remained unchanged as compared with time E1.

29. By 10:50:34:802 (*time F1)*, Y had cancelled all of his sell orders in the order book and entered buy orders, as a result of which he was present on the bid side on all price levels. He had a volume share of 100% on eight of ten price levels. As a result of this demand overhang, the inside market rose to CHF 309.75 – CHF 310.00 compared to CHF 307.00 – CHF 308.50 at time E3. The cumulative number of orders rose from 12 orders to 65 orders. The price spread on the bid side narrowed to CHF 307.50 – CHF 309.75 (CHF 2.25) compared to CHF 302.00 – CHF 307.00 (CHF 5.00) at time E3. On the ask side, Y was in the order book with a sell order for 24 registered shares of A at the first price level (CHF 310.00), which he placed in the order book precisely at time F1, 10:50:34:802. The cumulative number of orders from Y on the best ten price levels on the bid side reached at time F1 and F3, with 63 cumulative buy orders, the highest value of all order book situations shown in this example.

30. At 10:50:34:811 (*time F2),* another participant entered a buy order in the order book for 24 registered shares of A at a price of CHF 310.00, which was consequently executed with the sell order from Y (for 24 registered shares of A at CHF 310.00) already contained in the order book.

31. *Time F3* shows the order book immediately following the execution (24 registered shares of A at CHF 310.00) of the sell order from Y. In terms of the volume from Y, the bid side remained unchanged as compared to time F1.

32. In the following 35 seconds until 10:51:09:990 (*time G1)*, Y once again changed the order sides in the order book and went with his orders from the bid side to the ask side. He cancelled all buy orders that were in the order book at time F3 and instead, entered sell orders. The cumulative number of sell orders rose in relation to time F3 from 15 to 54 orders, the inside market came under pressure and fell to CHF 309.00 – CHF 309.25 as compared to time F3*,* when the inside market was at CHF 309.75 – CHF 310.75. At the same time, the price spread of the ten best price levels on the ask side narrowed to CHF 309.25 – CHF 311.50 (CHF 2.25). At time F3, this was still at CHF 310.75 – CHF 319.00 (CHF 8.25). Y was

represented on all price levels on the ask side with volume shares of between 77% – 100%, with a volume share of 100% on six of ten price levels. At 10:51:09:990 (time G1), he placed a buy order in the order book on the bid side for 48 registered shares of A at the first price level at CHF 309.00. He was the sole party interested in buying at this price level. At time G1 and G3, the cumulative ask volume of Y on the best ten price levels on the sell side, with 1,0008 registered shares of A, reached the highest cumulative volume value on the ask side of all of order book situations shown in this example.

33. At 10:51:10:028 (*time G2)* another participant entered a sell order in the order book for 48 registered shares of A at a price of CHF 309.00, which was immediately executed with the buy order from Y (48 registered shares of A at CHF 309.00).

34. Time G3 shows the order book immediately following execution (48 registered shares of A at CHF 309.00) of the buy order from Y. Now there were no longer any buy orders from him in the order book and his orders on the ask side are unchanged as compared with time G1.

35. In the 31 seconds following time G3, Y once again cancelled all his sell orders in the order book and entered buy orders *(time H1).* As a result, he was present on the bid side on all price levels and furthermore, represented 100% of the volume share on six of ten price levels. As a result of this demand overhang, the inside market rose to CHF 310.75 – CHF 311.00 compared to CHF 308.25 – CHF 309.25 at time G3. The cumulative number of orders rose on the bid side from 13 orders at time G3 to now 46 orders. The price spread on the bid side narrowed to CHF 308.50 – CHF 310.75 (CHF 2.25) compared to CHF 303.50 – CHF 308.25 (CHF 4.75) at time G3. On the ask side, Y was in the order book with a sell order for 14 registered shares of A at the first price level (CHF 311.00) in the order book, which he placed at 10:51:41:553.

36. At 10:50:41:565 (*time H2)*, another participant entered a buy order in the order book for 14 registered shares of A at a price of CHF 311.00. This was fully executed with the sell order from Y for 14 registered shares of A already contained in the order book.

37. *Time H3* shows the order book immediately following execution (14 registered shares of A at CHF 311.00) of the sell order from Y. There were now no longer any orders from Y in the order book on the ask side, the bid side was unchanged as compared to time H1.

38. 51 seconds following time H3, Y again changed sides in the order book and cancelled all his buy orders in the order book and entered sell orders *(time I1)*. He was present on the ask side on all price levels and generated 100% of the volume share on four of ten price levels. As a result of this supply overhang, the inside market fell to CHF 309.25 – CHF 309.75 in relation to time H3, when it was at CHF 310.75 – CHF 312.00. The cumulative number of sell orders rose from 21 orders at time H3 to now 63 orders. The price spread on the ask side narrowed to CHF 309.75 – CHF 312.00 (CHF 2.25) as compared with time H3, when the price spread was CHF 312.00 – CHF 316.75 (CHF 4.75). At time I1, there were no buy orders from Y on the bid side.

39. At 10:52:35:834 (*time I2)*, Y entered a buy order in the order book for 48 registered shares of A at CHF 309.75. This was consequently executed with the two sell orders already contained in the order book, being for 3 registered shares of A at CHF 309.75, entered at 10:52:27:497 by Y, and 31 registered shares of A at CHF 309.75 entered at 10:52:28:806 by another participant. Y thus caused a nostro-nostro cross in relation to 3 registered shares of A which he did, however, correctly cancel at 11:46:35.

40. Following the two partial executions of 3 registered shares of A (nostro-nostro cross that was cancelled) and 31 registered shares of A at CHF 309.75, there were still 14 registered shares of A at CHF 309.75 from the original buy order from Y remaining in the order book on the bid side *(time I3)*. As a result, he is still the only party interested in buying at this first price level.

41. 45 seconds following time I3, Y once again cancelled all his sell orders in the order book and entered buy orders, as a result of which he was present on the bid side on nine of the ten best price levels *(time J1)*. Moreover, he represented 100% of the volume share on five of ten price levels on the bid side. As a result of this demand overhang, the inside market rose to CHF 311.50 – CHF 312.75 compared to CHF 309.75 – CHF 310.00 at time I3. The cumulative number of buy orders rose from 12 orders at time I3 to now 58 orders. The price spread on the bid side narrowed to CHF 309.25 – CHF 311.50 (CHF 2.25) compared to CHF 304.50 – CHF 309.75 (CHF 5.25) at time I3. Y did not place any orders in the order book on the ask side.

42. At 10:53:22:138 (*time J2),* Y entered a sell order in the order book for 24 registered shares of A at CHF 311.50. This order was consequently partially executed with the buy order already in the order book for 2 registered shares of A at CHF 311.50, entered by another participant at 10:53:17:135.

43. Following this partial execution (sale of 2 registered shares of A by Y at the price of CHF 311.50), 22 registered shares of A from Y remained on the ask side of the order book *(time J3)*. On the bid side, he is now present on all of the ten best price levels with a total volume of between 29% – 100% per price level.

44. At *time K1*, Y, as compared with time J3, again cancelled all his buy orders in the order book and entered sell orders, as a result of which Y was present on the ask side on all of the ten best price levels. The cumulative number of sell orders rose from 14 orders at time J3 to now 48 orders. The price spread on the ask side narrowed to CHF 312.25 – CHF 314.50 (CHF 2.25) as compared with time J3, when it was at CHF 311.50 – CHF 317.00 (CHF 5.50). On the bid side, Y was in the order book with a buy order for 24 registered shares of A at the first price level (CHF 311.75). He placed this order in the order book at 10:54:06:099.

45. At 10:54:06:403 (*time K2)*, another participant entered a sell order in the order book for 24 registered shares of A at a price of CHF 311.75. This was fully executed with the buy order from Y for 24 registered shares of A on the bid side at the price level of CHF 311.75.

46. *Time* K3 shows the order book immediately following full execution (24 registered shares of A at CHF 311.75) of the buy order from Y. The volume shares on the ask side, however, remained unchanged as compared to time K1.

47. In the following 42 seconds, Y cancelled all sell orders that were still in the order book at time K3, and entered buy orders instead *(time L1)*. As a result, he was present on all of the ten best price levels on the bid side, with a volume share of 100% on seven of the ten best price levels. As a result, the inside market rose to CHF 312.50 – CHF 313.00 as compared with CHF 311.25 – CHF 312.25 at time K3. The cumulative number of buy orders rose from 14 orders at time K3 to now 45 orders. The price spread on the bid side narrowed to CHF 310.25 – CHF 312.50 (CHF 2.25) as compared with *time K3,* when it was at CHF 302.00 – CHF 311.25 (CHF 9.25). Y entered a sell order in the order book on the ask side at 10:54:48:202 for 72 registered shares of A at CHF 313.00.

48. The cumulative bid volume of Y on the best ten price levels on the buy side reached the highest cumulative volume value on the bid side of all of the order book situations shown in this example at times L1 and L3, with 1,091 registered shares of A.

49. At 10:54:48:244 (*time L2)*, another participant entered a buy order in the order book for 72 registered shares of A at a price of CHF 313.00. This was fully executed with the sell order from Y on the ask side for 72 registered shares of A at the price level of CHF 313.00.

50. *Time L3* shows the order book immediately following this full execution (72 registered shares of A at CHF 313.00) of the sell order from Y. The bid side is unchanged as compared to time L1.

51. In the 15 seconds following time L3, Y once again cancelled all his buy orders in the order book and entered sell orders, as a result of which he was present on the ask side on nine of the ten best price levels *(time M1)*. As a result of this supply overhang, the inside market fell to CHF 312.50 – CHF 313.00 compared to CHF 312.50 – CHF 313.75 at time L3. The cumulative number of sell orders rose from 10 orders at time L3 to now 29 orders. The price spread on the ask side narrowed to CHF 313.00 – CHF 315.25 (CHF 2.25) as compared with time L3, when this was at CHF 313.75 – CHF 322.25 (CHF 8.50). On the bid side, Y was in the order book with a sell order for 1 registered share of A at the first price level (CHF 312.50). He placed this order at 10:54:55:086.

52. At 10:55:03:944 (*time M2)*, another participant entered a sell order in the order book for 1 registered share of A at a price of CHF 312.50. This was fully executed against the buy order from Y for 1 registered share of A on the bid side at the price level of CHF 312.50.

53. *Time M3* shows the order book immediately following the full execution (1 registered share of A at CHF 312.50) of the buy order from Y. The ask side is unchanged as compared to time M1.

54. *Time N* shows the order book of registered shares of A following the activities of Y on this trading day. At *time N*, Y placed neither an order on the bid side nor an order on the ask side. For the first time since the projection of the order book prior to his activities (see time A), the cumulative bid and ask volume is in balance again.

55. In 9 minutes 2 seconds, Y thus placed a total of 440 buy orders and 428 sell orders in the order book by way of multiple orders on each price level. In these minutes, neither the general market and sector situation nor that of A Ltd. changed in any way.

56. The records of the entries made by Y show that between the times A to N, thus within the 9 minutes and 2 seconds mentioned, he changed sides of the order book a total of 12 times with his orders and dominated the order book each time for some seconds with his orders in registered shares of A and just a few seconds later, cancelled his orders again. Thus, the order volumes at time A (10:45:40:343), prior to the activities of Y, at the ten best price levels, were 987 registered shares of A and 1,188 registered shares of A on the bid and ask sides respectively; there were 11 buy orders against 17 sell orders. At time B1 (10:46:24:228), the order volume of the ten best price levels on the ask side rose only slightly from 1,188 registered shares of A to 1,202 registered shares of A. However, these 1,202 registered shares of A were now in the price spread of CHF 309.75 to CHF 312.00 in the order book, compared with time A, when the price spread was CHF 310.50 – CHF 316.00. With his volume of orders, Y is now present on all ten price levels on the ask side with a share of between 10% – 100%, and on five price levels, his volume share is 100%. The same happened in the other times C to M 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).

57. Y 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 and buyers wanted to take action at the same price level. In fact, however, there was no such great activity. It was Y 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.

58. There is no doubt that the overhang on the ask and bid side was deliberately created by Y in order to be able to subsequently buy and sell at a lower or higher price respectively. This is also evident from the fact that Y 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 or supply that he created. Y 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 to the other side 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, Y deliberately created an overhang and thus both artificially raised liquidity and distorted the price in the direction he wanted. Y then immediately cancelled 95.68% of his buy orders and 94.16% of his sell orders. 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.

59. Within the nine minutes, Y changed with his orders the sides of the order book 12 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.

60. The same result followed from the actions of Y found in the investigation in the other two shares mentioned in point 3 and does not need to be elaborated any further. In all three cases, the trading conducted by Y was decisive for the price development and the fact that other trading activities conducted by him using the same pattern produced a loss on balance, as he submitted, cannot exonerate him.

C. Considerations in relation to the rules and regulations breached

61. Y breached section 9.2, para. 1 and para. 2 lit a 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.
62. Specifically, Y systematically breached the following rules:
63. In the registered shares A ([date 3], 10:46:05 to 10:55:07), the registered shares B ([date 4], 09:01:56 to 09:06:46) and the registered shares C ([date 5], 11:43:08 to 11: 47:36), he placed a large number of orders in the order book at various price levels several times within minutes, thereby causing an overhang of buy and sell orders which led to 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.
64. In the registered shares A ([date 3], 10:46:05 to 10:55:07), the registered shares B ([date 4], 09:01:56 to 09:06:46) and the registered shares C ([date 5], 11:43:08 to 11:47:36), he placed several orders at 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.
65. In the registered shares A ([date 3], 10:46:05 to 10:55:07), the registered shares B ([date 4], 09:01:56 to 09:06:46) and the registered shares C ([date 5], 11:43:08 to 11: 47:36), 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.

D. Considerations in relation to the determination of penalty

66. Pursuant to section 18 lit. a of the 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 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.
67. Y systematically breached the above-mentioned provisions of SIX Swiss Exchange Rule Book, which is why a sanction must be issued against him.
68. It is not disputed that a sanction never had to be imposed against Y to date. It is also not disputed that Y carried out the activities deliberately and not due to negligence.
69. In the contested sanction decision, SVE described a suspension of six months as being appropriate. SVE held that Y 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 a number of 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.

70. SVE held that in the case of these orders, it was foreseeable to Y 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 Y 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”.

71. 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 (bis 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."

72. As mentioned, this case involves action with intent. Y 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.

73. 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 Y 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 Y, 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. Y did not dispute that the purpose of the FINMA Circular was clear to him. But its purpose is precisely to prevent market manipulation. Y cannot rely on a lack of awareness.

74. Y 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.

75. Y 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.

76. Y 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 6], the former Disciplinary Commission of the Exchange issued reprimands to various participants because they had allowed certain 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.

77. Y 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).

78. 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 regulationsIn fact, an extensive investigation discovered systematic conduct contrary to the rules and regulations. There is no question that Y 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 Y 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.

79. Y 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. Y 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.

80. In the further alternative, Y 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.

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

82. With this outcome of the proceeding, Y 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 Y himself (section 2.9 of the Rules of Procedure).

28 August 2012

(Translation)