DISCIPLINARY COMMITTEE AT NASDAQ OMX STOCKHOLM DECISION 2014:4 April 16, 2014

NASDAQ OMX Stockholm AB
Danske Bank
The Trader

Danske Bank A/S is a trading participant (a member) at NASDAQ OMX Stockholm AB (the "Exchange"). The bank has signed an agreement by which it has undertaken to comply with the Nordic Member Rules (NMR) as long as it is a member of the Exchange. The trader is employed by Danske Bank and is authorized to engage in trading on the Exchange on behalf of the bank.

The Exchange has requested that the Disciplinary Committee issue a decision on disciplinary action regarding Danske Bank and the Trader.

Danske Bank and the Trader have contested these charges.

A hearing was held regarding this matter on April 4, 2014, at which the Exchange was represented by Joakim Strid, Head of Trading Surveillance, and by its corporate lawyers Adam Göransson and Andreas Blomquist (the latter took part by telephone). Danske Bank and the Trader were represented by the bank's compliance officer, Anna Althoff , and by Attorney-at-law and professor, Mårten Knuts.

Relevant rules in NMR

The case in hand pertains to application of Sections 4.6.1 and 4.6.2 of NMR. In accordance with NMR, Section 4.6.1, all orders registered in the trading system must be genuine orders. Section 4.6.2 of NMR stipulates, inter alia, that a member may not place orders or complete transactions that are intended to improperly influence price formation in the trading system or which are devoid of a commercial purpose.

The parties' positions in summary

Concerning the matter, the *Exchange* states the following in summary:

The Trader has, by trading on Danske Bank's own behalf, participated in trading in AstraZeneca's shares ("AZN"), among others, during the period August 22 to August 30, 2013.

During this period, the Trader purchased, on behalf of the bank, 273,025 shares and sold 266,898 shares, which corresponds to a market share of approximately 4.6%. During the period, the Trader participated in 1,223 of the market's total 18,031 transactions.

The time period for the investigation has been chosen in light of the trading pattern having been identified in the same period, but also to delimit this matter.

The Trader trades in both shares and derivative instruments on the Exchange. Insofar as the Exchange understands, his trading in AZN for the period to which the matter relates has been closely associated with the bank's positions in derivative instruments with AZN as the underlying asset.

It is common in active, professional trading to simultaneously have several orders registered in an order book, and also that both buy and sell orders occur simultaneously. With regard to Danske Bank's trading, the Exchange has, however, noted a trading pattern that deviates from normally occurring trading and that the Exchange believes constitutes violations of NMR. The bank's trading in AZN indicates that orders have been registered without any intent to lead to trades, but rather that they have instead been intended to send signals to other market participants about a larger supply of, or demand for, AZN.

The orders that the Exchange believes that the bank has registered without intending for them to be executed have all related to blocks of 10,000 shares. 10,000 shares is a high volume for an individual trading order regarding AZN. An average order, during continuous trading registered within 0.5% of the best bid and offer prices, for AZN related to 450 shares during the period. The median order size was 300 shares.

Danske Bank through the Trader accounted for 111 buying orders of the current type. Not one of these buying orders was executed. Not a single share was acquired through these orders, which comprised 1,110,000 shares in total. Nor was any part of the Trader's 125 selling orders of the same kind executed. These 125 selling orders constituted 90% of the total 139 selling orders of at least 10,000 shares occurring during the period, passively registered within 0.5% of the best offer price. Danske Bank's total 236 orders were very short-lived and were on average registered for 6 seconds (median 4 seconds) in the order book.

In the registration of 233 of 236 orders referred to above, Danske Bank had opposite orders registered in the order book at the same time through the Trader. The following focuses on these 233 orders, which were registered on 45 occasions during the period August 22-30.

The orders that Danske Bank had registered on the opposite side of the order book have largely led to sales. They have been registered longer and they have consistently related to smaller volumes than the sum of short-lived orders registered at any time. They have also solely consisted of iceberg orders, i.e. orders with a part of the volume visible and a part concealed from the rest of the market. However, the larger, short-lived orders have in their entirety solely been fully visible for the other market players.

The Exchange cannot interpret the observed trading patterns in any way other than that these large, short-lived orders were registered for a purpose other than leading to a trade. It appears instead as if the purpose of them was to provide a more beneficial outcome for the bank's orders on the opposite side of the order book at all times. A more beneficial outcome would arise upon:

- A more advantageous price at execution.
- Execution of orders that would not have otherwise led to sales.
- Execution of orders at a point in time earlier than would have otherwise been the case.

As signs of one of these effects in short-term registration of potentially misleading orders, the following can be expected:

- Sales on the opposite side of the order book,
- Higher order volume on the same side of the order book, and/or
- Reduced order volume on the opposite side.

Danske Bank and *the Trader*, which have certified the actual circumstances with regard to the placement of orders cited by the Exchange, have in summary stated:

<u>The orders in question are genuine</u>

Because the concept "genuine order" is not defined in NMR, one must first and foremost establish what the term comprises. As the Disciplinary Committee has confirmed in earlier decisions, one must assume that an order that cannot be executed is a non-genuine order and it then lacks a commercial purpose. Conversely, the presumption for an order that can actually be executed must be that the order is thereby genuine and also has a commercial purpose.

In this case, it is indisputable that all orders that are subject to the Disciplinary Committee's review could have led to a trade. The orders have also been commercially motivated in part on the basis of Danske Bank having a large derivative portfolio. Due to the derivative portfolio, the Bank has had an interest in achieving executions in all orders it has placed. Although it is indisputable that the orders could have led to a trade, there is cause, for the sake of clarity, to reflect over what characteristics the orders have in this case, that binding offers usually have in a legal perspective:

- All of the orders Danske Bank placed and now mentioned have been placed in the order book and have reflected the share's current market price. Simply pursuant to this, their purpose has been to lead to a trade, thus making them genuine. From Danske Bank's perspective, a binding offer to buy or sell shares has been issued when the order has been placed in the order book. It has then been due to factors beyond the bank's control whether or not another market player has approved the offer or not. The offer was thereby genuine.

- It can be further added that the bank, in its capacity as a large player in AZN, had sufficient means to conclude all transactions that could have arisen had all of the orders been executed. If an offer to buy had been accepted, the bank would have had adequate liquidity to carry out the transaction and, if an offer to sell had been accepted, the bank would have had, or could acquire, an adequate amount of shares to be able to settle the transactions.
- Since the Exchange appears to attach a relative weight to the number of seconds placed orders were registered in the order book before being recalled, it should be particularly stated here that Danske Bank's orders were also genuine with regard to the fact that they were registered in the order book an adequate number of seconds for it to have been fully possible for other market participants to react to Danske Bank's orders. Although a median order time of 4 seconds may appear somewhat short compared with the duration of legal tenders in more traditional commercial contexts, modern stock trading is extremely rapid. For example, it is not uncommon for orders to have been registered and recalled in a fraction of a second. It is thereby clear that the bank's order in this respect too were found to be registered long enough to have led to a transaction.
- The fact that the bank's orders were deregistered without being executed is also not against the rules or even uncommon in modern stock trading. Accordingly, this also does not make the bank's order non-genuine**.**

<u>The bank's orders were not aimed to unduly influence price formation</u>

- The Exchange's claim that Danske Bank placed orders with the aim of improperly influencing the price level in AZN finds no support in the actual order placement, which in this matter is indisputable. Nor does Danske Bank see in its operations any such aim other than the appropriate aim that stock trading comprises, namely to buy shares at an inexpensive price and sell the shares at a higher price, or vice versa, to sell shares at an expensive price and buy the shares for less.
- In reality, Danske Bank has also had a large derivative position with AZN as the underlying instrument. The position on the derivative portfolio has been gamma long (y), which has made it highly commercially motivated for Danske Bank to be prepared to execute the deals according to the orders Danske Bank has placed. Danske Bank has also had a strong commercial interest in doing business according to how the momen-

tum traders' orders have affected price formation. Simply by buying AZN or selling AZN according to how the supply and demand in AZN fluctuated in the market, Danske Bank has been able to realize its derivative trading strategy and the hedging strategy it has chosen to strive for its delta (,) on the position in gamma (y) it has held towards its derivative customers over time.

- NMR does not prohibit recalling unexecuted orders. In reality, a significant share of all orders placed in stock trading are recalled.
- Because NMR does not prohibit the recall of unexecuted orders, there must be a strong presumption that the Exchange has not considered the recall of the orders to be harmful to price formation.
- In particular, it should be considered that a recall of orders that takes place after changes in the circumstances that prevailed when the orders were placed cannot be seen as reprehensible. The fact that trades were being made at a price level other than the one that prevailed when the offer was made should constitute one of the most natural reasons to recall the order that is no longer as competitive as orders that third parties are prepared to place. Orders are often also recalled if it turns out that a latent and intuitive counter offer is not revealed as a result of the orders. If a large buying order (at the best price) fails to attract a large contracting selling order, but only leads to counter-intuitive momentary traders' reactions to the order (not contraction, but better co-orders), many large trading houses move on to another share to strive for real trades there.

<u>The bank's order placement has had commercial aims</u>

All of the orders placed by the bank had the aim of implementing transactions in the AZN share on the exchange. Lacking a detailed definition of commercial purpose in NMR, it should already here on these grounds be considered to be ruled out that the bank's orders lacked a commercial purpose that was in conflict with NMR. In addition, the bank had a number of other commercial aims with the order placement such as the following:

• Danske Bank acts as a market maker in derivative trading concerning the AZN share and the aim of its market making is to contribute liquidity to trading in the share. Orders that are genuine and can lead to transactions are an important part of contributing liquidity and the choice to serve as a market maker has a clear commercial purpose for the bank, which is why the order placement and trading resulting from this should also be considered to have a commercial purpose.

• Danske Bank acts as counterparty in the derivative trading with its own and NOMX customers, which leads to the bank occasionally having considerable exposure to the AZN share through derivative positions. Danske Bank bears a commercial risk for its derivative trading and has a commercial strategy to manage this risk (hedging). Accordingly, it is in the bank's interest to protect itself from fluctuations in the AZN share and the bank can do this by conducting trades, or by placing orders, which if executed, perform the balancing strategy the bank has chosen to follow. Also on these grounds, the bank's market activities should be considered to be commercial, even though the Exchange's rules do not define commerciality in greater detail.

• Danske Bank's interest regarding activity in AZN, as well as the Exchange's interest regarding activity in AZN, is that trading in the AZN share on the Exchange should be a competitive alternative to trading in the same AZN share in New York and/or London or on other marketplaces where it is possible that the AZN share can be traded. Accordingly, it is in the bank's interest to enable attractive liquidity in the AZN share in Stockholm, which is achieved by continuously placing genuine orders in the AZN share, which despite the possibility of not being executed, could nonetheless have led to transactions. Furthermore, it is a fact, considering the bank's occasionally large exposure to the AZN share through derivative positions, that the bank has a commercial aim in also using orders to test the latent supply and demand that other market players may have towards AZN, to thereby strive for surprising and potentially harmful rushes in the share not being carried out by other market players, since such non-commercial transactions would harm the price formation in the AZN share in Stockholm. This aim may also be considered to be commercial according to NMR.

The parties have both developed their positions in detail in the matters currently being reviewed.

Request for information

With regard to the Exchange having attributed importance to the median order time of 4 second from registration to recall, *Danske Bank* and *the Trader* have requested information in the following respects:

- Shortest time interval (given in milliseconds) that occurred between registered order and recalled order in the trade on the Exchange during 2013.
- The total number of registered orders placed and then recalled within 4 seconds on the Exchange during 2013.
- The total number of cases of stated violations against NMR 4.6.1 brought before the Disciplinary Board by the Exchange for orders that during 2013 were registered, but recalled within 4 seconds.

In order to emphasize that orders that have been recalled without being executed should still be considered genuine orders, Danske Bank has also requested that the Exchange present information regarding

- The total number of registered orders on the Exchange during the 2013 trading year.

- The total number of registered orders recalled without being executed at the Exchange during the 2013 trading year.

The Exchange has declined to provide information in these respects with the following justification:

The Exchange has not remarked on the bank's orders solely on the grounds that they were registered for short periods of time. The Exchange has presented extensive materials where the short time periods for which some orders have been registered are one of several circumstances that jointly lead to the conclusion that orders have been registered without the intention of leading to a trade.

Against this background, the Exchange does not consider that the relatively resource-demanding input that would be required to satisfy the Bank's request would be of any significance in the case at hand. Accordingly, the Exchange sees no reason to facilitate the Bank's request in this respect.

When it comes to the Bank's request to receive information about the number of orders and order recalls, the Exchange refers to the fact that the Bank's mode of working is not being called in question solely because orders had been registered and recalled before execution. The recall of orders is something that other members also engage in to a great extent and, in many cases, orders have been found to have been registered for a significantly shorter period of time that in the cases involved here. What makes this case special is the fact that the Exchange has concluded that the inquiry shows that there had been no intention for Danske Bank's 233 orders to have ended up as trades — they have instead constituted a feature of a planned trading pattern — and the fact that they were recalled so shortly after being placed is one of the indications that has resulted in this conclusion.

Against this background, the Exchange does not consider that the relatively resource-demanding input that would be required to satisfy the Bank's would be of any significance i the case in question. Accordingly, the Exchange sees no reason to facilitate the Bank's request in this respect.

Generally accepted practices in the stock market

To further develop its assertion that the Bank's mode of working was in contravention of generally accepted practices in the securities market, the Exchange has referred to Section 8 of the Financial Instruments Trading (Market Abuse Penalties) Act (SFS 2005:377). After Danske Bank and the Trader contested the Disciplinary Committee's authority to determine whether this penal condition had been transgressed, the Exchange made it clear during the hearing that it was not requesting that the Disciplinary Committee issue a ruling on this matter.

Disciplinary Committee's considerations

It is stipulated in NMR, Section 4.6.1 that "Orders placed in the Order Book, Automatically Matched Trades and Manual Trades must reflect the current market value of the Instrument in question and constitute genuine Orders and Trades".

Although what is to be considered a genuine order is not clarified in detail in the rule book, the Disciplinary Committee is of the opinion that there can be no doubt that an order that is not intended to result in a trade and thus lacks any serious meaning constitutes a disregard of this condition. This interpretation is so obvious that the meaning must be regarded as being abundantly clear for the reader.

It is also completely clear that the fact that an order has been placed in the order book does not constitute a circumstance that in itself entails that the order is to be regarded as genuine – the regulation in question focuses specifically on the types of orders that have been placed in the order book. Nor can the circumstance that it is theoretically possible to add an order as a basis for a trade in itself result in the order being regarded as genuine. From a purely practical viewpoint, it could, of course, be the case that it is essentially out of the question that an order could lead to a trade and that this was quite clear to the party who has placed the order.

During the period in question, Danske Bank placed orders that related to very large blocks of shares and that were recalled after only a few seconds. In practice, it must have been virtually out of the question that these orders would lead to trades, and the Trader must have realized this. This mode of working was systematic and its magnitude was considerable, and it must be assumed that it was based on some sort of trading strategy.

Danske Bank has stated that, from the Bank's standpoint, it would have been to its advantage if the orders had been accepted, not least in consideration of the Bank's trading in derivatives. The Disciplinary Committee has no reason to doubt this claim, but finds it difficult to accept the thought that the placing of the orders could have had any intention to lead to trades. If that had been the case, the way the orders were placed would have directly counteracted this purpose and the strategy would have led to an obvious failure.

The Disciplinary Committee cannot arrive at any conclusion other than that by placing the orders in questions Danske Bank contravened Section 4.6.1 of NMR.

When it comes to the rationale for placing the orders, the Disciplinary Committee has in the above rejected the thought that the purpose could have been to lead to a trade. The fact that these very large orders to some extent, albeit briefly, affected price formation may be considered verified by the Exchange's inquiry, and the Trader must have realized that such an affect would have arisen. Neither Danske Bank nor the Trader part has proven any other reason for why this unorthodox trading strategy should have been applied. In the opinion of the Disciplinary Committee, it must be assumed that the intention had been to influence trading and thus price formation. The very fact that the orders were not seriously intended constituted such improper practice, which was compounded by the fact that the Exchange has proven that, to a great extent, the orders were intended to lead to favorable effects for the Bank due to the opposite order in AZN shares that the Bank had entered into the trading system.

Accordingly, the Disciplinary Committee finds that Danske Bank and the Trader also contravened Section 4.6.2 of NMR.

In making this judgment, there is no reason for the Committee to also address the matter involving the disregard of generally accepted practices in the securities market as a separate breach of the rules. Nor need the Committee address the matter to any greater extent than has already been done concerning the extent to which the bank's placement of the order lacked a commercial purpose.

Sanction

Although for its own part, the Disciplinary Committee cannot find the rules in question ambiguous, the Committee takes into account the fact that it has not previously addressed a completely similar case and also the fact that standard practice in this area is lacking. The Committee also assumes that neither Danske Bank nor the Trader had realized that the trading pattern that had been applied might have been prohibited and also takes into account the fact that no previous warning had been issued. It should also be noted that Danske Bank immediately after the disciplinary matter had been initiated, explained that the trading pattern in question would cease in all respects.

The sanction imposed on Danske Bank should be a fine at the lower end of the scale. For the Trader, the sanction should be a warning.

Decision

The Disciplinary Committee orders Danske Bank to pay a fine of five-hundred thousand kronor (SEK 500,000) and issues a warning to the Trader.

On behalf of the Disciplinary Committee

Johan Munck

Participating in the Committee's ruling were former Supreme Court Justice Johan Munck, Company Director Anders Oscarsson, former Stock Exchange Governor Carl Johan Högbom and Company Director Jack Junel.