

Subject: Guidance on Trade Surveillance

Notice to all Members,

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Pursuant to the DGCX By-Laws, and Clearing Rules of the DCCC, Members are hereby advised as follows.

Members will be aware that both the regulations issued by the Securities & Commodity Authority (SCA), and the DGCX By-Laws make reference to trading practices which are considered either to be “deceptive” (SCA Article (6-11) of Decision No. (157/R) of 2005) or “prohibited” (DGCX By-Law Part D.3). In doing so, both SCA and DGCX are following the trend of other markets and regulators globally, and most notably the European Securities and Markets Authority (ESMA) with their regulations covering market abuse.

Whilst it is a responsibility of exchanges to have in place systems and controls to monitor and detect for potential abuse, and DGCX does indeed have such systems in place that provide real-time monitoring of all market activity (i.e. orders and trades), there is also a responsibility placed upon market participants to similarly undertake monitoring of trading activity. Clearly the monitoring that market participants are expected to perform would be of more limited scope when compared with that undertaken by an exchange, but nonetheless there is a role for market participants to perform. DGCX is mindful that aside from stating in its By-Laws what trading practices are prohibited it has not, to date, addressed the issue of Member responsibilities in this area and this Notice seeks to rectify that omission.

In doing so DGCX is aware that the regulatory cost of compliance has increased significantly in recent years, for all market participants not just Members but also their clients, and therefore is keen to ensure that an appropriate and pragmatic response is required when addressing this issue. This is reinforced by the fact that the nature and type of business that DGCX Members undertake is wide and varied and consequently there can be no “one size fits all” approach. Therefore, DGCX considers it to be more appropriate to issue guidance rather than additional By-Laws to Members as to what areas they should take into consideration when looking at their own systems and controls for the monitoring of trading activity.

Guidance

As a general principle, market participants should have in place automated market abuse controls, covering the full range of trading activities undertaken by the firm and all orders submitted by it. A surveillance system’s design should have regard to the nature, scale and complexity of the firm’s trading activity, such as the type and volume of instruments traded, the size and complexity of its order flow and the markets that it accesses on a routine basis.

Monitoring of activity may be performed in near real-time and/or on a T+1 basis and must have specific alerts that cover all relevant regulations. In this instance Members should have regard to

Subject: Guidance on Trade Surveillance

the Prohibited Practices detailed in Part D.3 of the DGCX By-Laws, as well as the Deceptive Trading provisions set out in Article (6-11) of SCA Decision No. (157/R) of 2005.

A typical list of alerts would cover the following trading practices:

Abusive squeezes – the build-up of a position in a particular (physically-delivered) product designed to distort the price at which physical deliveries will take place.

Frontrunning – where a trader/broker with knowledge of a client order places a proprietary order, or order on behalf of another client, for the same product into the market ahead of the client order, seeking to take advantage of the price movement that follows the execution of the client order.

High order rates (including cancellations) – where firms use algorithms in the execution of orders, the rapid submission and cancellation of orders to the market may give rise to a misleading appearance of interest in a particular product.

Layering – similar to spoofing but in this instance the manipulative orders are placed at different price levels so as again to mislead the market as to the true indication of interest in the product.

Marking-the-Close – designed to manipulate the daily settlement price for a product, or the reference price used to determine the final exercise price for options products. It typically takes the form of the execution of small volume orders during the period within which the daily settlement price/reference price is calculated.

Spoofing – the placing of one or more orders in order to generate selling or buying interest in a product, thereby misleading the market as to the true indication of interest in the product. As the market responds and the price moves so the initiator benefits by trading on the other side of the market and immediately cancelling all other resting orders in the market.

Wash trading – the simultaneous buy and sell of the same product at the same price with no change in the beneficial ownership of the resulting trades.

This is a non-exhaustive list and Members may well wish to give consideration to other types of alerts that they may deem to be more appropriate to the type of business activity which they undertake. However, it is likely that most types of trading activity that is considered to be abusive will have some element that is included in the alerts listed above.

As noted above, this Notice contains guidance only and it may well be the case that Members already have in place appropriate systems and controls for the monitoring of trading activity. Where this is not the case, then those Members may wish to consider the implementation of such systems and in doing so, make reference to the guidance contained herein.

Subject: Guidance on Trade Surveillance

DGCX is committed to continuing to invest in appropriate systems and controls to safeguard the market, fulfilling its responsibility in this area, and by way of example will be looking to implement self-trade prevention measures in due course. Further, DGCX will be looking to engage with appropriate system suppliers in order that Members may have the opportunity, if they wish, to view what technology solutions are available in this space, and more details will be provided in due course.

Members requiring further information with regard to this Notice should contact their relationship manager.

For Dubai Gold & Commodities Exchange

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