an SWX Group company

virt-x compliance

Newsletter from virt-x Regulation and Compliance Department
Issue 17

21 May 2007

Contents

- Market Notices
- Updates to Rules and Directives
- Special topics

Special topics in this issue

- Connectivity checks
- Stop loss orders

We hope you will find this issue of virt-x *compliance* useful. We welcome your comments and suggestions.

Emma Vick
Director of Regulation and Compliance

Market Notices

Since the last Compliance Newsletter, Market Notices 004/2007 to 010/2007 inclusive have been issued. The contents of those Market Notices have been included in standing data.

All Market Notices are available at www.virt-x.com in the Regulation section.

Updates to Rules and Directives

Since Compliance Newsletter 16, virt-x has not changed the Rules or Directives, which are available at www.virt-x.com in the Regulation section.

Draft changes for MiFID were set in virt-x's Market Notice 09/2007 and are open for comments by members until 15 June.

The changes include the following:

- Changing the trade reporting deadline to "as close to real time as possible and in any case within 3 minutes"
- Replacing the existing ERT and block regime with the standard MiFID deferred and delayed publication regime (which is included in the Appendix to this Newsletter for information)
- Adapting requirements to include the inclusion of new Trade Type Codes on entry of:
    - a corrected trade, to show that it is an amendment
    - trade(s) executed by reference to criteria other than current market price/value, including VWAP trades
- Documenting in the Rules an outline of the criteria for the execution of orders (i.e matching rules)
- Adding processes to ensure issuers' compliance with initial and ongoing/ad hoc disclosure obligations
- Adding a requirement that virt-x will not suspend an instrument which no longer complies with the admission criteria if it would be likely to cause significant damage to the interests of investors or the orderly functioning of the financial markets.

The proposed changes to the Trade Type Codes, as set out in section 5 of Directive 4 (Orders, Off-order Book Trades and their Attributes), are as follows:

- "A" for inputting an amendment to a previous trade report to virt-x
- "C" for a cancellation
- "D" for a transaction with a price determined by factors other than the current market valuation
- "N" for a negotiated transaction
- "PT" for a portfolio trade
- "VW" for a Volume Weighted Averaged Price transaction.

Members are asked to note the following in respect of the drafts:

- Rule 3.3 stated that "D" would be required to be input when reporting transactions with a settlement due date which is not T+3. We have since received clarification from the FSA that a transaction for special settlement will not need to be flagged as executed at a special price
- The Table in Section 5 states that members will be required to input "N" on amendments and cancellations of order-book transactions. The "N" will in fact be generated by the virt-x Trading System and not by member input
- A change in the reporting of VWAP transactions on virt-x is proposed, to remove the current requirement to submit a Trade Advice in advance of binding VWAP orders to be executed immediately against in-house trading inventories (nostro positions) on a firm-price basis; Trade Advices are visible only to virt-x and are not published. MiFID does not set a requirement for Trade

Advices and members have commented that to continue with such a requirement would put virt-x out of line with other exchanges in the EU. It should be particularly noted that this proposed change in respect of VWAPs applies only to virt-x and not to VWAPs on SWX Swiss Exchange. SWX is not subject to the requirements of MiFID but to obligations imposed on it as a self-regulatory organisation by the Swiss Federal Banking Commission ("SFBC"). The regulation that the SFBC expects SWX Swiss Exchange to have in place includes the receipt of Trade Advices for VWAPs.

Connectivity checks

Last year, virt-x proposed to introduce a practice note to Rule 2.1 (Access) to the effect that the virt-x system must not be used for testing purposes.

One member represented to virt-x that limited testing in the live environment should be allowed under certain conditions and we recognise that a connectivity check on the virt-x production system can be useful after testing in the designated testing environment has been completed successfully.

We do not currently propose to amend the virt-x Rules but instead to set out the following principles which should be adhered to by members in carrying out such connectivity checks on virt-x:

- functional testing must only be carried out in the designated testing environment;
- connectivity checks may only take place outside of trading hours and more than one hour before the market open or one hour after the close;
- the number of orders should be as low as possible in order to confirm a successful connectivity connection;
- the checks should not lead to a transaction taking place. However, any resultant inadvertent trades will be deemed as transactions under the terms of virt-x rules;
- the order entry and subsequent deletion must not affect the theoretical opening price (TOP) of the security. (Note: low priced bids or high priced offers are less likely to affect the TOP);
- the orders must have a size of 1 unit; and
- the member should seek to make the order deletions within 60 seconds.

Members' attention is drawn to virt-x's Rules 2.10 concerning Market Integrity. Members should be prepared to justify their actions accordingly.

Please also note that Trader IDs are personal and that virt-x's Directive 12 stipulates a fine of £1,500 for misuse of a Trader ID (e.g using another person's ID) except where an inadvertent breach is notified by a member to virt-x. These provisions apply also in the case of connectivity checks.

Stop loss orders

In order to maintain an orderly market, virt-x will normally instruct a trade reversal in accordance with Rule 2.15 when the price of a transaction is more than 2.5% away from the current market price.

Members are asked to note that stop loss orders could be triggered and lead to the execution of trades on virt-x.

Stop loss orders do not reach the Exchange System until the price condition is met and, until then, any such orders are stored locally at the member's Trading System - stop loss order do not therefore reside in the virt-x Exchange System but in a member's own trading system and under the control of the member.

We are aware that the Cash Market Advisory Board (the Kommission für Wertpapiere ("KW")) recently considered whether such orders are beneficial to the market and appropriate in relation to virt-x's mistrade policy. The view of the Advisory Board participants was that no changes should be made to the mistrade regime as such. The Advisory Board also confirmed that the maintenance of conditional orders is at the members' discretion.

Topics for Future Compliance Newsletters

We welcome topics for inclusion in future issues of the compliance newsletter.

Please contact us with suggestions. Thank you!

Please address any comments/questions/suggestions to
regulation@virt-x.com
Tel: +44 (0) 20 7074 4545 - Fax: +44 (0) 20 7074 4532