Electronic Inter-Dealer Market Trade Cancellation Procedure Recommendations[1]

Preamble
The present rules were approved (and hence constitute a binding agreement) on 21 September 2009 by the following member firms of the EPDA[2]: Banca IMI, Banco Santander, Barcap, BNP Paribas, Calyon, Citi, Credit Suisse, Deutsche Bank, Commerzbank, Goldman Sachs, HSBC, ING, J.P.Morgan, Merrill Lynch, Morgan Stanley, Natixis, Nomura, Royal Bank of Scotland, Société Générale, UBS & Unicredit.

The EPDA firmly believes that there should be clear rules on trade cancellations to be put in place across the different Trading Platforms in a competitive European Government bond market environment in order to ensure consistency of impact across the market and in particular minimize the risk that cancellation requests for interdependent trades across platforms being subject to different outcomes and thereby resulting in trading risk to counterparties. The association therefore recommends the following principles and cancellation mechanisms to be adopted by the inter-dealer electronic Trading Platforms in the Euro-zone. The EPDA also reminds the counterparties to a trade that, in most inter-dealer electronic Trading Platform, they can set price protection warnings on their own desktop.

1. Bilateral Cancellation Request

Cancellation of trades shall be performed by the inter-dealer electronic Trading Platform upon request of one of the counterparties for a bilateral cancellation communicated to the Trading Platform via telephone, email or fax provided that such communication is received within 15 minutes of the close of trading on any Trading Day, unless permitted otherwise at the Trading Platform Board's sole discretion. [Note: counterparties should be mindful of the requirement to make unilateral cancellation requests within 15 minutes of a trade execution should they wish to avail themselves of that rule as well]. Upon receipt of the notification, the Trading Platform will then immediately notify the other counterparty of the request and ask the other counterparty if they would be willing to agree to a bilateral cancellation of the trade. EPDA members are recommended to allow their identity to be revealed should that be requested by the Trading Platform in order to encourage fair settlement of a cancellation request[3].

If the cancellation request is made as above and both parties agree on the cancellation request then the cancellation of the trade shall be performed by the Trading Platform subject to the following procedure. Prior to cancellation, the trade cancellation must either:

[1] This recommendation aims to cover both the Cash market and Basis transactions. The EPDA aims to get acknowledgement from the dealers (*i.e.* its members) that they are bound by the present rules.
[2] The European Primary Dealers Association's (EPDA) Executive Members are: Banca IMI, Barclays Capital, BNP Paribas, Calyon, Citigroup, Crédit Suisse, Deutsche Bank, Dresdner [Commerzbank], Goldman Sachs, HSBC, ING, J.P.Morgan, Merrill Lynch, Morgan Stanley, Natixis, Nomura, Royal Bank of Scotland, Société Générale, UBS & Unicredit. At the date of the release of the recommendation Grupo Santander signed off on the recommendation but as a member of the EPDA and not yet as an Executive member.
[3] The revealing of the counterparty identity should allow both counterparties to contact each other directly to encourage dialogue and settlement of the cancellation of the trade.

(1) Have been entered into via a recorded telephone call (on the part of the Trading Platform between each counterparty and the Trading Platform and then confirmed by email or fax to each counterparty by the Trading Platform (but with no requirement of reply by each counterparty); or (2) (i) Have been subject to a telephone, email or fax request, (ii) which terms were confirmed by the Trading Platform by email or fax as being acceptable to both counterparties, and (iii) which was subsequently confirmed by each counterparty by email or fax.

In both cases, agreement must be reached and properly notified within 60 minutes of the close of trading on any Trading Day. Such cancellation (once agreed) shall then be notified to any applicable central counterparty or settlement institution.

2. **Unilateral Cancellation Request**

Where the trade cancellation request is made only by one of the counterparties only to a trade, the following procedure shall apply.

The cancellation request must be notified to the Trading Platform via telephone, email or fax within 15 minutes of the execution of the trade[4]. If the notification is made by telephone where the Trading Platform does not utilise recorded telephone lines, the request must be subsequently accompanied either by fax bearing an authorised signature or by email which must be confirmed by a return email from the Trading Platform.

Upon receipt of the notification, the Trading Platform will immediately contact the other counterparty with regard to the cancellation request.

- If the other counterparty confirms to the Trading Platform within 15 minutes of receipt that it agrees with the trade cancellation request, the request shall be treated as a bilateral request and subject to the "Bilateral Cancellation Request" procedure above.
- If the other counterparty does not respond within such time or does not agree with the trade cancellation request, in order to proceed with the cancellation, the Trading Platform must verify that the trade in question was executed at a price level which is inconsistent with the market value at the time of execution. To be "inconsistent" with the market value, the trade price must have been executed at a price that was greater than 50% outside the current bid/offer spread on a specific instrument at the time of its execution.

In order to calculate whether the trade is greater than 50% outside the current bid/offer spread, the Trading Platform may request up to five (5) dealers, but no less than three (3) *(excluding the counterparties)* to provide a firm two-way inter-dealer electronic quote for that instrument at the time of execution of the trade. Within 15 minutes of the poll, the dealers[5] will need to communicate their current bid/offer spread *i.e.* the quote of a firm two-way price they entered or would have entered into any inter-dealer electronic Platform to the Trading Platform for that

[4] The latest deadline would therefore be within 15mn of the close of trading on any Trading Day.

[5] Between three (3) and five (5) as mentioned above. The dealers polled should not be aware of the price at which the transaction subject to the cancellation request was made by the participant. Please see the practical example for more information on the operation of this mechanism.

instrument at that time[6]. After excluding both the highest and lowest price and averaging the remaining quotes in order to determine the average bid/offer spread, the trade will be 'off-market' if it is was executed at a price that was 50% wider than the average bid/offer spread which was calculated. It is recommended that EPDA members who are counterparties to the trade do not contact any of the group of dealers[7] concerning the trade dispute. The Trading Platform will then communicate its decision to both counterparties as quickly as possible but no later than 60 minutes from the time of the execution of the trade in question.

There are two (2) cases which may be identified:

- ***Error sale*** (*i.e.* cancellation request is made by the seller):
  Should the price at which the trade was made be at a price greater than 50% below the current bid/offer spread as defined above at the time of the execution of the trade then the transaction will be cancelled by the inter-dealer electronic trading platform.
- ***Error purchase*** (*i.e.* cancellation request is made by the buyer)
  Should the price at which the trade was made be at a price greater than 50% above the current bid/offer spread as defined above at the time of the execution of the trade then the transaction will cancelled by the inter-dealer electronic trading platform.

Such cancellation (once agreed) shall then be notified to any applicable central counterparty or settlement institution.

Practical Examples: Poll Average Example

Belgian OLOs 3.5 28 March 2015

The Trading Platform had the following best bid/offer on the screen – 107.15/110.25

Seller aggresses bid at 107.15 and then reports it as an error trade (being an error sale).

Following a poll of five market participants, the five quotes are as follows:

108. 60/109.75
108.50/109.65
107.90/109.50
108.25/109.30
108.10/109.20

The high/low bid and high/low offer are thrown out which leaves the following:

108.50/109.65
107.90/109.50
108.25/109.30

[6] *i.e.* the Platform concerned by the transaction cancellation request.
[7] Dealers polled by the Platform to provide a firm two-way price.

The average bid/offer spread is therefore:
108.22/109.48

If we apply the 50% deviation margin to the average bid/offer spread (126 cts) we obtain the following bid and offer limits:
107.59/110.11

The sale executed at 107.15 will be cancelled as the low parameter is 107.59 *i.e.* all sales < 107.59 may be cancelled should that be requested by the seller in the present example.

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