DISRUPTIVE TRADING PRACTICES

FAQs

January 2015

This material may not be reproduced or redistributed in whole or in part without the express, prior written consent of Intercontinental Exchange, Inc.

© Copyright Intercontinental Exchange, Inc. 2015 All Rights Reserved.

Q1: What factors may be considered in assessing a potential violation of the Rules regarding disruptive trading practices, including spoofing?

A1: The Regulatory Division may consider a variety of factors in assessing whether conduct violates the Rules, including, but not limited to:

- whether the market participant's intent was to induce others to trade when they otherwise would not;
- whether the market participant's intent was to affect a price rather than to change his position;
- whether the market participant's intent was to create misleading market conditions;
- market conditions in the impacted market(s) and related markets;
- the effect on other market participants;
- the market participant's historical pattern of activity;
- the market participant's order entry and cancellation activity;
- the size of the order(s) relative to market conditions at the time the order(s) was placed;
- the size of the order(s) relative to the market participant's position and/or capitalization;
- the number of orders;
- the ability of the market participant to manage the risk associated with the order(s) if fully executed;
- the duration for which the order(s) is exposed to the market;
- the duration between, and frequency of, non-actionable messages;
- the queue position or priority of the order in the order book;
- the prices of preceding and succeeding bids, offers, and trades;
- the change in the best offer price, best bid price, last sale price, or other price that results from the entry of the order; and
- the market participant's activity in related markets.

Q2: What does "mislead" mean in the context of the Rules?

A2: The language is intended to be a more specific statement of the general requirement that market participants are not permitted to act in violation of just and equitable principles of trade. This section of the Rule prohibits a market participant from entering orders or messages with the intent of creating the false impression of market depth or market interest. The Regulatory Division generally will find the requisite intent where the purpose of the participant's conduct was, for example, to induce another market participant to engage in market activity.

Q3: Is there a specific amount of time an order should be exposed to the market to demonstrate that it does not constitute a disruptive practice?

A3: Although the amount of time an order is exposed to the market may be a factor that is considered when determining whether the order constituted a disruptive trading practice, there is no prescribed safe harbor. The Regulatory Division will consider a variety of factors, including exposure time, to determine whether an order or orders constitute a disruptive practice.

Q4: Is it a violation of The Rules to modify or cancel an order once it has been entered?

A4: An order, entered with the intent to execute a bona fide transaction, which is subsequently modified or cancelled due to a perceived change in circumstances, does not constitute a violation of the Rules.

Q5: Will orders that are entered by mistake constitute a violation of The Rules?

A5: An unintentional, accidental, or "fat-finger" order will not constitute a violation of the Rules, but such activity may be a violation of other Exchange rules, including, but not limited to rules pertaining to acts that are detrimental to the best interests of the Exchange. Market participants are expected to take steps to mitigate the occurrence of errors, and their impact on the market. This is particularly true for entities that run algorithmic trading applications, or otherwise submit large numbers of automated orders to the market.

Q6: Does a partial fill of an order demonstrate that the order did not violate the Rules?

A6: While execution of an order, in part or in full, may be one indication that an order was entered in good faith, an execution does not automatically cause the order to be considered compliant with the Rules. Orders must be entered in an attempt to consummate a trade. A variety of factors may lead to a violative order ultimately achieving an execution. The Regulatory Division will consider a multitude of factors in assessing whether the Rules have been violated.

Q7: Under this rule, is a market participant prohibited from making a two-sided market with unequal quantities (e.g., 100 bid at 10 offered)?

A7: No. Market participants are not precluded from making unequal markets as long as the orders are entered for the purpose of executing bona fide transactions. If either (or both) order(s) are entered with prohibited intent, including recklessness, such activity will constitute a violation of the Rules.

Q8: Is the use of iceberg orders considered misleading under the Rules?

A8: No. The use of iceberg orders, in and of itself, is not considered a violation of the Rules. However, a violation may exist if an iceberg order is used as part of a scheme to mislead other participants; for example, if a market participant pre-positions an iceberg on the bid and then layers larger displayed quantities on the offer to create artificial downward pressure that results in the iceberg being partially or completely filled.

Q9: Is a market participant allowed to enter order(s) at various price levels throughout the order book in order to gain queue position, but subsequently cancel those orders as the market changes?

A9: It is understood that market participants may want to achieve queue position at certain price levels, and given changing market conditions may wish to modify or cancel those orders. In the absence of other indicia that the orders were entered for disruptive purposes, they would not constitute a violation of the Rules.

Q10: How does the Regulatory Division define "orderly conduct of trading or the fair execution of transactions?"

A10: Whether a market participant intends to disrupt the orderly conduct of trading or the fair execution of transactions, or demonstrates a reckless disregard for the orderly conduct of trading or

the fair execution of transactions, may be evaluated only in the context of the specific instrument, market conditions, and other circumstances present at the time in question. Some of the factors that may be considered in determining whether there was orderly conduct or the fair execution of transactions were described by the CFTC as follows: "[A]n orderly market may be characterized by, among other things, parameters such as a rational relationship between consecutive prices, a strong correlation between price changes and the volume of trades, levels of volatility that do not dramatically reduce liquidity, accurate relationships between the price of a derivative and the underlying such as a physical commodity or financial instrument, and reasonable spreads between contracts for near months and for remote months." *Antidisruptive Practices Authority, 78 Fed. Reg. at 31,895-96*. Volatility alone, however, will not be presumptively interpreted as disorderly or disruptive, as market volatility can be consistent with markets performing their price discovery function.

Q11: What factors will the Regulatory Division consider in determining if an act was done with the prohibited intent or reckless disregard of the consequences?

A11: Proof of intent is not limited to instances in which a market participant admits their state of mind. Where the conduct was such that it more likely than not was intended to produce a prohibited disruptive consequence, intent may be found. Claims of ignorance, or lack of knowledge, are not acceptable defenses to intentional or reckless conduct. Recklessness has been commonly defined as conduct that "departs so far from the standards of ordinary care that it is very difficult to believe the actor was not aware of what he or she was doing." *See Drexel Burnham Lambert, Inc. v. CFTC, 850 F.2d 742, 748 (D.C. Cir. 1988).*

Q12: Are orders entered for the purpose of igniting momentum in the market prohibited by the Rules?

A12: A "momentum ignition" strategy occurs when a market participant initiates a series of orders or trades in an attempt to ignite a price movement in that market or a related market. This conduct may be deemed to violate the Rules if it is determined the intent was to disrupt the orderly conduct of trading or the fair execution of transactions, if the conduct was reckless, or if the conduct distorted the integrity of the determination of settlement prices. Further, this activity may violate the Rules if the momentum-igniting orders were intended to be canceled before execution, or if the orders were intended to mislead others. If the conduct was intended to create artificially high or low prices, this may also constitute a violation of the Rules.
.

Q13: Is changing from buying to selling prohibited by The Rules?

A13: The Regulatory Division recognizes there are many variables that can cause a market participant to change their perspective of the market. The Rules do not prohibit market participants from changing their bias from short (long) to long (short). However, certain activity may be considered disruptive to the marketplace. For example, repeated instances of a market participant cancelling orders on one side of the market and then entering orders in the other direction that are large enough to turn the market (i.e., being of a sufficient quantity to sweep the entire quantity on the book at the particular price level and create a new best bid or best offer price) can be disruptive to the orderly conduct of trading or the fair execution of transactions.

Q14: Does the Regulatory Division consider cancelling an order via ICE's Self Trade Prevention Functionality ("STPF"), or other self-match prevention technology, indicative of an order being in violation of the Rules?

A14: The means by which an order is cancelled, in and of itself, is not an indicator of whether an order violates the Rules. The use of STPF in a manner that causes a disruption to the market may constitute a violation of the Rules. Further, if the resting order that was cancelled was non-bona fide at the time of its entry, it would be considered to have been entered in violation of the Rules.

Q15: What type of pre-open activity is prohibited by the Rules?

A15: As described in Q1, any activity that influences a market price may be considered when reviewing disruptive trading practices. This includes order activity during the pre-open period that

influences a price visible to the market, such as the indicative opening price, if the purpose of that order activity is not to execute a bona fide transaction.

Other activity related to the pre-open may also be considered disruptive, including but not limited to the entry of orders prior to the beginning of the pre-open in an attempt to “time” the FIFO priority queue.

Q16: Is the creation or execution of User Defined Strategies (“UDS”) for the purposes of deceiving or disadvantaging other market participants a violation of the Rules?

A16: Yes. UDS functionality requires users to exercise diligence and care in the creation of option spread instruments, including the creation of covered option strategies. Market participants are reminded that knowingly creating and/or trading UDS instruments in a manner intended to deceive or unfairly disadvantage other market participants is considered a violation of the Rules. Additionally, Market Supervision may price adjust or cancel trades that are deemed to negatively impact the integrity of the market pursuant to the provisions of the Exchange’s Error Trade Policy.