

European Cash Markets

The Collar Logic

Questions & Answers

What is the Collar Logic?

The Collar Logic has been designed to modernize our current volatility management mechanisms and is a new Trading Safeguards mechanism aimed at protecting investors from the impacts of erroneous orders while avoiding blocking trades.

What is the rationale for change?

Given the competitive environment in which NYSE Euronext now operates, our exchange can no longer promote market halts, especially because trading halts on our platform do not necessarily imply any halts on our competitors' platforms.

How does the Collar Logic work?

The Collar Logic is based on the following principles:

- No order price check is performed at order entry
- No aberrant order can lead to a trading halt
- Trading Safeguards must prevent the market from erroneous trades due to aberrant orders.

The Collar Logic does not impact the Auction mode as collars operate like the current static thresholds during an opening.

In Continuous Trading mode, an incoming order which attempts to trade with an order at a price which is outside of the collar's is traded up to the collar and rejected for the remaining quantity with the error message "Rejected for Collar". In this case, collars are not updated and trading continues as normal.

What if my order is genuine?

Within a defined timeframe (currently set to 30 seconds), you can confirm your order either automatically or manually depending on the way your trading software has been developed by your technology department or your provider.

To send such a confirmation, you need to send a confirmed modification (cancel/replace function) to the original incoming order with a price equal to the original price and a total quantity equal to the rejected quantity.

So I can generate a large price movement within a limited timeframe. How can I limit the risk and handle the impacts on my end-customer?

1. Limiting the client risk at broker level: enhancement of filters

In addition to measures taken at the exchange level, the risk of missed trades and malfunctioning of the collar logic can be limited at the member level by enhancing the order filtering procedures.

For instance, particular attention should be paid to market orders placed on illiquid stock. Euronext has noticed that this is common practice for some members trading retail orders. In such cases, the efficiency of credit control is often limited by the absence of price in the order. One suggestion would be to implement a strict credit control based on the last traded price +/- a deterrent variation rate.

It should be noted that the Euronext Market Data Feed contains a lot of static or dynamic data that, once integrated, can definitely help members to better filter their client orders (hence limiting the rejections linked to the Collar Logic) and consequently help brokers to fulfill their best execution obligations.

2. Limiting the client risk at broker level: smart handling of order rejections

The Collar Logic allows an automated rejection of orders generating trades above or below the collar. The order can be reinstated depending on the broker execution policy. However, it should be noted that it is not an “all or nothing” kind of choice. For instance, brokers could agree with their clients to reinstate an order only X number of times, thus maximizing the execution probability while maintaining a proper level of execution risk management.

How dependent is the Collar Logic on the trading platform?

The current NSC trading platform supports only the current threshold mechanism (reservation).

The Universal Trading Platform supports both the Collar Logic and the reservation mechanism.

What is the scope of securities traded on each platform for the European Regulated Markets?

Bonds have been traded on the Universal Trading Platform since 8 December 2008.

Equities and Trackers will be traded on the Universal Trading Platform as of 16 February 2009.

All the other products (warrants, funds, etc) will migrate to the Universal Trading Platform in the course of 2009.

What is the scope of the securities covered by the Collar Logic?

1. Auction securities are not impacted by the functioning of the Collar Logic as collars operate like the current static thresholds during an opening.

2. Securities traded in Continuous mode

2.1 Equities

Given its importance in view of recent competition, the Collar Logic will apply as from 16 Feb to all stocks pertaining to the AEX, BEL20, CAC40 and PSI20 indices. Indeed, the Collar Logic has been designed to mainly address situations arising in liquid markets.

After 16 Feb:

The reservation mechanism will be maintained on less liquid stocks for an additional period of 3 months. This will allow members to adapt their filtering procedures. At the same time, NYSE Euronext will review the categorization of securities between continuous and auction trading and implement additional monitoring procedures on aberrant orders.

2.2 Trackers

ETFs/Trackers will remain submitted to their current volatility management mechanism (halt of the market when thresholds set around the indicative net asset value are breached). This mechanism, which has some drawbacks in the competitive ETF environment, has recently been improved to clarify the threshold allocation for each ETF and to increase the accuracy of the INAVs. Additional modifications will be considered in the coming months.

2.3 Bonds

The Collar Logic implemented on Bonds since 8 December will be maintained. At the same time, NYSE Euronext will review the categorization of bonds too between continuous and auction trading and will propose a plan to modernize the Bonds Market Model.

Examples

Example 1 - order execution within the collars

Initial order book:

- Reference price = 30
- Collar: +/- 3% [29,10 /30,90]

Buy				Sell		
Order 1	100	30.00		30.10	10	Order A
Order 2	70	30.00		30.10	50	Order B
Order 3	200	29.90		30.13	100	Order C
				30.15	100	Order D

A new order enters the Market

- Order 4: Buy limit order at 30,12 for 60 shares
- Trade 60 shares at 30.10

Buy				Sell		
Order 1	100	30.00		30.13	100	Order C
Order 2	70	30.00		30.15	100	Order D
Order 3	200	29.90				

- Collars and reference price are updated according to the last traded price
 - ➔ Updated reference price: 30.10
 - ➔ Updated collars: +/- 3% [29.20 /31.00]

Example 2 - order execution outside the collars

Initial order book:

- Reference price = 30
- Collars: +/- 3% [29,10 /30,90]

Buy				Sell		
Order 1	100	30.80		31.00	10	Order A
Order 2	70	30.00		31.10	50	Order B
Order 3	200	29.95		31.13	100	Order C
				31.15	100	Order D

A new order enters the Market

- Order 4: Buy limit order at 31 for 60 shares
- ➔ Potential trade at 31.00 is outside the collars. The order is automatically rejected and the member receives a rejection message
- ➔ Collars and reference price are not modified. The order book remains open for all members
- ➔

If the member confirms the Order 4:

- ➔ Reference price is updated = 30,90
- ➔ Updated collars: +/- 3% [29,97 /31,83]
- ➔ Trade occurs for 10 shares at 31.00
- ➔ Updated reference price: 31.00
- ➔ Updated collars: +/- 3% [29,45/32,55]

Buy			Sell		
Order 4	50	31.00	31.10	50	Order B
Order 1	100	30.80	31.13	100	Order C
Order 2	70	30.00	31.15	100	Order D
Order 3	200	29.95			

Example 3 - Partial order execution within the collars

Initial order book:

- Reference price = 30
- Collars: +/- 3% [29,10 /30,90]

Buy			Sell		
Order 1	100	30.20	30.30	10	Order A
Order 2	70	30.00	30.50	50	Order B
Order 3	200	29.95	31.00	100	Order C
			31.15	100	Order D

A new order enters the Market

- Order 4: Buy limit order at 31 for 80 shares
- The order is partially executed:
 - ➔ Trade for 10 shares at 30.30
 - ➔ Trade for 50 shares at 30.50
- Potential trade at 31.00 is outside the collars
 - ➔ The remaining part of the order is automatically rejected (20 shares at 31.00)

- ➔ The collars and reference price are not updated. The order book remains open for all members
- ➔ The member has the ability to confirm its order by sending a confirmation message