Best Practice for Managing Erroneous Trades

Business Rules Guidance Note 03

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PURPOSE OF THE GUIDANCE NOTE	Managing erroneous trades on the stock exchange is a critical aspect of a Participating Organisation's responsibilities. These trades can occur due to various reasons, such as technical glitches, human error, or market volatility. They may occur owing to client error or internal error. When such errors happen, it's essential for Participating Organisations to have well-defined best practices in place to mitigate risks, maintain market integrity, and protect their clients' interests. Set out below are the expected practices for Participating Organisations to manage erroneous trades.
THE MAIN POINTS	1. Time of the essence 2. Errors Accounts 3. Reversal or correction 4. Client management
RELATED MATERIAL	• Global Master Securities Lending Agreement 2018

Guidance

The issue of this guidance note is to assist Participating Organisations with the procedure for managing erroneous trades.

This Guidance Note may be replaced at any time. The Participating Organisation must ensure they have the latest version of the guidance note. This guidance note is only a guide.

Effectively managing erroneous trades is a process that requires a combination of proactive measures, clear communication, collaboration with stakeholders, and adherence to regulations.

Participating Organisations must prioritize risk management, invest in robust monitoring systems, and cultivate a culture of transparency to navigate such challenges.

By implementing best practices, Participating Organisations can minimize the impact of erroneous trades, protect client interests, and uphold the integrity of the stock exchange.

Internal Procedures

1. Owing to the potential risks to the financial viability of a Participating Organisation, it is expected that Participating Organisations will have well documented internal procedures for managing all orders including errors. These procedures should be closely monitored by the internal compliance function.
2. Monitoring the financial impact of errors upon the Participating Organisation should be a key element of the procedures.

Immediate Identification

1. The first step is swift identification of the erroneous trade. Monitoring systems should be in place to detect unusual or erroneous transactions as soon as they occur.
2. Automated alerts and real-time monitoring tools can help in quickly flagging trades that deviate significantly from normal patterns.

Pause Trading

1. Upon detection, the Participating Organisation should consider pausing trading in the affected security or by the affected client(s) to prevent further erroneous transactions.
2. This pause allows time for a thorough investigation before more erroneous trades exacerbate the situation.
3. This pause also allows time to notify relevant stakeholders including the stock exchange and clients about the erroneous trade.

Escalation and Notification

1. The Participating Organisation should promptly escalate any erroneous trade internally so that proper controls can be established to minimise risk to the broker, client and market. Depending upon the scale of the error, escalation may involve notifying the trading manager, IT manager, finance manager, risk manager and compliance manager.
2. The Participating Organisation should promptly notify relevant parties, including the stock exchange and clients, about the erroneous trade.
3. Transparency is crucial to maintaining trust, so informing clients about the situation and its impact on their portfolios is essential.

Investigation

1. Conduct a thorough internal investigation to determine the cause of the error. This may involve reviewing trading logs, communication records, and system reports.
2. Engage with the trading team, IT department, and compliance officers to understand the root cause comprehensively.

3. PNGX may also initiate an investigation in relation to compliance with the Business Rules were warranted.

Communication

1. Clear and timely communication with clients is paramount. Provide updates on the investigation progress, steps being taken, and potential impacts on their investments.
2. Transparency helps in managing client expectations and maintaining trust even in challenging situations.

Collaboration

1. Work closely with the stock exchange and regulatory authorities. They may have specific protocols and requirements for managing erroneous trades.
2. Collaboration ensures compliance with market regulations and facilitates a smoother resolution process.

Evaluation of Impact

1. Assess the impact of the erroneous trade on the market, affected clients, and the brokerage firm itself.
2. This evaluation helps in formulating an appropriate response and developing preventive measures for the future.

Reversal or Correction

1. If possible and permitted, consider reversing or correcting the erroneous trade. This could involve cancelling the trade, executing an offsetting trade, borrowing shares, or adjusting positions. Whichever action is taken, it must be given effect in sufficient time to allow normal settlement of the erroneous trade. Failure to do so will result in a failed settlement of the trade.
2. A trade may only be cancelled if the counterparty broker agrees to the cancellation, the client agreement contains clauses allowing cancellation and the client agrees to the cancellation and can only occur intraday on the trade date.
3. However, not all trades can be easily reversed, especially if they have already had widespread market impacts. The Exchange will only cancel trades in extraordinary circumstances.
4. It would be prudent for a Participating Organisation to have in place permanent borrowing arrangements with institutional clients to permit borrowing of shares in the event of an error. It is recommended that borrowing arrangements be managed under a *Global Master Securities Lending Agreement 2018*.

Client Compensation

1. In cases where clients have incurred losses due to an erroneous trade caused by the Participating Organisation, the Participating Organisation should consider fair and reasonable compensation. A client should never incur a loss as a result of an error by the Participating Organisation. In short, the client's position should be "made whole".

2. In cases where clients have incurred losses due to an erroneous trade caused by the client, any losses or profits as a result of rectifying the error by the client should be attributed to the client.

Recording and Management

1. A Participating Organisation must at all times maintain an internal “errors” account which is a principal account and segregated from all other accounts (eg Broker XYZ <error a/c>). This account should be monitored daily by senior management, compliance, and risk management.
2. All erroneous trades should be allocated to the errors account as soon as possible.
3. The errors account must be cleared as soon as possible.
4. A Participating Organisation should have an internal written policy on how errors and losses are managed and minimised, to what extent the adviser and/or DTR responsible for the error incurs the loss, and how errors are to be rectified.

Review and Improvement

1. After resolving the issue, conduct a comprehensive review of processes and systems to prevent similar errors in the future.
2. Implement necessary improvements such as enhanced risk controls, additional training for staff, or upgraded technology infrastructure.
3. The use and management of errors accounts will be reviewed by PNGX as part of any assessment of compliance with the Business Rules.