Execution of Orders in Illiquid Stocks

Guidance Note 05

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PURPOSE OF THE GUIDANCE NOTE	The purpose of this Guidance Note is to clarify the obligations of PNGX Participating Organisations when executing client orders, particularly in illiquid or thinly traded securities, in order to promote and maintain a fair and orderly market. It explains how Participating Organisations are expected to exercise judgment and discretion when client instructions may materially affect price formation, liquidity or market integrity, and reinforces that compliance with client instructions does not override obligations under the *Capital Market Act* 2015 and PNGX Business Rules. The Guidance Note also outlines PNGX's expectations regarding orderly price discovery, appropriate execution practices, record-keeping, and the Exchange's role in monitoring, investigating and responding to potentially disorderly trading behaviour.
THE MAIN POINTS	1. Material price movements in illiquid securities. 2. Price discovery process to be followed. 3. Considerations for dual listed securities. 4. Acceptable Trade Ranges.
RELATED MATERIAL	• *Capital Market Act* 2015 (**CMA**) • Business Rules for Participating Organisations

Guidance

The issue of this guidance note is to assist Participating Organisations with their obligations for the maintenance of an orderly market.

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.

Ensuring orders in illiquid securities and maintaining an orderly market requires Participating Organisations to exercise both careful judgement and skill.

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 risk of creating a disorderly market and can better uphold the integrity of the stock exchange.

SECTION 1 – Obligations

As an approved market operator, Section 13 of the CMA requires PNGX, to the extent reasonably practicable, to do all things necessary to ensure that its market is fair and orderly.

For the purposes of this Guidance Note, considerations of an orderly market relate both to the overall functioning of the market and to trading in individual securities. An orderly market is characterised by trading conditions in which market Participating Organisations are able to determine, with an appropriate degree of certainty, the prices and volumes at which they may transact on PNGX, and in which unreasonable or disorderly price variations between trades are avoided.

The Business Rules require PNGX Participating Organisations to ensure that their conduct promotes and helps maintain an orderly market, including when giving effect to orders placed by clients. This obligation applies irrespective of whether the Participating Organisation is acting on an agency or principal basis.

SECTION 2 – Orderly Market Considerations

In relation to trading conduct, PNGX considers that, in the absence of new or material information, a key indicator of an orderly market is the steady and non-volatile movement in the price of a security.

In ensuring that their trading conduct promotes and helps maintain an orderly market, PNGX Participating Organisations must consider the circumstances relevant to the prevailing market conditions for each security. Before permitting an order to proceed to the market, Participating Organisations must consider whether execution of the order is consistent with recent trading activity in the relevant security and whether execution of the order is likely to materially affect the price or market for that security.

In assessing these matters, Participating Organisations should have regard to factors such as liquidity, recent trading volumes, prevailing bid-offer spreads, and the cumulative effect of multiple or sequential orders. Particular care is required in relation to “at market” orders, limit orders that trade materially through the best bid or offer, or strategies involving a series of orders that may collectively influence price formation.

While Participating Organisations are required to maintain orderly trading, they also have a “gatekeeper” obligation to support a market that accurately reflects genuine supply and demand. Orderly markets do not preclude price movement; rather, they require that price discovery occurs through a fair and transparent process.

SECTION 3 – Trading in Illiquid Securities

PNGX acknowledges that certain securities traded on its markets are relatively illiquid. However, illiquidity does not relieve PNGX Participating Organisations of their obligation to consider the market

impact of order execution. Simply following client instructions is not a valid basis for disregarding the effect an order may have on the market as a whole.

Price discovery is a critical element of ensuring an orderly market.

PNGX is unlikely to have concerns where a Participating Organisation submits an order that results, or is likely to result, in a significant price movement in an illiquid security, provided that the Participating Organisation has taken reasonable steps to ensure that the process of price discovery and execution support orderly trading. For example, where a Participating Organisation proposes to execute an order at a price significantly above or below the last traded price in the absence of material new information, the Participating Organisation should, where reasonably practicable, seek to identify potential buyers or sellers at prices between the last traded price and the proposed execution price by a process of gradual price discovery.

This may involve placing orders close to the last traded price and incrementally adjusting those orders in a manner consistent with normal trading behaviour for the security, thereby facilitating price discovery and potentially achieving a better outcome for the client. Each incremental order need only remain in the market for a reasonable period, having regard to the liquidity of the security, which may range from a few minutes to a few hours or longer periods in particularly illiquid stocks.

Establishing an acceptable range for intra-day movement of a security is not fixed across all securities owing to the potential price range from 0.1 toea to hundreds of kina.

As a general indicator of orderly trading, and absent new material information, prices should not ordinarily vary by more than the acceptable trade range percentage set out in Appendix A (**Acceptable Trade Range**) from the previous traded price within a single trading day without execution during that day. The indicators are not a safe harbour and do not preclude regulatory concern where smaller price movements arise from disorderly execution practices. It also does not create an expectation that a Participating Organisation can place an order at the maximum of the Acceptable Trade Range without exposing orders at lesser prices first. If an order which is being managed by gradual price discovery executes early during the day (for example, within the first hour), PNGX is of the view that the Acceptable Trade Range threshold resets.

In fulfilling their obligations, PNGX Participating Organisations are expected to perform a proactive gatekeeper role. Where client instructions would, if executed immediately or aggressively, result in sharp price movements, those orders should be exposed to the market and the price adjusted gradually towards the client's limit, with the rate of adjustment reflecting the liquidity of the security. This approach supports both best execution and fair price formation.

Example

> *Security ABC last traded 1 month ago at 6.00 kina. Security ABC is only listed on PNGX. A client wishes to purchase at 4.00 kina. There has been no news from ABC within the last month. Broker XYZ is aware that the order represents a 33% price decrease. Broker XYZ is also aware of PNGX guidance regarding orderly markets. The broker acknowledges that PNGX has given guidance of 10% movement per day if the last sale was above 1 kina. Aware of these factors, the broker places a bid at 5.70 kina (5% decrease) at the opening of trading. By midday there have been no offers so the broker amends the order to 5.40 (10%). By the close of trading there have been no offers.*

The following day, Broker XYZ reduces the bid by a further 5% to 5.10 kina. The order partially executes at 10.30am representing a price decrease of 15%. This resets the 10% threshold. It could now be considered orderly for the price to fall by a further 0.50 kina in the day representing a total 23% decrease (0.90 plus 0.05) for the day if appropriately managed.

SECTION 4 – Considerations for Dual Listed Securities

Trading in dual listed securities may require special considerations.

Certain securities may have their primary listing on another market (e.g. ASX, NYSE, TSX). These other markets may present a deeper and more liquid pool of liquidity and hence more appropriate pricing.

Circumstances may arise whereby a dual listed security, which has a deeper pool of liquidity on another market, does not trade on PNGX for a considerable period of time. When next orders are received on PNGX, there may be a considerable variation from the last trade on PNGX notwithstanding that the prices of those order are in line with the primary offshore listing market.

In these circumstances it may be appropriate for there to be a material price movement without the abovementioned comprehensive price discovery process if the new prices on PNGX are aligned with the primary offshore listing market.

SECTION 5 – Order Records and Client Instructions

PNGX Participating Organisations must ensure that all client instructions and execution decisions are properly documented and retained so that any enquiry by the PNGX can be supported by appropriate records.

Where a client, acting without advice, provides explicit instructions that are likely to result in sharp price movements, the Participating Organisation should obtain a written client acknowledgement explaining the basis for the instruction and confirming the client's understanding of the potential market impact (other than in the circumstances of a dual listed security as outlined above). Such acknowledgements do not absolve Participating Organisations of their regulatory obligations but form part of prudent risk management and evidentiary records.

In the circumstances of an order for a dual listed security where the order has potential market impact, the Participating Organisation should keep a record, with the associated order records, of the reference price on the overseas primary market.

PNGX reserves the right, in its absolute discretion, to investigate any matter relating to market conduct and in the interests of maintaining market integrity. PNGX may refer anomalies identified in trading activity or order documentation to the Securities Commission of Papua New Guinea for further consideration.

SECTION 6 – Transactions outside an Acceptable Trade Range

A transaction executed or reported outside the Acceptable Trade Range set out in Appendix A and which has not been effectively managed through price discovery as set out above will be deemed to be a trading error. PNGX will cancel that securities transaction as soon as practicable after becoming aware of the trade subject to the trade being identified by PNGX, or notified to PNGX, no later than 3.50pm on the same trading day (or 11.50am on trading days when the market closes at 12.00 noon).

A transaction executed or reported outside the Acceptable Trade Range set out in Appendix A and which has been effectively managed through price discovery as set out above will not be cancelled by PNGX.

A transaction which is inside the Acceptable Trade Range set out in Appendix A will not be cancelled by PNGX.

Appendix A – Acceptable Trade Ranges

Where the Reference Price for a securities transaction is in the following price range:	Acceptable Trade Range percentage away from the Reference Price
0.1– 0.9 toea	Up to or equal to 200.0% above or below the Reference Price
1.0 - 4.9 toea	Up to or equal to 100.0% above or below the Reference Price
5.0 – 9.9 toea	Up to or equal to 25.0% above or below the Reference Price
10– 49.9 toea	Up to or equal to 20.0% above or below the Reference Price
50 – 99.9 toea	Up to or equal to 15.0% above or below the Reference Price
Above 100 toea	Up to or equal to 10.0% above or below the Reference Price

For new securities at the time of first quotation – the Reference Price is the issue price, or an equivalent price as determined by PNGX.

For all other securities quoted on PNGX – the Reference Price is the last on-market trade price (subject to considerations for dual listed securities).