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NYSE Trading Snafu Draws Fire

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A mistake that forced NYSE Euronext to cancel a number of trades in June recalls the events of May 6, in which orders were cancelled on a massive scale.

The incident illustrates the fact that even supposedly automated markets are still subject to human failure, and this is likely to become a focus for regulators.

“In a financial environment with an increased focus on regulation and a growing list of fines and penalties that directly impact the bottom line, controlled automation is critical for businesses to ensure the accuracy of data and to ultimately preserve income,” Patrick Murray, CEO of STP Investment Services, told Markets Media. “Both systematic and human controls should be put in place to ensure that data is timely, and most importantly, accurate.” STP provides middle- and back-office services for investment advisers.

The incident began on May 10, when U.S. Bancorp commenced an offer to exchange up to 1.25 million Depositary Shares, each representing an interest in a share of preferred stock, for an equal number of fixed-to-floating rate securities, called Normal ITS. The purpose

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of the offer was to improve U.S. Bancorp's capital structure by replacing the Normal ITS, which are hybrid securities, with preferred stock, which is a more traditional form of equity capital.

The Depositary Shares were approved for listing on the NYSE under the symbol USB PRA. On June 11, the NYSE opened the shares for trading, but trading didn't commence until June 16, at about \$79 per share. There were additional executions near that same price on June 17 and 18, the NYSE said in a regulatory filing.

On June 18, NYSE learned that the prices at which trades had executed were not consistent with the market value of the security, which was closer to \$800. Upon learning of the pricing disparity, the NYSE immediately halted trading in the Depositary Shares and alerted U.S. Bancorp and other exchanges that traded in the Depositary Shares of the pricing discrepancy.

Apparently, the number of Depositary Shares that were issued was ten times more than it should have been, which resulted in the price being ten times less than it should have been.

As a result of the snafu, the NYSE has asked the SEC for a rule change concerning the ability of an exchange officer to act to review potentially erroneous executions.

Under SEC Rule 128(g), an exchange officer may declare such transactions null and void, but such action must be taken no later than the start of the trading day following the date of execution in question.

The NYSE has taken the position that the trading in USB PRA from June 16 to 18 constituted a single event because “that trading was based on incorrect or grossly misinterpreted structural or issuance information that resulted in severe price dislocation,” the NYSE said in the regulatory filing.

Because the shares were halted before the price ceased to be dislocated, and have remained halted, the NYSE believes that an officer may declare null and void all trading in the shares, provided such declaration is made before the security resumes trading. The shares were scheduled to resume trading on July 30.



INVESTMENT SERVICES INC.