

**DISCIPLINARY COMMITTEE AT OMX
NORDIC EXCHANGE STOCKHOLM**RULING November 3rd, 2008
2008:12OMX Nordic Exchange Stockholm AB
HQ Bankaktiebolag
Fredrik Crafoord

HQ Bankaktiebolag (HQB) is a member of OMX Nordic Exchange Stockholm AB (“the Exchange”). Membership is regulated, inter alia, by the Exchange’s Norex Member Rules (NMR). HQB has undertaken to comply with NMR as long as its membership is active.

As shown in the enclosed appendix, the Exchange, by virtue of the NMR rules, has requested that the Disciplinary Committee announce a ruling regarding disciplinary action against HQB and that the exchange trader Fredrik Crafoord, who is employed by the HQB, and is also the Trading Manager and Vice-President of the bank, be issued a warning.

HQB and Fredrik Crafoord have contested the claims.

Finansinspektionen (Swedish Financial Supervisory Authority) has stated that it has nothing to add to the matter.

An oral hearing was held in this matter on October 22, 2008, during which the Exchange was represented by Anders Ackebo, Department Manager; Ulf Lindgren, Senior Legal Counsel; and Joakim Strid, Market Surveillance Manager; and at which HQB and Fredrik Crafoord were represented by Richard Berlin, Senior Legal Counsel, and at which Fredrik Crafoord attended personally.

Item 4.6.1 of NMR prescribes the following:

“Orders placed in the Order Book, Automatically Matched Trades and Manual Trades must reflect the current market value of the Instrument in question and constitute genuine Orders and Trades.

“Current market value” for Trades means prices, which, upon a comprehensive assessment, reflect the current pricing of the Instrument in question. When assessing the current market value, consideration should be made to, among other things, the changes in the pricing of the Instrument during the relevant Exchange Day, the changes in the pricing of the Instrument on previous Exchange Days, the volatility of the Instrument and the general changes in the pricing of comparable Instruments and, where relevant, other particular conditions related to the Trade.

An Order will not reflect current market value if placed in the Order Book with a price that would not be considered current market value for a corresponding trade. The Order's period of validity must be taken into consideration when assessing the price of the Order."

Among other points, 4.6.2 adds the following:

"The Member may not place Orders or enter into Trades which, individually or together, are intended to improperly influence the price structure in the Trading System, which are devoid of commercial purpose, or which are intended to delay or prevent access to the Trading System by other Members."

According to Item 4.4.2 in NMR, a Member of the Exchange is responsible for all actions that a trader or other parties take via the Member's link to the trading system,

In this matter, the *Exchange* has stated the following:

What is stated in NMR Items 4.6.1 and 4.6.2 also applies during what is referred to as "the call" prior to the opening of continuous trading operations. The call procedure commences at 08.45. Up to 09.00, market players may not only place orders but can also cancel them. Immediately after 09.00, there is a period of 7-8 minutes when outstanding sell and buy orders are matched, resulting in trades. The call procedure is aimed at determining the market price that should apply when trading opens. During the execution of the call process, an equilibrium price is computed – an indicative price based on existing orders – which is made available to all market players. During the call, market players may naturally cancel their orders; however, a prerequisite for the functioning of the call is that the players only place orders at prices and volumes that, at least during the actual order, they are willing to conduct trades. Any other actions could be aimed at misleading other market players as regards the impending price pattern and, thereby, prompting them to act in a manner that they would not otherwise have done.

On June 17, 2008, the Hennes & Mauritz share closed at SEK 320. On June 18, 2008, and prior to the opening of the Exchange, Hennes & Mauritz (HM) released its report for the period December 1, 2007 – May 31, 2008. On the same morning, HQB placed orders on own account during the call for at most 250,000 HM B shares, of which orders for 200,000 shares were limited to SEK 350 and 360. For most of the call, HQB accounted for the majority of the order volume that provided the basis for the calculation of the equilibrium price and thus dominated most of the order book's buy side. However, just before the call closed, HQB cancelled its previous orders and conducted trades during the call at an equilibrium price of SEK 343.50 for only 25,000 shares. Final trading volume during the call amounted to 183,000 shares, that is, a smaller total volume that HQB had just a few minutes earlier indicated it was prepared to buy. Subsequently, over the course of the day the average price of the share was SEK 342.30.

Accordingly, the orders placed by HQB during the call of June 18, meant that HQB initially declared itself willing to buy, on own account, substantial volumes of the HM share at prices that significantly deviated from the price at which other players were willing to trade, and also deviated from the price at which HQB subsequently executed the purchase and sale of shares. As a direct result of HQB's order placing, the equilibrium price for most of the call remained at a clearly higher level than that at which trading would later be conducted. Thus, the market gained the impression that the opening price, to be set during the call, would be considerably higher than what was later the case. However, just before the opening share price was to be set, it transpired that HQB did not back its orders but instead cancelled them, leading the price level in the call to retreat.

The orders were placed by Fredrik Crafoord. During discussions with the exchange in connection with the particular order placing, Fredrik Crafoord stated that he possibly did not intend to back his orders completely but that the intention was partially to attract sellers. The extent to which he intended to complete the orders depended on the magnitude of the subsequent volume.

The Exchange concludes that it was never HQB's intention that the entire order volume placed in the trading system should lead to trades. Accordingly, a substantial amount of the order volume was not represented by genuine orders. As a result, the price structure in the call was incorrect and misleading. Consequently, in the opinion of the Exchange, the order placing breached the provisions of NMR Items 4.6.1 and 4.6.2.

In a letter dated October 22, 2004, what was then Hagströmer & Qviberg AB (HQ) was censured for similar behavior in respect of the call for Ericsson. On that occasion, HQ cancelled all its buy orders a few seconds before the call terminated. At that time, Fredrik Crafoord was responsible for trading operations at HQ.

In the opinion of the Exchange, HQB's responsibility for brokerage operations and, to a certain extent, its repeated behavior means that its infringement cannot be viewed as minor.

In addition, the Exchange requests that the Disciplinary Committee issue Fredrik Crafoord with a warning pursuant to NMR Item 4.11.8 for the aforementioned breach of NMR.

HQB and *Fredrik Crafoord* have stated:

The Bank and Fredrik Crafoord contest OMX's claim and maintain that Fredrik Crafoord did not act contrary to the Norex rules. In any case, any blame that may be ascribed to Fredrik Crafoord is of such a minor and excusable nature that there are no reasons for prescribing sanctions.

The purpose of the call procedure is to facilitate market players in finding a market price for each individual instrument, and which is meant to apply when continuous trading opens. The purpose of permitting market players to cancel an order is to permit the adjustment of a player's final orders to market indications deriving from other market players and other information available during the call procedure.

OMX's claim that "it was never HQB's intention that the entire order volume placed in the trading system in connection with the call would lead to trades" is incorrect. This was the intention when the order volume was placed. After the orders had been placed, it became evident to Fredrik Crafoord that market conditions did not match his expectations, which was confirmed by the fact that the Exchange just before 09.00 contacted him by phone and questioned the orders. It was against this background that Fredrik Crafoord cancelled the particular orders in line with the right granted by the rules.

Fredrik Crafoord was interviewed personally, in conjunction with which he stated primarily the following.

Trading at HQB, where Fredrik Crafoord is the trading manager, primarily involves derivatives, but the Bank seeks to achieve a positive or negative exposure to individual shares in a manner that is most profitable at any time.

On the morning of June 18, 2008, Hennes & Mauritz presented an interim report that was extremely positive and which, in Fredrik Crafoord's opinion, should have led to a sharp rise on opening and throughout the day, especially as the HM share had been under pressure during the days preceding the report. Other factors that added to this assessment were that the US and German exchanges saw sharp rises on June 17. Fredrik Crafoord believed that HQB should look for positive exposure on opening in an effort to gain from a continuing rise during the day. According to his experience, the most effective way of getting volume at the lowest price is to bid high for a substantial volume in order to sound out selling interest and then gradually adjust the volume to the identified interest. Attracting larger volumes frequently leads to an order book with superior depth and one that offers matching potential for even greater volumes. Bidding low and increasing the volume and price enhance the risk of what is referred to as front running during the final stages of the call. This approach was the

background to the orders that Fredrik Crafoord placed in the system ahead of the opening of the call. He did this already at 08.40 to ensure that the orders would be noted immediately when the call commenced at 08.45.

Just before 09.00 on June 18, 2008 Fredrik Crafoord received a telephone call from the Exchange that questioned whether the orders were genuine. This telephone call made Fredrik Crafoord somewhat unsure, since he did not understand the Exchange's reason for it and this contributed to him canceling one of the buy orders for 100,000 shares. When this order was removed, the call was not significantly affected, but instead continued to hover around SEK 345. Another contributory factor underlying Fredrik Crafoord's decision to cancel one of the orders was that he noted that HQB was almost the sole buyer of the HM share in the call, which was not what he had expected and this generated a certain degree of uncertainty. He had assumed that the call would be considerably more extensive for HM shares and that many buyers would show an interest.

When continuous trading commenced, the Europe index opened up before immediately retreating and the call procedure in Stockholm was marked by selling pressure due to the fact that the OMX Future was trading below its theoretical value. When the OMF Future trades below its theoretical value it creates selling pressure in the OMX basket, as well as in the HM share, which is a sizeable component of the index. These movements in the OMX Future and other European index futures prompted Fredrik Crafoord to vacillate somewhat from his previous conviction of positive stock trading and when a selling surplus of about 100,000 shares emerged in the HM call, as far as he remembers, he reduced HQB's second buy order to 25,000 and attempted instead to buy additional shares in continuous trading, which he managed to do. By this means, HQB acquired an additional 25,000 shares at SEK 342 each. Thus, overall, HQB purchased 50,000 of the indicated 200,000 HM shares in close conjunction with the call, which cannot be viewed as remarkable given the volatile market at the time. The fact that the HM share, despite a considerably negative trading day, traded at an average of SEK 342.30 also shows that Fredrik Crafoord's assessment of the share was not unfounded.

The orders that Fredrik Crafoord placed during the call were meant to be genuine when they were placed. The continuing progress of the call, with the surprising telephone call from the Exchange, shook his expectations, leading him to adjust his orders after he hastily reassessed the situation. Accordingly, he did not intend to improperly influence the pricing of the HM share; instead, any shortcomings in his action must be sought in the inability, in the initial stages of the call, to make a correct assessment of the demand for the HM share. If the Exchange had not contacted him, he would probably not have cancelled such a large portion of the originally placed orders.

For its part, *the Disciplinary Committee* states the following:

The rules governing the call permit market players to freely cancel orders up until matching commences at 09.00. However, there is no doubt that the provisions in Item 4.6.2 of NMR also apply to issues involving the call procedure. Accordingly, also during the call, an Exchange member may not place an order designed to improperly influence price formation or that is devoid of commercial purpose. The occurrence of this represents an infringement of the rules, and is aimed at counteracting the purpose of the call procedure. Notwithstanding this, it is *per se* acceptable for an Exchange member to cancel or alter an order placement, depending on developments during the call.

The Committee concludes that, during the call on June 18, 2008, Fredrik Crafoord placed orders for a highly substantial volume of HM shares at a price that sharply exceeded the average share price for the preceding day and then cancelled the majority of the orders immediately prior to the commencement of matching at 09.00. This undoubtedly raises suspicions that the orders were not genuine, especially in view of the Exchange's information that Fredrik Crafoord had previously acted in a similar fashion on behalf of HQ. In common with the Exchange, the Committee believes that such behavior could have been aimed at influencing price formation in conjunction with Exchange trading.

However, in the present case, the Disciplinary Committee believes that the explanation presented by Fredrik Crafoord cannot be disregarded, and it attaches special consideration to the indisputable fact that Hennes & Mauritz presented a highly positive report on the morning of June 18. The Disciplinary Committee also notes that the average share price for the HM share during June 18 was 342.30 kronor, proving that there was reason for Fredrik Crafoord to expect a sharp rise during the day compared with the preceding day. Of course, even on this basis the appropriateness of placing orders in the volumes in question during the call may be severely questioned. However, the fact that Fredrik Crafoord obviously made an incorrect assessment does not lead to the conclusion that the orders were devoid of commercial purpose. The Committee also takes into account the fact that it is conceivable that the – highly warranted – telephone call that Fredrik Crafoord received from the Exchange may have confused him and influenced his decision to cancel such a large portion of the orders.

In brief, the Committee believes – despite certain embarrassing circumstances for HQB and Fredrik Crafoord – that it has not been sufficiently demonstrated that the particular orders were designed to improperly influence price formation in the trading system or that they were devoid of commercial purpose.

The Disciplinary Committee has decided to let the matter rest.

On behalf of the Disciplinary Committee,

Judge Johan Munck, Marianne Lundius, Madeleine Leijonhufvud, Hans Mertzig and Stefan Erneholm participated in the committee's ruling. Unanimous.