

# MARKET REGULATION ADVISORY NOTICE

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<b>Exchange</b>	<b>CME</b>
<b>Subject</b>	<b>Outtrades</b>
<b>Rule References</b>	<b>Rule 527</b>
<b>Advisory Date</b>	<b>August 30, 2021</b>
<b>Advisory Number</b>	<b>CME RA2105-2</b>
<b>Effective Date</b>	<b>October 1, 2021</b>

Effective on trade date Friday, October 1, and pending all relevant CFTC regulatory review periods, this Market Regulation Advisory Notice will supersede CME & CBOT Market Regulation Advisory Notice RA0804-3 from March 11, 2008. It is being issued as a CME-only Advisory Notice in connection with amendments to CBOT Rule 527 that become effective on October 1, 2021.<sup>1</sup>

The rules and procedures for the proper resolution of outtrades in no way limit a member's right to submit a claim related to the resolution of an outtrade to arbitration in accordance with the provisions of Chapter 6 ("Arbitration").

Members who discover an outtrade during Regular Trading Hours ("RTH") must immediately 1) notify the opposite trader, 2) determine who will cover the outtrade, and 3) cover the outtrade. Outtrades discovered after an RTH session has ended must be resolved no later than the opening of the next RTH session.

It is imperative that members resolve outtrades in a timely fashion. Financial liability resulting from the resolution of an outtrade is limited to the opening price(s) of the next RTH session. However, a party who unreasonably fails to cover an outtrade during the intervening period may be liable for the difference between the opening price(s) of the next RTH session and the price at which the outtrade could have been covered during the intervening period, including during electronic trading hours or in an appropriate alternative market.

The text of Rule 527 begins on page 4 of this Advisory Notice.

## **Straight Out Outtrades Involving Orders**

A floor broker who discovers that they have a straight out outtrade in connection with a trade that was executed in the market for an order has two options for resolving the outtrade.

1. Re-execution - The broker may re-execute the order. If the re-execution price is worse than the original execution price, then the broker must adjust the customer by check to the original execution price. If the re-execution price is better than the original execution price, the customer is entitled to the better price.
2. Assignment - The broker may assign the opposite side of the trade that cannot be cleared to their error account, thereby filling the order at the original execution price. The broker may not liquidate the position assigned to their error account until at least ten minutes have passed from the time of the original execution of the order and the bracket period in which the outtrade occurred has ended (unless the liquidation takes place during the post close session where such time restrictions do not apply). Any profits or losses resulting from the liquidation of the position in the broker's error account belong to the broker and they may retain or disburse any profits at their discretion.

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<sup>1</sup> Please see Special Executive Report S-8833 from August 27, 2021, for additional information on the rule amendments.

### **Price Outtrades**

Provided that the members involved in the outtrade agree that the trade was executed at one of the two prices in question, the outtrade must be resolved by clearing the trade at the execution price.

If the outtrade involves a price discrepancy between a local and a broker and the parties cannot agree on the price of execution, the price recorded by the broker shall be used to clear the trade. If the outtrade is between two locals or two brokers and the parties cannot agree on the price of execution, the buyer's price shall be used to clear the trade.

In the case of a price outtrade between two brokers in which the members cannot agree on the execution price and the buyer's price is therefore used to clear the trade, the broker representing the sell order may resolve the outtrade in any of the following ways:

1. Clear the sales for the order at the buyer's price. If the price is worse than the originally confirmed price, the broker must adjust the customer by check to the confirmed execution price.
2. Clear the sales at the buyer's price in their error account and re-execute the order. If the re-execution price is worse than the original execution price, then the broker must adjust the customer by check to the original execution price.
3. Clear the sales at the buyer's price in their error account and assign a fill at the original execution price to the sell order opposite their error account pursuant to the assignment trade procedures.

### **Quantity Outtrades**

Provided that the members involved in the outtrade agree that the trade was executed for one of the two quantities in question, the outtrade must be resolved by clearing the trade at the executed quantity.

If the outtrade is between two locals and the parties cannot agree on the quantity that was executed, the higher quantity shall be used to clear the trade.

A broker may assign the opposite side of the uncleared portion of a quantity outtrade that they believe they have executed to their error account and assign a fill to the order at the execution price pursuant to the assignment trade procedures.

### **Bona Fide Contract Month, Strike, Put vs. Call and Side of Market (Buy vs. Buy or Sell vs. Sell) Outtrades**

A broker who believes that they have executed an order in accordance with its instructions and is involved in an outtrade due to a contract month, strike price, side of market or put/call discrepancy may resolve the outtrade in any of the following ways:

1. The trade may be busted. If the broker re-executes the order at a price less favorable than the price to which the order was entitled, the customer must be adjusted by check. If the order is re-executed at a more favorable price, the customer is entitled to the better price.
2. Either or both trades may be cleared in accordance with the members' recorded data.
3. The broker may assign the opposite side of the order to their error account, thereby filling the customer at the execution price, and may also agree to clear the other party's outtrade in their error account.
4. If both members are representing customer orders, both brokers may assign the opposite side of their respective orders to their error accounts pursuant to the assignment trade procedures.

## **Assignment Trade Requirements**

### **Error Account Requirements**

All assignment trades must be placed into the broker's error account. Firms that utilize house brokers and allocate the brokers' errors to the firm's error account must maintain sub-accounts held in the name of each floor broker for this purpose.

### **Liquidation Requirements**

If a broker assigns an **outrade** to their error account, the position may not be liquidated until 1) at least 10 minutes have elapsed since the time of the original execution **and** 2) the bracket period has changed. Therefore the broker must wait at least 10 minutes, and possibly as long as 15 minutes, after the original execution before liquidating the assigned position. However, an assignment trade may be liquidated during the post-close session regardless of when the outrade occurred. Profits or losses resulting from the offset of such assignments belong to the floor broker and any profits may be retained or disbursed to whomever they choose at their discretion.

In the case of an **unfilled or underfilled order**, the order must first be executed in the market and may be assigned only if the quantity executed in the market is at a worse price than the price to which the customer was entitled. In this case, the trade executed in the market and the assignment trade will offset each other at a loss in the broker's error account.

### **Recordkeeping Requirements**

Assignment trades must be clearly identified as a type "Z" trade on the trading documents used to record the trades for the broker's error account. Firms must keypunch the broker's assignment trade allocated to the broker's error account as order type "Z".

The circumstances surrounding the assignment trade must be documented in writing. Members may record the circumstances on the trading document used to record the assignment trade. Members recording the circumstances on another document must retain the document and must provide the document to Market Regulation upon request.

In accordance with Rule 536, trades that are not recorded contemporaneously due to an error or an outrade must be recorded on the member's next pre-printed, sequentially numbered trading card. If the trade is not recorded in sequence (and the member uses trading cards to record their trades), the member must cross out the pre-printed sequence number and write "9999" on the card. If a person other than the member records the trade, the person who records the trade must initial the card.

**Under no circumstances shall it be permissible for a floor broker to guarantee, directly or indirectly, the execution of an order, or any of its terms, except in the case of a bona fide error or mishandling.**

**No member firm may pressure a floor broker to improperly guarantee an execution or to resolve an outrade other than in accordance with Rule 527. Additionally, no member firm may refuse to accept a bona fide fill from a floor broker which results from the floor broker's resolution of an outrade in accordance with Rule 527.**

**Violations of Rule 527 may result in disciplinary action.**

Questions regarding this Advisory Notice may be directed to one of the following individuals in Market Regulation:

Erin Middleton, Senior Director, Rules & Regulatory Outreach, 312.341.3286

Barry Schauer, Trading Floor Investigations Specialist, 312.341.7640

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For media inquiries concerning this Advisory Notice, please contact CME Group Corporate Communications at 312.930.3434 or [news@cmegroup.com](mailto:news@cmegroup.com).

## **527. OUTTRADES, ERRORS AND MISHANDLING OF ORDERS**

### **527.A. Outtrades Discovered During a Regular Trading Hours Trading Session**

It shall be the duty of a member discovering an outtrade during a Regular Trading Hours session to immediately notify the opposite trader. Thereafter, if the matter cannot be resolved between the parties, they shall immediately determine who will cover the trade and the trade shall immediately be covered.

### **527.B. Outtrades Discovered After a Regular Trading Hours Trading Session**

A clearing member that is unable with diligent effort to resolve an outtrade with another clearing member shall notify the member who executed the trade. Such notice shall be given prior to the following day's Regular Trading Hours session in sufficient time to allow the member to make provisions for the resolution of the outtrade.

Outtrades discovered after a Regular Trading Hours session shall be resolved between the parties to the outtrade as provided in this rule, no later than the opening of trading of the next Regular Trading Hours session.

### **527.C. Outtrades Resolution**

To resolve an outtrade, the parties shall attempt to agree upon: (1) the reconciliation of any discrepancy in the terms of the trade, (2) which party will cover the trade and the method for covering the trade, if applicable, and (3) the apportionment of the financial results of the outtrade. In the event the parties are unable to agree on the apportionment of the financial results, the parties must nevertheless immediately reconcile the outtrade.

The price at the time of the open of the next Regular Trading Hours session shall fix the limit of liability as a result of the outtrade. Regardless of the ultimate determination of financial responsibility for the outtrade, a party who unreasonably refuses to cover the outtrade via an appropriate alternate market may be liable to the other party for the difference between the price at which the outtrade could have been covered in the alternate market and the price at the time of the open of the next Regular Trading Hours session.

Outtrades shall be resolved in accordance with the procedures below:

#### **1. Straight Out Customer Outtrades**

If a floor broker discovers that all or some portion of a customer order was executed but cannot be cleared, the broker shall either 1) re-execute the order in the market and adjust the customer by check if the re-execution price is worse than the original execution price, or, if the re-execution price is better than the original execution price, the customer is entitled to the better price or 2) assign the opposite side of the portion that cannot be cleared to their error account and assign a fill to the customer at the execution price. The floor broker shall not liquidate the assigned position until at least ten minutes have elapsed after the execution of the order giving rise to the outtrade and the bracket period in which the outtrade occurred has ended; however, these liquidation restrictions shall not apply to a liquidation during the post close session. Any profits or losses resulting from the liquidation of the assigned position belong to the floor broker and any such profits may be retained or disbursed at their discretion.

A floor broker who assigns the opposite side of an order pursuant to this rule shall: 1) clearly identify all such transactions by appropriate designation; 2) submit such trade information to their qualifying clearing member in sufficient time to enable the clearing member to submit the trade for the next intra-day reconciliation; 3) document in writing the circumstances surrounding any such transaction and promptly provide such documentation to the Market Regulation Department upon request; and 4) identify the subsequent liquidation of the assigned trade on the floor broker's trading card or other document.

#### **2. Price Outtrades**

When an outrade exists due to a price discrepancy, members making the trade may choose to resolve the discrepancy by electing either of the two prices in question, if they agree that the trade was executed at that price.

If an outrade involves a price discrepancy between a local and a broker, and the members cannot agree on the price of execution, the price recorded by the broker shall be used to clear the trade.

If an outrade between locals or an outrade between brokers involves a price discrepancy, and the members cannot agree on the price of execution, the buyer's price shall be used to clear the trade.

### 3. Quantity Outtrades

When an outrade exists due to a quantity discrepancy, members making the trade may choose to resolve the discrepancy by electing either of the two quantities in question, if they agree that the trade was executed for that quantity.

If an outrade between locals involves a quantity discrepancy and the members cannot agree on the quantity that was executed, the higher quantity shall be used to clear the trade.

A broker may assign the opposite side of any quantity which they believe that they have executed, but which cannot be cleared, to their error account, pursuant to Section 1 above.

### 4. Bona Fide Contract Month, Strike, Put vs. Call and Side of Market (Buy vs. Buy or Sell vs. Sell) Outtrades

When an outrade exists due to a contract month, strike price, side of market, or put/call discrepancy, and any party who executed a customer order believes that the order was executed in accordance with its instructions, the outrade may be resolved in any one of the following ways:

- a. The trade may be busted. If a broker re-executes their order, any losses incurred by the customer as a result of the delay in execution must be adjusted by check. If the order is executed at a more favorable price, the customer is entitled to the better price.
- b. The members making the trade(s) may agree to clear either trade or both trades in accordance with the members' recorded trade data.
- c. A broker may assign the opposite side of their order to their error account, pursuant to Section 1. above, and they may agree to the clearing of the transaction according to the terms of the other member's recorded trade data.
- d. If both members involved in the outrade are brokers, they may each assign the opposite side of their respective orders to their error accounts pursuant to Section 1. above.

A customer shall not be entitled to any portion of any profits realized by a local who was on the opposite side of an outrade between the local and the customer's broker, as a result of the local's liquidation of their position. Such profits belong to the local, and may be retained or disbursed at their discretion. If the local chooses to disburse any portion of such profits to the broker, and the broker's customer has received a fill in accordance with the broker's recorded trade data, the broker is not obligated to offer such profits to their customer.

Nothing herein shall in any way limit a member's right to submit an outrade to Exchange arbitration if the outrade cannot be resolved by agreement.

## **527.D. Errors and Mishandling of Orders**

If a broker overbuys or oversells for an order, the customer is not entitled to any of the quantity executed in excess of the order quantity. A position that has been established as a result of an erroneous execution or mishandling of an order must be placed in the error account of the broker or firm responsible for the error or order mishandling. Any profits resulting from the liquidation of trades placed in a broker's or firm's error account belong to the relevant broker or firm, and any such profits may be retained or disbursed at the broker's or firm's discretion.

### 1. Unfilled or Underfilled Orders

If a broker fails to execute an order or underbuys or undersells for an order, the broker shall do one of the following:

- a. Execute the order or the remainder of the order in the market and adjust the customer by check if

the customer is filled at a price less favorable than that to which they were entitled due to the broker's error or mishandling of the order. If the order is filled at a more favorable price, the customer is entitled to the better price.

- b. Execute the order or the remainder of the order in the market. If the order, or the remainder of the order, is filled at a worse price than that to which the customer was entitled but for the error or mishandling, the broker may allocate the fill to their error account, pursuant to Section C.1. above, provide the customer a fill at the price to which the customer was entitled, and place the opposite side of the customer fill into their error account. If the order is filled at a more favorable price, the customer is entitled to the better price.

## 2. Wrong Contract Month, Wrong Strike, or Wrong Commodity Executions

When an order has been executed in the wrong contract month, wrong strike price, or wrong commodity, and the erroneous transaction has been placed in the relevant broker's or firm's error account, the error may be corrected by one of the following:

- a. Execution of the order in accordance with its terms, with an adjustment to the customer by check if the order is executed at a worse price as a result of the error or mishandling of the order.
- b. Execution of a spread or combination transaction to execute the order and liquidate the position arising from the initial erroneous execution of the order, whereby one leg of the spread or combination transaction represents the correct execution of the order and the other leg offsets the erroneous position in the broker's or firm's error account. The broker or firm must clearly identify such transactions by appropriate designation, clearly document in writing the circumstances surrounding the nature of the error and promptly provide such documentation to the Market Regulation Department upon request.

## 3. Wrong Side of Market Executions

When an order has been executed on the wrong side of the market and the erroneous execution has been placed in the relevant broker's or firm's error account, the order shall be executed in accordance with its terms, with an adjustment to the customer by check if the order is executed at a worse price as a result of the error or mishandling of the order.