Order Management Guidelines

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Revised as of January 4, 2021

Tokyo Stock Exchange, Inc.

Osaka Exchange, Inc.

Japan Exchange Regulation

I. Purpose of These Guidelines

Tokyo Stock Exchange and Osaka Exchange (hereinafter the "Exchanges") enforced rules concerning order management systems at trading participants in 2006 with the aim of preventing trading participants from accepting or placing orders that contain errors (hereinafter "erroneous orders"), thereby securing confidence in the Exchanges and their trading participants and contributing to the public interest and investor protection. With these rules, the Exchanges have required trading participants to impose limits that prohibit the placement of orders in excess of a certain quantity or monetary amount (hereinafter "one-shot limit(s)")[1] and to thoroughly conduct risk management of order placement in accordance with the forms of trading at the trading participant.

Trading based on automated order placement by using an electronic data processing system continues to expand in the market. Given concerns over the impact on the market caused by a situation such as a malfunction in electronic data processing systems, we believe it is increasingly important for trading participants to establish effective order management systems.

With the April 2018 introduction of the registration regime, etc. for entities that conduct Low Latency Trading, the Exchanges have revised its rules to clarify that trading participants should implement certain restrictions on orders that they deem appropriate[23] in addition to their existing one-shot limits. This revision aims to prevent the placement of many small sliced orders that result in an excessively large combined quantity or monetary amount.

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[1] Rule 4, Paragraph 1, Items 1 and 2 of Rules Concerning Order Management Systems at Trading Participants

[2] Rule 4, Paragraph 1, Item 3 of Rules concerning Order Management Systems at Trading Participants

[3] For derivatives, there are provisions that stipulate that trading participants should conduct risk management deemed to be appropriate with respect to positions possibly arising from excessively large orders (Rule 5-5, Item 2 of Enforcement Rules of Regulations for Transaction Participants of Osaka Exchange).

Moreover, with increasingly complicated and sophisticated forms of trading that use such electronic data processing systems, trading participants are called upon to further enhance risk check functions to ensure their effectiveness. As such, the Exchanges require that, when a trading participant unexpectedly receives an irregular order due to a situation such as a system malfunction, they should immediately implement measures to prevent the placement of such order to the Exchanges.[4] At the same time, the Exchanges have determined to clarify in their rules that trading participants should have direct and exclusive risk management control over such restrictions and measures, including their existing one-shot limits.[5]

Trading participants are required to appropriately manage orders, regardless of whether or not they accept orders for Low Latency Trading, according to their business conditions, size, customer attributes, etc.[6]

These guidelines lay out points of attention for order management and examples of order management methods that are deemed to be appropriate particularly for trading participants to prevent the placement of excessively large orders or creation of positions. These examples should not, however, hamper the adoption of other management methods that are sufficient for conducting appropriate order management suitable for the purpose of these guidelines. Concerning matters other than those related to order management specified in these guidelines, trading participants are expected to establish appropriate management systems based on the purpose of these guidelines.

We hope these guidelines will aid trading participants in developing effective systems for order placement management.

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4 Rule 4, Paragraph 1, Item 4 of Rules concerning Order Management Systems at Trading Participants

5 Rule 4, Paragraph 2 of Rules Concerning Order Management Systems at Trading Participants

6 The Exchanges and Japan Exchange Regulation (JPX-R) may verify the adequacy of order management conducted by trading participants in examinations, etc. by JPX-R.

II. Order Management Required at Trading Participants

1. Related to Rule 4, Paragraph 1, Items 1 and 2

Trading participants are required to implement one-shot limits on all orders in accordance with Rule 4, Paragraph 1, Items 1 and 2 of "Rules concerning Order Management Systems at Trading Participants".

2. Related to Rule 4, Paragraph 1, Item 3

(1) Automated Trading (including Low Latency Trading)

In automated trading, an accumulation of small, sliced orders across a short time span, for example, caused by a malfunction in order placement systems (including systems of customers; hereinafter the same) may result in erroneous order placement that cannot be prevented with existing one-shot limits. Thus, when accepting automated order placement via direct market access (DMA) or the like, many trading participants generally impose further limits on order placement by setting thresholds other than the one-shot limits for customers.

Below are examples of such additional limits. Trading participants should appropriately determine which management method to adopt based on their own situations. Combinations of multiple methods may also be considered.

① Limits to cumulative positions, etc.

In order to prevent customers from creating excessively large positions that do not align with their characteristics, set certain limits on cumulative positions, etc.[7] and prevent the placement of orders in excess of such limits.

② Limits to the number or monetary amount of orders across a certain time span

Prevent the placement of orders whose number or monetary amount exceed certain threshold values across a certain time span (e.g., for a period of milliseconds, seconds, or minutes)

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[7] Cumulative positions can be managed based on net positions obtained by netting out short and long positions or based on gross positions of short and long positions.

Reference: Notes on order management

○ Completeness of limits set for order placement

Effective order limits are required to be set to all accounts that handle automated trading. Trading participants are also required to regularly verify the coverage and adequacy of the order limits.

○ Process of setting and changing order limits

Trading participants are required to set and change order limits based on their internal rules, etc. via their official internal approval processes.

○ Monitoring system

It is desirable that trading participants should establish a monitoring system that enables them to immediately detect excessively large orders or positions by means such as installing alert functions in systems.[8]

○ Order management methods that involve deliberate placement, etc. of erroneous orders

Trading participants are required to appropriately handle, in their systems, customer orders that breach their order limits to avoid unnecessary stress on the Exchanges systems, and by extension any impact on market stability.

For example, the following order placement restrictions are not appropriate:

(a) A management method that is based on a trading participant placing orders to the Exchanges after deliberately modifying the order parameters to those that will obviously be rejected as an error (e.g., setting the order quantity to zero, setting the order price outside the daily price limits) by the Exchanges systems (i.e., Malformed Order).

(b) A management method that is based on a trading participant overwriting order messages into incorrect formats to make them invalid (i.e., Malformed Packet).

[8] For monitoring in position risk management, the frequency of detections may change depending on the positions managed and characteristics of thresholds (i.e., whether a position is for a specific market or product, or cross-market, etc.; or whether thresholds are static values such as certain quantities or monetary amounts, etc. or dynamic values that change depending on risk assessment, etc.)

(2) Online Trading

Trading participants that handle online trading generally adopt the "advance deposit system" where trading participants accept orders within the scope of money and securities that customers have deposited or the "evaluation system of deposited assets", a mechanism to set limits to the quantity of orders that customers can place based on the amount of money or the securities valuations that the customers have deposited. In these cases, if the scope of money and/or securities deposited by each customer is set as the order limit in the order placement systems that are used by the customers then the order management can be considered to be effective.

(3) Face-to-face Transactions, Call Center Transactions, etc.

Trading based on orders that are accepted face-to-face or over the phone via call center, etc. but not processed by an automated order placement system is considered low risk compared to automated trading. Thus, trading participants can conduct order management according to such risks. For instance, when accepting orders from customers, if the sales representative or relevant staff is able to determine the maximum quantity or monetary amount of orders after checking the customers' financial resources, etc., then the order management can be considered to be effective.

Reference: Notes on order management

○ Process of setting the maximum monetary amount of orders that can be accepted

To prevent excessively large monetary amounts from being set as order limits, trading participants are required to appropriately set the maximum monetary amount under their official internal approval process. Before changing the amount (including special approval), trading participants are also required to check their customers' financial resources and trading activities, etc. at the time.[9]

(4) Proprietary Trading[10]

When trading participants conduct proprietary trading, there are in general order limits (e.g., position or risk tolerance) in place for each trader, and trading

9 Reference: Rule 4 of "Rules concerning Order Management Systems at Trading Participants"

10 Excluding trading described in (1) above.

is conducted within such order limits. In these cases, if said order limits are set on the system with a function to block erroneous order placement, then the order management can be considered to be effective.

3. Related to Rule 4, Paragraph 1, Item 4

In the event of a malfunction, etc. of the order placement system, there is a possibility that a series of irregular orders might be unexpectedly placed. In this case, trading participants are required to immediately implement measures to prevent such irregular orders from being placed to the Exchanges.

If measures referred to in Rule 4, Paragraph 1, Item 4 are deemed adequate in light of each trading participant's risk management policy, such measures can be substituted by the risk management functions provided by the Exchanges. However, this does not hamper the implementation of additional measures by trading participants according to their business conditions, size, customer attributes, etc.

In consideration of the characteristics of Low Latency Trading, trading participants that accept orders for Low Latency Trading have been required to implement further detailed measures against Low Latency Trading since November 2018[11]. Notwithstanding the provisions of Rule 4, Paragraph 1, Item 4, trading participants continue to be required to implement such measures.

4. Related to Rule 4, Paragraph 2

Trading participants are required to implement restrictions or measures referred to in each item of Rule 4, Paragraph 1 with direct and exclusive risk management control over customer orders.

The term "direct and exclusive" refers to situations where only the trading participant can conduct management of the restrictions and measures referred to in each item of Rule 4, Paragraph 1 (e.g., setting and modifying risk parameters for order limits) and its customers cannot alter such the settings. Specific methods could be, for example, where the trading participant uses systems that are independently developed by themselves and located in a place physically separated from those of its customers. Also, as long as the trading participant has direct and exclusive control, they can use risk check solutions

[11] Cancellation of placed orders, etc. For details, refer to Appendix 3 "Checklist for Trading Participants Accepting Low-Latency Trading Orders on the Tokyo Stock Exchange" of "Inspection of Low-Latency Trading Management" dated November 26, 2018 and "Checklist for Trading Participants Accepting Low-Latency Trading Orders on the Osaka Exchange" of "Introduction of J-GATE Checklist Pertaining to Management System of Trading Participants Accepting Low-Latency Trading Orders, etc." dated March 29, 2019.

provided by third parties (i.e., vendors and the Exchanges, etc.). If the trading participant uses a risk check solution provided by a third-party vendor, the third-party vendor is required to be independent from the trading participant's customers.

Reference: Notes on order management

○ Indirect order management using software

For example, if software equipped with risk check functions required by the trading participant is installed on a system managed by its customer, and the trading participant confirms that the settings and parameters are not changed (including cases where the customer has entered into a contract, etc. in advance not to change the settings and parameters), such a case is considered as indirect control, not direct and exclusive control.

○ Acceptance of orders from affiliate companies of the trading participant

Concerning trading based on orders that trading participants accept from their overseas affiliate companies, if trading participants have established systems to appropriately implement restrictions and measures referred to in each item of Rule 4, Paragraph 1 for orders from overseas affiliate companies, trading participants are not required to manage such orders in a location that is physically separated from said affiliate companies.

5. Other notes

Trading participants are asked to understand their own trading status, etc. along with changes to their business models, properly check whether their order management is appropriate, and review their order management system as needed.

FAQ on Introduction of Market Access Rules, etc.

Tokyo Stock Exchange, Inc.
Osaka Exchange, Inc.

* This FAQ is prepared to facilitate understanding of matters on which many inquiries are received. Some answers have been prepared with a focus on simplicity. For more details, please also see the related laws and regulations as well as exchange rules.

FAQ: Table of Contents

1. "Direct and Exclusive Risk Management Control"

Q1-1
If a trading participant accepts orders from overseas affiliate companies, is it required to manage such orders in a location that is physically separated from the affiliate companies?

Concerning trading based on orders that trading participants accept from their overseas affiliate companies, if the trading participant has systems that appropriately implement restrictions and measures referred to in each item of Rule 4, Paragraph 1, it is not necessary to conduct order management in a location that is physically separated from the affiliate companies. Please note that if such an affiliate company accepts orders from its customers, restrictions and measures for orders from those customers must also be subject to the direct and exclusive risk management control of the trading participant.

Q1-2
Are trading participants not required to have direct and exclusive risk management control over risk check items they specify on their own, other than those required by the Exchange rules?

Trading participants are not required to have direct and exclusive risk management control over risk check items they specify on their own. Still, considering the possible risks associated with indirect order management, trading participants are expected to implement appropriate measures for risk check items they specify on their own, such as by managing orders using hardware in a location that is physically separated from the customers.

Q1-3
If a trading participant has a swap contract with a Low Latency Trader, is said trading participant also required to have direct and exclusive risk management control over orders that are placed based on the contract?

Concerning order placement based on a swap contract with customers, orders entrusted by the customers are substantially considered as those placed on the trading participant's proprietary account. Thus, such orders must be subject to direct and exclusive risk management control in the same way as with ordinary entrusted orders.

Q1-4
What should we take note of if we use risk management functions provided by a third-party vendor?

If a trading participant uses risk management functions provided by a third-party vendor, the vendor is required to be independent from the trading participant's customers, and the trading participant is required to have direct and exclusive risk management control over its use of the functions. In order to determine the vendor's level of independence from the trading participant's customers, matters such as relationships between the customers and the vendor, including capital relationships and personnel relationships, will be comprehensively assessed on a case-by-case basis.

2. Requirements to Introduce Functions to Prevent Order Placement

Q2-1
What kind of situations does "if an irregular order is unexpectedly placed, etc. due to a situation such as an order placement system malfunction" refer to?

For instance, unintended orders may be placed repeatedly and continuously due to abnormal operations of a customer's algorithm. Trading participants should appropriately determine the specific requirements for triggering the functions to prevent order placement, as well as the scope of the functions, based on aspects such as customer attributes and forms of trading.

Q2-2
What orders are subject to the order placement prevention functions?

All new order placement at the Exchanges (including changing orders) must be subject to the functions. Orders placed to cancel existing orders are not subject to the functions.

Q2-3
Is there any problem if we adopt manual triggering for the order placement prevention functions?

Regarding the method of triggering the order placement prevention functions, trading participants can decide on the appropriate method according to customer attributes and forms of trading by customers. The functions do not need to be automated. Please note that internal systems such as the criteria and procedures for the triggering of the functions are still needed, regardless of whether manual triggering is adopted.

Q2-4
Is it sufficient if we only use the risk management functions provided by the Exchanges such as kill-switch for arrowhead?

Trading participants can choose to use only the risk management functions provided by the Exchanges if they determine that such use is sufficient based on their risk management approach. Please note, however, that trading participants shall use the risk management functions provided by the Exchanges at their own responsibility in the same way as with their use of risk management functions provided by third-party vendors.

Q2-5
If we accept Low Latency Trading orders, is it correct to understand that no additional measure is required if we have introduced the kill-switch[12] function based on the checklist?

Securities companies who accept orders for Low Latency Trading from Low Latency Traders are not required to introduce functions to prevent order placement other than the kill-switch based on the checklist as a measure for managing orders from Low Latency Traders. However, measures are separately required if there is no function to prevent order placement from customers that are not Low Latency Traders.

12 Refer to Appendix 3 "Checklist for Trading Participants Accepting Low-Latency Trading Orders on the Tokyo Stock Exchange" of "Inspection of Low-Latency Trading Management" dated November 26, 2018 and "Checklist for Trading Participants Accepting Low-Latency Trading Orders on the Osaka Exchange" of "Introduction of J-GATE Checklist Pertaining to Management System of Trading Participants Accepting Low-Latency Trading Orders, etc." dated March 29, 2019.

3. Prohibition of Order Management Methods That Involve Deliberate Placement of Erroneous Orders, etc.

Q3-1 What is the purpose of prohibiting order management methods that involve deliberate placement of erroneous and such orders?

The purpose is to avoid unnecessary stress on the Exchanges systems and impact on the stability of the market due to the deliberate placement of erroneous orders, etc. In line with this purpose, a trading participant is required to establish systems that enable effective management and control, such as automatically preventing the order or disconnecting the line immediately if it receives an order that breaches the order limits, etc.

Q3-2 Will the order management method be deemed inappropriate if there are orders that result in errors, such as those in violation of the short selling price restrictions?

Order placement methods that are deemed inappropriate are limited to cases where apparent motives can be identified, such as where there are programs installed at trading participants systems to generate errors. Thus, this does not include cases where there are orders that end up resulting in errors, such as those in violation of the short selling price restrictions or transactions immediately after the initial price of an IPO is determined.

4. Other Matters

Q4-1 How do you check whether the order management system required by the Exchanges rules has been appropriately established?

The order management systems of trading participants will be checked in the course of regular inspections by JPX-R.