ERCC: best practice recommendations for error trade cancellations
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This document outlines proposed best practices that have been prepared on the basis of ERCC member feedback and agreed by the ERCC Committee. We would welcome further feedback from market participants and relevant infrastructure providers. Please send your comments or questions to ercc@icmagroup.org*.*

1   From time to time, a party to a transaction executed on an automatic trading system (ATS) --- which means an electronic platform operating a central limit order book (CLOB) --- requests that transaction to be cancelled on the grounds that the transaction in question was executed in error. The operating of the ATS may, at its discretion, agree to pass on that request to the party on the other side of the transaction.

2   **Cancellations should be exceptional**. Automatic trading systems (ATS), particularly those connected to CCPs, are infrastructures at the core of the European repo market. They are essential to the efficient reallocation of cash and collateral surpluses and deficits between dealers, and therefore to price discovery and market liquidity. Erroneous trades distort price discovery. On the other hand, error trade cancellations raise numerous problems. They are manual interventions and therefore represent an inherent contradiction to automatic trading. They have the potential to disrupt the clearing of ATS transactions. As ATS, particularly those connected to CCPs, operate in the most liquid repo markets, best practice would be for a party in error to immediately execute an opposite trade (this procedure should also be followed for error trades that settle same-day --- see paragraph 12). Trade cancellations should be permitted only in exceptional circumstances.

3   **Regulatory risks**. The cancellation of transactions undermines the reliability of the price or volume information published by an ATS. It is also possible that cancellation could be used to manipulate the market. Parties should therefore be aware cancellations may pose regulatory risks.

4   **Operator controls**. Operators of ATS should have controls in place to identify quotes and orders that appear to be anomalous and check with the inputting party in order to prevent error trades arising. It might be appropriate for the operator to alert other users to a check.

5   **User controls**. Users should endeavour to prevent error trades arising by putting in place controls to screen and update the orders they post to ATS. In addition, in line with their regulatory obligations, users should also ensure that trading staff, particularly inexperienced staff, are adequately trained and supervised.

6   **Economic materiality**. The cancellation of an ATS trade exposes the party or parties on the other side of the transaction to unexpected risk. It could require replacement or hedging transactions to be executed at less advantageous prices. There are also significant operational costs to the counterparties and the operator. Where cancelled trades are relatively small and/or very short-term, the cost-benefit ratio is unlikely not justify the cancellation. Operators of ATS should only consider, and users of ATS should only request, a trade cancellation where the underlying error is economically material.

7 **Manifest error**. The cancellation of transactions executed on an ATS should be allowed only (if at all) where there is an error caused by incorrect execution rather than a poor trading decision. An example of incorrect execution would be unintentionally entering too many zeroes and inputting an order of a size that could disrupt the market.

8 **Justifying a cancellation request**. Parties requesting the cancellation of a transaction executed on an ATS should explain clearly the nature of the error behind their request to cancel a transaction.

9 **User policies and procedures to request a cancellation**. Parties should expressly document whether or not their dealers will be permitted to request the cancellation of a transaction executed on an ATS and under what circumstances as well as the procedures to be followed. Procedures should include a requirement for the written approval of a line manager of suitable seniority and the recording of the steps taken.

10 **User policies and procedures to consider a cancellation request**. Parties should expressly document whether or not they will consider a request from a counterparty for the cancellation of a transaction executed on an ATS from the other party and under what circumstances. Agreement to cancel a transaction should have the written approval of a line manager of suitable seniority and the steps taken should be recorded.

11 **Transparency of operator procedures for assessing a cancellation request**. Where an ATS operator will consider requests to cancel a transaction, the procedures to assess whether the transaction concerned is indeed a manifest error (for example, by seeking indications of the market level from a panel of active users) should be clearly explained in the rules of the operator.

12 **Deadline for cancellation requests**. Transactions must be cancelled before the purchase date, which means that overnight repos and repos with a purchase leg settling same-day cannot be cancelled. Instead, repos settling same-day would have to be paired off by agreeing an equal and opposite transaction with the other party or parties. In order to assist the ATS operator and counterparties to assess whether a transaction for which a cancellation has been requested is indeed an error, and not just a consequence of market volatility or illiquidity, requests for cancellation should be made as quickly as possible after the trade. Operators may wish to impose deadlines.

13 **Anonymity**. It is _not_ recommended that operators of ATS linked to CCPs and offering anonymous trading reveal the name of parties requesting the cancellation of transactions as this would undermine the principle of anonymity and potentially reveal the trading strategies of the parties to each other.

14 **Compensation**. ATS operators have the right to charge a fee for considering and arranging the cancellation of a trade which should be shared with the party or parties on the other side of the trade. Compensation should reflect the cost of cancellation to the operator and counterparty or counterparties.

15 **Confirmation**. Cancellations should be promptly confirmed by both parties.

16 **Monitoring cancellations**. ATS operators should monitor requests for the cancellation of transactions, promptly investigate any suspicious patterns of behaviour and report to the regulator.

17 **Transparency of cancellations**. The cancellation of a transaction (including pairing off repos with purchase legs settling same-day with equal and opposite repos) should be highlighted by the ATS operator to other users as soon as possible, preferably using a flash message on screen, and removed from the record of published market data in order to maintain the integrity of that data and any derived information such as indices.