

THE PRINCIPLED TRADER INSTITUTE

A Principled Trader's *Mindset*

ISSUE NO. 06 —
A PATTERN WORTH RECOGNIZING EARLY

Notes on judgment, integrity, and the long game of a trading career — for aspiring commodity traders.

A Pattern Worth Recognizing Early

A Principled Trader's Mindset — Issue 6

Two issues ago, the point was that the prices a trader lives by are assessed, not found. Last issue, that any process built from inputs can be fed an input chosen to steer it, and that the features of such an input tell you where to look harder, not what someone did. This issue sets both ideas beside one real, finished case, in a market many readers of this column are preparing to trade.

The number TAS contracts lean on. In 2007, the daily settlement prices of NYMEX crude oil, New York Harbor heating oil and New York Harbor gasoline futures were set from the volume-weighted average price of trades in a two-minute closing window, 2:28 to 2:30 p.m. Trading at Settlement contracts, known as TAS, were priced directly off that number: they let two parties agree to deal at whatever the day's settlement turns out to be, plus or minus a fixed differential. That is useful and ordinary. It also means anyone holding a large TAS position has a direct interest in where two minutes of trading lands.

What the regulator alleged. In July 2008 the US Commodity Futures Trading Commission sued Optiver Holding BV, a Netherlands-based proprietary trading firm, together with two of its subsidiaries and three individuals. The CFTC alleged that on 11 trading days in March 2007 the firm built large TAS positions, then traded heavily in the opposite direction in the futures market shortly before and during the close, to push the settlement price its way: 19 attempts, at least five of them successful, for about $1 million in profit. The CFTC described this as "banging" or "marking" the close. It further alleged that when the exchange began an inquiry, false statements were made to its compliance officials to conceal the scheme.

Set that against last issue's list. On the CFTC's account, the features were all there: activity concentrated in the final minutes of the window, sized to matter against it, placed by a party with an obvious stake in where the print landed.

Now the part a discerning reader holds onto. The CFTC's case ended in April 2012 with a consent order in federal court: a $13 million civil penalty, $1 million in disgorgement, a two-year restriction on the US subsidiary trading those contracts around the close, and trading bans on the three individuals. The defendants neither admitted nor denied the allegations, and the order contains no court finding that the alleged manipulation occurred. So what is established is the settlement and its terms. What happened in March 2007 is what the CFTC alleged. This Institute's curriculum puts the distinction in five words: a settlement is not a verdict.

Who noticed, and how. By the CFTC's own account, NYMEX's proactive surveillance program detected the trading. The exchange opened an inquiry, its own investigation gave the CFTC important information, and its surveillance contributed to the activity stopping. That is what recognizing early looks like inside a market: proactive monitoring of how the number is formed, and questions asked through a formal process, not a suspicion attached to a name. The concealment allegation is the other half of the lesson. The CFTC charged the alleged false statements as a violation in their own right, separate from the trading: how a question is answered carries its own weight.

The features alleged here are ones a trader who understands a settlement window can learn to recognize. Recognizing them is not an accusation. It is knowing your market well enough to notice when a number may be leaned on, and being straight with the people whose job is to ask.

A question worth carrying onto the desk: if you hold a position priced off today's close, do you know exactly how that close is set, and would the way you trade into it stand up to an honest question?

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