

Conduct Rules Scenarios

The Rogue Algorithm

Scenario

Alice is a Certification Employee (“Algorithmic trading”). She is responsible for the development and deployment of algorithms for Super Broker Ltd.

Alice’s algorithm has been in deployment for 18 months when she realises that there is an error in the way in which it executes transactions on behalf of clients. Essentially, the error is that time zone differences have not been factored in properly during the order execution process. As a result, client orders have not been executed in a timely manner.

Looking back over the last 18 months, Alice estimates that clients have lost approximately £2 million pounds as a result. Six months ago, Alice’s algorithm was subject to review by both the Compliance Department and Internal Audit. Neither function noticed the error embedded deep within the code of the algorithm.

Super Broker Ltd collected commission on all of the orders placed in the normal course of business.

It is 2 months until bonus time. Alice corrects the algorithm but decides to ‘let sleeping dogs lie’ as far as the historical problems with the algorithm are concerned.

What conduct rules may have been breached? Why?

How should the firm respond?

What controls could have been implemented?