rewarded. However, the official reports must stand based on broadly accepted principles and practices, even if (at first) it shows a worse P&L compared to the traders' proprietary models etc.

17.3.2 Deal Breakers

The markets generally operate with at least a little "honour", and reasonably reliable technology. There are a variety of legitimate reasons why (apparently) good deals should be "broken", "reversed", or otherwise "undone". Deals transacted by unauthorised counterparties will be in this category.

However, a "bad deal" may arise between authorised counterparties. Roughly speaking, any deal that is considered to have been transacted at a "bad price" due to some "event" (man-made or otherwise) will be/can be reviewed and "broken" if deemed a "bad deal". Unexpected technical events, or unexpected results due to "man/machine interaction" (e.g. the "flash crash") will be subject for review.

Deals intentionally enacted with the view to or as a result of manipulated prices will not only be broken, but also those at the cause may face some consequences, even criminal prosecution.

There are rough guides for deciding the condition for bad deals. They often involve comparing the price of the deal to prices that could have been reasonably expected under the given circumstances. If a market normally trades in the range 91 – 97, and you get a bid filled at 11, it will raise some eyebrows, especially if that was the only (or one of a few) deal(s) at that price, and then everything reverted to the 91 – 97 range, and there was not some obvious "market/economic" event to be seen as a reasonable cause.

Some such circumstances are a little controversial. For example, suppose you place a bid below at 11, with the current market at 91 – 97, and this is on an electronic order system. The principle *modus operandi* of electronic systems is to "match orders", so there will be bids below, and offers above, each with a stated size. Now, suppose the market is 91 bid at 97 100-up (i.e. there are two counterparties one wishing to pay 91 for 100 contracts, and another counterparty wishing to sell 100 contracts at 97). In the real world, there may well be other bids further below, and offers further above. However, for simplicity, imagine that these are the only two "immediate" bids/offers, and there is one other entry of 11 bid for 200 (way) below. Now, suppose that a new trader places an "at market" order to sell 200 contracts. This means that the trader is willing to receive whatever the market is willing pay. The first step is that bid at 91 for 100 "gets hit", and ½ of the "at market" order is filled. Now, as the next bid is way below at 11, the system simply does what it has been told to do, and fills the remaining 100 contracts of the "at market" order by hitting the (next) bid at 11.

There has been no particular economic/market event; it is simply a "thin" market. Should this deal be broken? On the one hand the trader placing the "at market" order may claim they had acted "carelessly", but still the trade should be broken. The buyer paying 11 might say, that seller was so keen to sell his contracts that he used an "at market" order, meaning he was willing to "get anything" for his contracts, so "tough bananas". Who is right?

The answer is: it depends. There have been slight variations of this exact scenario. In one instance the deal was broken, in another instance it was not.

> Aside: Two (of many) certainties in trading are: At some points in your career you will act stupidly. This is counted as "two certainties", due to its importance. For example, one bit of "stupidity" all traders eventually make is bidding when they should be offering, or vice versa. Another certainty is that you should deal with the mistake immediately. Do not lie about it; don't try to hide the trade, etc. It is a certainty that will make things worse.

Deal breaking is a somewhat "easier/more sensible" process in listed markets since all trades are supervised by a single entity (the exchange), and they have (legally) the "last word".

The situation can be somewhat more complicated in the OTC world. Here, the usual procedure is for the counterparties to attempt reconciliation ("pull the tapes", have some discussions, etc.). However, it can end up in court. For professional trading houses, court is almost always a "bad thing", even if they win. The bad press during deliberations can cost considerably in terms of loss of business just because of the "bad press". Moreover, if one counterparty is a trading firm, and the other is, say, a corporate, then the courts can have a tendency to see the dealer as "experts" and "too clever", while viewing the corporate as the "innocent/inexperienced" client duped by the "experts". For example, in a famous case between Bankers Trust and Procter & Gamble (P&G), where P&G had "lost their shirt" on some complex derivatives, the courts found in favour of P&G. However, there is some evidence to suggest that P&G had in fact employed "fierce traders", who may have known exactly what they were doing, but simple took a big "punt" that went wrong (and possibly trading beyond their mandate). The courts often take the usual KYC[508] position that as a dealer you must be able to show that you took every reasonable measure to ensure that the client was entering into "appropriate risk" and that they had clear understanding of the risks.

[508] KYC: Know Your Client. This is a concept heavily emphasised for professional accreditation, especially for "RR" (Registered Representative status). If you don't know what this is, do yourself a favour and complete your RR at your earliest convenience (hopefully your employer will pay for it).