AUTORITÉ DES MARCHÉS FINANCIERS

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A stop loss order does not give investors control over the execution price

Investors should be fully aware of the characteristics of the orders they choose. Choosing orders without clearly understanding the difference will lead to frustration, especially with stop loss orders, which are executed without a price limit. In the "stop" order category, it is only with "stop limit" orders that investors can control the price. Mixing up these two order types may have costly consequences for investors, as this mediation case shows.

The facts

On 19 January 2021, Mr G placed two sell orders for a closing auction security on Euronext Paris, shortly before the start of the preparation of the closing auction.

The characteristics of the orders were as follows:

- 1st stop loss order:
  - 100 shares;
  - Trigger limit set at €12.03.
- 2nd stop loss order set at
  - 150 shares;

- Trigger limit set at €11.98.

The closing auction for the previous day had been €12.05.

However, Mr G noted that his two orders had been executed at €11.42 when, in his opinion, the trigger thresholds had not been reached.

Mr G also felt that his financial service provider had executed orders that did not match the characteristics he had defined. In particular, he felt that the institution had neither complied with its best-execution obligations nor the rules on order execution priority.

Following his complaint, the institution's securities department sent him a rebuttal letter, first, summarising the characteristics of the orders placed and, second, providing details of the opening price of the security and the execution price of the two disputed positions.

This was when Mr G asked me to intervene.

Feeling that he had suffered a loss through a fault attributable to the institution, Mr G requested a refund of the difference between the limits he considered he had set and the price at which his order was executed.

The investigation

As part of the investigation of this case, I contacted the institution in question, which provided me with its observations.

First of all, the institution told me that since the disputed orders had been placed at the client's own initiative, they were executed as part of the reception and transmission of orders (RTO) service, which does not include the provision of investment advisory services. Moreover, Mr G had decided not to define his investor profile, by refusing to answer the traditional questionnaire provided for by law. Consequently, in accordance with the legal obligations in this case, he systematically received a warning notice when his orders were entered.

Secondly, the institution confirmed the characteristics of the disputed orders. These were indeed stop loss orders, with no lower limit for execution since the client had not entered a range with a limit. Moreover, this security had the specific characteristic of being a closing auction security. The last auction on 18 January 2021 was €12.05. The sell orders were

received on 19 January 2021 and accepted in the central order book because the threshold limits set by Mr G were lower than the last quoted price.

The financial service provider pointed out that the rationale applied is that of a market sell order without limit if the price falls below the limit defined.

It explained that on the trading day of 19 January 2021, the opening auction was at €11.34. The triggers were therefore activated and orders were automatically placed "at the market" for the next auction. The second auction for the day was at €11.42, so the orders were executed at this price.

Lastly, the service provider pointed out that if Mr G did not want his order to be executed below €12.03 and €11.98, then he had not used the right order type.

Recommendation

With regard to the nature of the order, I noted that the choice of orders placed and the characteristics defined by Mr G were clear. It should be noted that the stop loss order chosen by Mr G, is admissible during the periods of accumulation of orders prior to an auction. It can legitimately be entered into the book if the last traded price or the auction price is less than or equal to the trigger threshold, which is what happened in this case.

It must be remembered that stop orders have a limit above which they become "market" orders. Indeed, when the limit set by the investor is reached, the order is automatically activated and transformed into a "market" order. This type of order therefore ensures maximum execution of the purchase or sale but does not allow for a control of the price. In this mediation case, it became apparent to me that there was a mix-up - which I frequently observe among investors - between the notion of "stop limit" and "stop loss". To control the cost of the transaction, Mr G. should have chosen a "stop limit order" or even a "limit order" instead of a "stop loss order".

The distinctive feature of the stop loss order is that when the price hits a "limit", the order is then executed as a market order, i.e. without a limit price and, in addition, becomes a priority order. In the case of a sell order, the investor sells only when the market falls below the limit that it has set. It should be noted that in the event of high volatility and significant market movements, investors run the risk of seeing their sell order executed at a level well below the limit they have defined.

It is only in the case of a stop limit order that the investor sets a second limit in addition to the trigger limit. When this limit is hit, it is triggered as a "limit price" order and can

therefore be partially executed. With this order, the cost of the transaction can be controlled. However, after the limit has been reached, the order is executed at the limit price and is therefore not a priority order.

Given that the very nature of the sell orders placed was not in question and given the documents produced, which confirmed that they were indeed two orders with a trigger point set at €12.03 and €11.98, I did not consider that there was any discrepancy or failure in the execution of the disputed orders at the price of €11.42, and consequently the financial service provider could not be held responsible.

Lessons to be learned

Firstly, investors must regularly ensure that they clearly understand the specifications of the orders they choose, particularly where there are priority orders and no price control.

A stop loss order is first and foremost a way of protecting oneself against a possible market reversal, by limiting losses or ensuring a minimum return, but it does not allow the investor to control the price.

If, for example, the investor owns shares and expects the price to rise, but instead the price falls, it is possible to place a stop loss order at a price below the acquisition price to mitigate the loss. This is because the share will be sold as soon as prices fall to or above this level. Although the investor will suffer a loss, this will be limited.

However, it is also important not to set a price that is too close to the current price, in order to avoid unwanted buying or selling at the slightest jolt in the stock market.

The stop loss order offers the investor a significant additional guarantee: it contains an additional limit below (for sell orders) or above (for buy orders) which the order will not be executed.

Investors should also take into account the specific characteristics of a security, such as the type of quotation, whether continuous or by auction.

FOCUS on continuous trading and auctions

Continuous trading makes it possible to determine prices throughout a trading session, so long as this is permitted by market conditions (see price reservation assumptions). In this case, securities are traded though continuous matching of orders

at opposite sides of the central order book. This quotation method is reserved in particular for liquid instruments.[1]

Conversely, quotations may be made through call auction procedures, i.e. the general matching of orders after a period of accumulation without execution. This type of listing is reserved for less liquid instruments (2,500 transactions per day) and based on other objective criteria. For example, Euronext Paris organises call auctions on the regulated markets at 11.30 am and 4.30 pm. The method of calculating trading prices through auctions makes it possible to determine the price that will produce the maximum executable volumes based on all the orders that have accumulated in between two auctions.

Note: there are also auctions during the opening and closing phases of continuous trading sessions and when the quotation is resumed after a reservation. Investors must therefore be vigilant about the risk of a gap at opening, when there is a significant difference between the last known price and the resumption price.

[1] Euronext harmonised Rule Book, point 4301: The allocation of Equity Securities between continuous and auction mode trading shall be determined by the Relevant Euronext Market Undertaking on the basis of objective criteria including (without limitation) historical and expected trading volumes, the inclusion in a Euronext or other internationally recognised index and the presence of Liquidity Providers and Market Makers.

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