

Melissa D. Jurgens, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
United States
www.cftc.gov

Chris Barnard
Germany

29 January 2014

- **17 CFR Chapter I**
- **RIN Number 3038-AD52**
- **Concept Release on Risk Controls and System Safeguards for Automated Trading Environments**

Dear Ms. Jurgens.

Thank you for giving us the opportunity to comment on your Concept Release on Risk Controls and System Safeguards for Automated Trading Environments.

This Concept Release raises a debate concerning the regulatory approaches we need to promote to cater for the impact of technological change and automated trading on markets. I agree that traditional risk controls and safeguards that relied on human judgment and speeds, and which were appropriate to manual and/or floor-based trading environments, must be reevaluated in light of new market structures. Most regulators have been slow so far to react to the rapid technological developments in financial markets, including their facilitation of algorithmic trading and high frequency trading. This is something we have to work on in order to improve market integrity and transparency and maintain confidence in markets. I will make some specific comments on high frequency trading here.

High frequency trading¹

The recent history of high frequency trading (HFT) is one of technological developments driving market practices and operations, and influencing the behaviour of market participants. This has both positive and negative implications. My view is that technology should not solely determine market practice, but that regulators should determine market rules that define

¹ HFT is really a subset of algorithmic trading generally.

acceptable practices and boundaries in the context of market integrity and efficiency, and that technology should operate within these acceptable practices and boundaries.

HFT has received a lot of bad press recently, some of it well-deserved.² However, we must be careful to act discriminately here, and recognise that HFT may bring some benefits to market efficiency, as well as detrimental costs.³ For example, HFT can affect liquidity, spreads, volatility and the price discovery process, and we need to ensure that the positive effects outweigh the negative effects.

Certain strategies, for example momentum ignition and spoofing, are or should be illegal, and therefore should be prohibited under general antidisruptive practices rules. Flash orders clearly create a two-tiered market, in which certain investors have access to information which allows them to trade unfairly. This is not dissimilar to front running, and the practice should be prohibited.⁴ Certain other practices, such as order anticipation are parasitic in nature.⁵ They do not add liquidity or aid the price discovery process, they involve no investment or hedging component, rather speculation, and in my opinion should also be prohibited. For completeness here I would suggest that all market regulators should undertake a principles-based review of these kinds of harmful, manipulative or disruptive practices, consistently across markets and regions, and propose rules and guidance thereon where appropriate.

I would recommend that you should consider one regulatory principle, which would reduce the negative impacts of HFT, whilst allowing reasonable algorithmic trading in financial markets to continue. I would recommend that you should consider mandating minimum resting times⁶ for orders submitted to order books, which should vary by market type and asset class. Minimum resting times of between 1 and 10 seconds may be appropriate. This could result in marginally wider spreads, but should also improve real liquidity in the market, whilst reducing overall the most harmful effects of HFT.

² For example see Rise of the machines, The Economist, 30 July 2009; A Market Solution That Puts Investors in a Fix, Wall Street Journal, 24 August 2010; Rein in the Cyber Cowboys, The Financial Times, 6 September 2010; The New Speed of Money, Reshaping Markets, The New York Times, 1 January 2011; The race to zero, speech given at the International Economic Association Sixteenth World Congress in Beijing, China by Andrew Haldane, Bank of England Executive Director of Financial Stability, 8 July 2011; Financial Arms Races, speech given at the Institute for New Economic Thinking, Berlin by Andrew Haldane, Bank of England, 14 April 2012; Knight Shows How to Lose \$440 Million in 30 Minutes, Business Week, 2 August 2012; High Frequency Traders and Current Market Structures Penalize Investors, Forbes, 16 January 2013; High-Speed Traders Pulled Back, Not Out, After Fake Tweet, The Wall Street Journal, 24 April 2013; High-Speed Traders Exploit Loophole, The Wall Street Journal, 1 May 2013; High-frequency trader fined in transatlantic clampdown, The Financial Times, 22 July 2013.

³ See The Flash Crash: The Impact of High Frequency Trading on an Electronic Market, Kirilenko, Kyle, Samadi, and Tuzun, Social Science Research Network Working Paper, 26 May 2011; High Frequency Trading and Price Discovery, Brogaard, Hendershott and Riordan, European Central Bank Working Paper no. 1602, November 2013.

⁴ See SEC File No. S7-21-09, Elimination of Flash Order Exception from Rule 602 of Regulation NMS, 2 July 2010, and my comment letter thereon.

⁵ Such practices may be detrimental, regardless whether a particular trader benefits or profits from it.

⁶ This has been proposed by the European Commission in its Review of the MiFID Directive, section 2.3.f), available at: http://ec.europa.eu/internal_market/consultations/docs/2010/mifid/consultation_paper_en.pdf

Please note that the comments expressed herein are solely my personal views

Yours sincerely

C.R.B.

Chris Barnard