Weltwirtschaft, Ökologie & Entwicklung
World Economy, Ecology & Development
weed

Eldenaer Str. 60, 10247 Berlin, www.weed-online.org
Contact person: Markus Henn
Tel. 0049-(0)30-27582-249, Markus.Henn@weed-online.org

IOSCO – Technical Committee
Mr. Werner Bijkerk
International Organization of Securities Commissions (IOSCO)
Calle Oquendo 12
28006 Madrid
- via email to market-integrity@iosco.org -

Berlin, 5 August 2011

Comment to the Consultation Report on "Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency"

Dear Mr Bijkerk,

WEED – World Economy, Ecology & Development is a Berlin based think tank and advocacy organization that has worked on global finance issues for about 20 years. It has outstanding expertise on the development impact of the global financial system. WEED regularly testifies to the German parliament and is a member of the recently founded organisation Finance Watch. WEED has been part of several EU funded projects on international financial markets, currently implementing two of them. For more information, please see www.weed-online.org.

We thank you for the opportunity to comment on your consultation report. We think that the impact of technological changes is an issue which is not only important for traders and market participants but for the society as whole given the huge impact that exchanges have in today's economy. We are particularly concerned about the (food) commodity markets which now also increasingly are dominated by automated and high frequency trading.

On your specific questions, we would like to comment as follows (only to selected questions):

> **Q2 What are your views on the suggestion that proprietary trading firms (including HFT firms) that are not currently subject to registration/authorisation by a regulator should be required to obtain such a registration/authorisation? Are there specific regulatory requirements you believe such firms should face?**

We generally urge IOSCO to require all trading firms being covered by rules on registration and authorisation. All firms should meet appropriate technical, staff and other requirements. Authorisation should be subject to withdrawal in case of infringements.

> **Q3 What recommendations, if any, would you propose to strengthen the regulatory requirements around pre- and post-trade risk controls? In particular, what measures, if any, do you think regulators should introduce that relate specifically to the use of and risks posed by algorithmic trading and/or HFT?**

We think that transparency is important. Also, all algorithms should be approved by regulatory authorities, or at least be subject to obligatory tests by the trading firms, for example stress tests for extreme market conditions.

> **Q4 To what extent do you believe the use of trading control mechanisms such as circuit breakers and limit-up/limit-down systems by trading venues should be mandated? If you**

believe they should be mandated, should venue operators be permitted to design their own controls or should they be harmonised/coordinated across venues (including between interrelated instruments such as a derivative and its underlying)?

We strongly support the introduction of circuit breakers and limit-up/limit-down systems. Financial markets are prone to "irrational exuberances" (Robert J. Shiller), especially herding behaviour. Circuit breakers make sure that, at least, this herding behaviour is mitigated. Modern financial markets are much less efficient in terms of price discovery than many economists suggest. This is why speeding them up does not necessarily make them more efficient. As Andrew G. Haldane, Bank of England Executive Director said, finance needs more patience.[1] Price limits can be one element in slowing the markets down. As trader Paul Tudor Jones has pointed out at a CME conference last year: "Every exchange traded instrument including all securities, futures, options and any other form of derivatives should have some form of a price limit. And this is all the more urgently needed now that electronic execution dominates trading."[2]

Q5 To what extent do you believe market maker schemes offered by trading venues should be subject to mandatory minimum criteria? Should the criteria be determined by the trading venue alone? To what extent do you agree with the suggestion that the use of stub quotes should be prohibited?

We think that minimum criteria for market makers should be prescribed by IOSCO and not (only) left to trading venues. As the financial crisis has demonstrated, voluntary measures are insufficient.

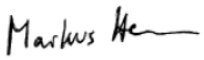
Q6 Do you have suggestions for improvements to regulators' surveillance capabilities with respect to the markets and modern trading techniques? Please elaborate. Who should bear the cost of investing in such capabilities and the cost of operating and supervising the markets in order to ensure fairness among market participants? Please elaborate.

We think that European Regulators should be equally equipped like US regulators. ESMA staff of 150 people so far is almost negligible compared to the thousands employed by the SEC and the CFTC.

Q14 To what extent do you have other comments related to the risks to market integrity and efficiency raised by the issues in this report?

We think that commodity markets should be covered by a special regulatory environment. The danger of commodity derivative markets being troubled by automated or high frequency trading should be weighted against the advantages regarding liquidity. Recent events like the 8% drop in 14 seconds in the US natural gas markets – which probably has been caused by modern trading techniques – are a warning signal. In order to make sure that commodity derivative markets are not subject to this, we urge for ex-ante position limits for all individual traders across all markets and products, and for automated trading as trading class. Position limits have also been recommended by CFTC commissioner Bart Chilton: "Given our experience with the Flash Crash and mini flash crashes, it is appropriate to consider if there should be limits on high frequency trading. For example, on position limits, let us say that we allow 10 percent of open interest in a market."[3]

Kind regards,



Markus Henn

---

[1] Haldane, Andrew G (2010): Patience and Finance. Speech at the Oxford China Business Forum, Beijing, September 2, 2010. http://www.bankofengland.co.uk/publications/speeches/2010/speech445.pdf.

[2] Tudor Jones, Paul (2010): Price Limits: A Return to Patience and Rationality in U.S. Markets. Speech to the CME Global Financial Leadership Conference, October 18, 2010. http://www.scribd.com/doc/53011644/Paul-Tudor-Jones-Speech

[3] Chilton, Bart (2010): Speed. Spech before the High Frequency Trading World, USA 2010 Conference, New York, December 8, 2010 http://www.cftc.gov/PressRoom/SpeechesTestimony/opachilton-35.html.