SOCIETE GENERALE
Corporate & Investment Banking

Haroun Boucheta
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**SOCIETE GENERALE RESPONSE
TO THE
OICV-IOSCO CONSULTATION REPORT
ON
REGULATORY ISSUES RAISED BY THE IMPACT OF
TECHNOLOGICAL CHANGES ON MARKET INTEGRITY AND EFFICIENCY**

Mr. Werner Bijkerk
IOSCO
Calle Oquendo 12 - 28006 Madrid - SPAIN

Société Générale is one of the leading financial services group in Europe, operating in 82 countries and employing 163 000 staff from 122 different nationalities. The Group is organised around five core business: French networks, International retail banking, Financial services, Global investment management and services and Corporate and investment banking. The latter employs 12 000 employees in 44 countries. It offers its clients bespoke financial solutions combining expertise, innovation, advice and high execution quality in three areas: capital markets, structured finance and derivatives.

In the context of that consultation paper, Société Générale was involved in various industry working groups at national and international level and supports the responses given by AFME/ISDA and AMAFI.

As a global operator operating in activities involving technological changes, Société Générale has also chosen to answer separately.

1 – GENERAL COMMENTS

Société Générale welcomes the opportunity to comment on this consultation and looks forward to further active engagement in the ongoing work that will be required to adapt the regulatory tools to the latest technological changes.

As preliminary remarks, we would like to highlight the following points:

- Some of our key views have already been provided to the European Commission in the course of our response to the MiFID consultation,

- In order to ensure that measures that may be proposed will be enforceable and to avoid any regulatory arbitrage, we feel that regulators should coordinate their efforts on a global

basis. Obviously, this includes, at the very least, a proper coordination between relevant regulators in Europe,

- In addition, we think that an adequate coordination between regulators and the implementation of comparable rules and regulation would allow to manage properly the operational risk,

- It is critically important that regulators understand the impact of technological developments (HFT included) on the markets before introducing legislation that has the potential to curtail the benefits automated trading has notably on the liquidity (HFT activities) and on the treatment of clients' orders (brokerage activities). We believe therefore that further study is both urgent and absolutely necessary to determine what should be the regulatory tools to be used in the context of the latest technological changes.

2 - DETAILED ANSWER TO THE CONSULTATION REPORT

Q1/ What impact have the technological developments in the markets in recent years had on your own trading? Has it encouraged, discouraged or had no impact on your willingness to participate on the lit markets, and how does this differ between asset classes and/or instruments?

In a context where both the competition between players (trading venues included) and volumes traded on markets have significantly increased, the technological developments allowed us to optimize and create new services. Two specific examples can be used as an illustration.

*** The first example is the development of the broker crossing networks** ("BCNs"). We are of the opinion that BCNs form part of the discretionary treatment of clients' orders by brokers, which corresponds to a service very different from the one provided by regulated markets and MTFs (non discretionary matching of members' orders). Indeed, there is a fundamental difference between:

- on the one hand, multilateral platforms (regulated markets and MTFs), the role of which is to match and execute buying and selling interests in a non-discretionary way ;
- on the other hand, intermediaries (brokers) who execute their clients' orders, necessarily in a discretionary manner, as it is their duty to choose, together with their clients, the way the orders will be executed (facilitation, execution agency, search for blocks, VWAP…), their limits being the respect of best execution and the management of conflicts of interests.

BCN does not induce a new way of managing clients' orders, and simply consists of using the technological developments to increase the effectiveness of the long-standing search of crosses opportunities to the best interest of clients, within the usual framework of

discretionary clients' order management.

Brokers have always tried to match their clients orders internally, with their clients' prior consent and when technically or legally feasible. To this extent, new methods of crossing based on the technological developments only optimize the broker's job, by using algorithms, without fundamentally changing the nature of this job.

*** The second example is the high frequency trading** ("HFT"). Regulatory changes and technological improvements have encouraged the development of this activity. Although there have been many negative comments from market observers, we are of the opinion that several positive aspects result from the HFT when these activities are properly regulated.

It should notably be highlighted that HFT brings additional liquidity to the market, can reduce price volatility in particular in the case of crisis when markets are volatile, reduces spreads and unifies prices across the various trading venues in the best interest of issuers and investors (including retail).

Those examples show that technological developments are just tools to optimize the services we provide or to improve markets efficiency. They have not discouraged at all our willingness to participate on the lit markets. Lit and dark markets are actually complementary and market participants, for their own account but also on behalf of their clients, are willing to actively participate on both of them.

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?
To what extent do your answers differ if the proprietary trading firm accesses the market as the customer of an intermediary firm through DEA (i.e. under that intermediary's trading rules/codes) rather than as a direct member of the market itself?

Within the last decade HFT is estimated to have grown from negligible amounts to an estimated 60-70% of equity trading volume in the US, and to 30-50% within the EU. It is clear that the development of HFT has spurred debate about the ability of market supervisors to monitor potential market abuse.

Given this in mind, we are of the view that proprietary trading firms (including HFT firms) should be registered / authorised by a financial market regulator to perform their activities.

Please note that in the EU, under the MiFID, entities providing at least two investment services (trading on own account and another one) should be registered as investment

firms and should therefore comply with the MiFID and all the other relevant rules and regulations. On the other hand, entities, even based in the EU, which only perform the activity of trading on own account (HFT for example) benefit from the exemption "solely for trading on own account" which allows them not to be registered as investment firms. We think that the revision of the MiFID is an opportunity to prevent such players to remain in the shadow system considering the risks to which they expose the market.

Furthermore, we are of the opinion that the fact that proprietary trading firms access the market via intermediary's systems does not change the situation. The aim of such registration / authorisation is for the regulators to be able to supervise the players notably to prevent market abuse and to impose organisational requirements. Accessing the market through DEA does not avoid the need for regulators to improve their supervisory duties in such as case.

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?

As a preliminary remark, it should be underlined that in Europe credit institutions and investment firms are subject to a very strict regulation on operational risks and subject to permanent and periodic controls (internal audits, external audits by prudential authorities). It is obvious that when they have HFT activities, this regulation fully applies.

*** With regard to pre-trade risk controls:**

Reviewing existing regulatory requirements regarding pre-trade risk controls applicable to intermediaries could be useful.

We think that regulators should consider the ban of DEA in case of naked access i.e. when no appropriate pre-trade controls are in place. We believe that naked access may have significant negative consequences because customers are able to access to trading platforms both without pre-trade risk control and without revealing their identity to the market.

This is the reason why we fully support measures recently taken by the SEC.

*** With regard to post-trade risk controls:**

We think that post-trade risk controls could be usefully increased by the implementation of a consolidated tape.

In the EU, difficulties have arisen concerning post trade data consolidation. It seems to be the major failure of the MiFID. Data are neither harmonised, nor available nor reliable. Such a consolidated tape would allow the regulators to perform their supervisory functions.

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 agree with the principle of mandating the use of trading control mechanisms. We fully support measures taken by the SEC to this extent and we are of the view that those measures should be imposed by regulators following a coordination action at international level.

Regarding specifically the proposed measures, we think that:

- circuit breakers, which by the way are already widely used in EU exchanges, are a useful tool to curb risks related to HFT activities. In addition to circuit breakers, a limit-up/limit down rule is also to be considered in order to prohibit trades a certain distance away from the market price,

- the rules of the various trading venues regarding circuit breakers and limit-up/limit-down systems should be the same (or as close as possible) in order to avoid any arbitrage between these venues,

- all the trading venues should be imposed to include those measures in their rules, whatever they are in the "lit space" or in the "dark space",

- the system of circuit breakers and limit-up/limit-down systems to be put in place should be carefully calibrated

We are of the opinion that mandating an appropriate system of circuit breakers and limit-up/limit-down will be complex and should be the top priority. Once the market practice will show that this system has been appropriately calibrated, harmonisation with interrelated instruments could be considered.

At last, regarding the harmonisation between interrelated instruments such as derivative and its underlying, we share the concerns expressed by some associations which have expressed the view that identifying those interrelated instruments is a very complex task that would require further analysis.

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?

First of all, it is clear for us that in the case of crisis, when markets are volatile, liquidity provided by HFT is one of the best ways to reduce price volatility. Market making by HF traders may be seen as a sort of arbitrage: abnormal prices are removed from the market resulting in better and more efficient price formation.

In that context, we can understand parties who could have proposed to impose possible market making requirements for HFT players with obligations to provide bids and offers throughout the trading day in order to prevent dramatic price drops and spikes caused by participants withdrawing the market at the same time.

Nevertheless, we believe that even if HFT can reduce price volatility and abnormal prices, HF traders should not be required to always provide liquidity on an ongoing basis.

That being said, we think that if some HF traders are willing to enter into a market maker agreement with a trading venue, they should be encouraged to do so under strict conditions agreed together with the relevant trading venues. We believe that current contractual arrangements between those venues and the market makers already provide a safety environment and encourage competition between trading venues (notably with regard to the fee structures).
Furthermore, it has been reminded that in the EU trading venues are either market operators or investment firms providing the investment service of management of an MTF. As such, they are submitted to a strict regulatory framework. In that context, regulators are entitled to investigate and analyse how contracts with market makers have been designed.

At last, regarding "stub" quotes (i.e. quotes at levels far away from current market prices used sometimes to fulfill a market making requirement), we share the suggestion that they should be banned as they could be assimilated to some form of market abuse.

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.

Modern trading techniques have made necessary for regulators to adapt their surveillance capabilities. We think that the following improvements may be considered:

- to build, as mentioned below, a registration / authorisation process for proprietary trading firms (including HFT firms) and to consider the ban of DEA in case of naked access,

- to build and use a consolidated tape: in a context where data are neither harmonised, nor available nor reliable, such a consolidated tape would allow the regulators to perform their supervisory functions, notably detecting potential market abuse on an *ex post* basis,

- to improve the way regulatory reporting are made: conditions of such reporting (in terms of timing, format etc.) should be harmonised at international level (for instance amongst Member States in the EU).

With regard to the cost, we are of the opinion that cost linked to additional capabilities, in terms of technology and human resources, should be shared amongst all stakeholders active of the financial markets as they all benefit from the various positive aspects resulting from the HFT (additional liquidity to the market, price volatility reduction in particular in the case of crisis, spreads reduction and prices unification across the trading venues) and will all benefit from the above-mentioned improvements.

Q7/ What do you perceive as the major causes of settlement indiscipline and settlement failures? What steps, if any, do you believe regulators should take to address these causes?

We are not aware of any settlement indiscipline or failure which would be directly linked to the HFT. We underline the fact that most of our strategies imply a net flat position at the end of each trading day which prevents settlement indiscipline or failures to happen.

Nevertheless, when volatility and volumes are particularly high, any additional liquidity may be difficult to manage by the relevant post-trade infrastructures. Clearing houses and central securities depositories should be robust and be submitted to appropriate requirements in order to be able to provide their services properly and avoid any failure or buy-in.

It has to be underlined that the European Markets Infrastructure Regulation (EMIR) envisages to create such a framework including for post-trade infrastructures providing their services in the cash equity environment.

Q8/ Have the appropriate steps been taken to limit or manage conflicts of interest that arise where an investment firm simultaneously conducts client-serving activities and proprietary trading or a trading participant is also a shareholder in a venue on which it trades? If you believe conflicts management is inadequate, please explain how this manifests itself and any recommendation you have for how conflicts management could be improved.

Société Générale is of the view that, at least for European investment firms, appropriate measures are already in place. MiFID contains relevant provisions requiring European

investment firms to manage properly their potential conflicts of interest and disclosing them to their clients.

When we simultaneously conduct client-serving activities and proprietary trading or when we are also a shareholder in a venue on which we trade, we comply with specific rules and regulation (contained in the French Monetary and Financial Code and in the General Regulation of the Autorité des Marchés Financiers) to prevent and avoid conflicts of interests. In this context, appropriate procedures are followed, notably:
- we create and maintain an effective conflicts of interest policy identifying the circumstances which constitute or may give rise to a conflict of interest.
- such policy specifies procedures to be followed and measures to be adopted in order to manage such conflicts,
- we identify the business departments conducting client-serving activities and proprietary trading,
- we send relevant disclosure to clients,
- we implement separation (including a physical one) of these departments in order to avoid any undue disclosure of information.

Furthermore, regulators have regularly assessed the way European investment firms have implemented such provisions, notably using onsite inspections.

We think therefore that apart from a registration / authorisation process for all proprietary trading firms (including HFT firms), additional measures are not necessary (in Europe for instance). Any measure would definitely be counterproductive with the current provisions of the MiFID.

Q9/ Do you think existing laws and rules on market abuse and disorderly trading cover computer generated orders and are relevant in today's market environment?

Existing rules and regulation are appropriate. In Europe, the Market Abuse directive contains relevant provisions aimed to define various market practices as market abuse.

As mentioned above, the problem is for regulators to adapt their surveillance capabilities in order to be able to properly detect those potential market abuse behaviors. In addition to the improvements proposed above, we think that a close cooperation between international regulators is absolutely needed in this area as HF strategies often imply orders executed in different market places.

Q10/ Are there any strategies employed by HFT firms that raise particular concerns? If so, how would you recommend that regulators address them?

No, as long as they do not enter into the definition of market abuse by the relevant rules and regulation, strategies do not raise particular concerns.

We share the view that speed is not a concern in itself. Whatever could be the speed (low, medium or high), what is important is whether a strategy constitutes a market abuse.

Having said that, as mentioned above, we think that when volatility and volumes are particularly high, any additional liquidity may be difficult to manage by the relevant post-trade infrastructures. Clearing houses and central securities depositories should be robust and be submitted to appropriate requirements in order to be able to provide their services properly and avoid any failure or buy-in.

Q11/ Should charges or fees be imposed on messages, cancellations or high order-to-trade ratios? If so, how should the fees or charges be determined and on what basis?

Firstly, we think that such as in the other comparable matters (services provided by market infrastructures such as co-location services or information data services by trading venues, clearing services and collateral management provided by CCPs, settlement services provided by CSDs etc.), fees applicable to HFT should continue to be at the full discretion of trading venues. Therefore, we do not think that regulators should mandate any specific fees in that context.
Nevertheless, we agree with the principle of imposing to all market infrastructures, trading venues included, that their fee grids are publicly available.

Secondly, we disagree with the proposed measure consisting in imposing to firms involving in HFT a limit on a ratio of orders. That would be counterproductive and would limit some of the various positive aspects resulting from the HFT (additional liquidity to the market, price volatility reduction in particular in the case of crisis, spreads reduction and prices unification across the trading venues).

Q12/ Should market operators be required to make their co-location services available on a fair and non-discriminatory basis?

We are of the opinion that fair conditions should be granted so as to avoid any discriminatory measures.

As a preliminary remark, we would like to stress that co-location is not only relevant in the context of HFT. The agency business is also concerned as many of our clients are interested in reducing access time.

In a context where speed has become a more and more determining factor, the question of equality of access to trading systems (transmission of orders) and to market information (pre and post trade data) has become more and more pressing. Co-location enables, with complete transparency, to guarantee this equality even if it is likely that not all participants will be able to collocate with all trading venues. Co-location avoids situations where those

who have the capacity to set up offices as close as possible to the quotation centers have an advantage over those who are situated further away.

Regulators should make sure that trading venues which offer co-location services make these services available to any party which has an interest (members but also other markets and information routers). It must be also ensure that technical conditions are identical for all entities which benefit from the co-location service (e.g. the length of cable between the server of the entity benefiting from the co-location service and the market server must be the same as that of the server which is furthest from the market server) so as to avoid any discriminatory measures.

Q13/ Should market operators be required to provide testing environments to enable participants in stress test their algorithms? If so, what kind of minimum requirements are reasonable?

We believe that testing environments designed by market operators should be helpful to enable HFT players to test their algorithms.

That being said, such tests should not imply any disclosure of strategies or algorithms to those market operators. The latter should only be mandated to design and make available a relevant testing environment.

Furthermore, we should highlight the fact that such testing environments should be used at the discretion of the HFT players that can choose not to use them notably for their strategies which do not fit with / require such testing environments.

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?

Whilst the consultation report focuses predominately on HFT, it also envisages a number of issues linked to the technological changes. As interested parties are invited to give responses on questions which do not envisage some of these issues, Société Générale would like to take this opportunity to express its views on the followings:

*** Tick size:**

We are in favour of a tick harmonisation. We believe that this would have an immediate positive effect on the management of operational risk and would mitigate against the race to the bottom.

* **Indication of Interests (« IOIs ») :**

In the course of its consultation on the revision of the MiFID, the European Commission

proposed the assimilation of actionable IOIs as orders (subject to pre trade transparency). This seems perfectly reasonable to us as actionable IOIs create information asymmetry.

3 - CONTACTS

Société Générale Corporate & Investment Banking Public Affairs:

Haroun Boucheta: haroun.boucheta@socgen.com

Eric Litvack: eric.litvack@sgcib.com

Philippe de Soumagnat: philippe.de-soumagnat@sgcib.com