CHEUVREUX
CRÉDIT AGRICOLE GROUP

IOSCO Public Consultation: Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency

Comments from Crédit Agricole Cheuvreux

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About Crédit Agricole Cheuvreux

Part of the Crédit Agricole Group, CA Cheuvreux is the ***Number 1 pure-agency European equity broker****. Its historical, multi-local model positions CA Cheuvreux as a cutting-edge outperformance provider for its* ***1,200 institutional clients****. CA Cheuvreux offers extensive, high value-added services in* ***Research****,* ***Sales*** *and* ***Execution****. With 90 analysts and economists, and an unparalleled coverage of 700 stocks, CA Cheuvreux is continuously ranked in the* ***Top 5 for European Country research*** *and* ***Top 3 European Corporate Access provider.*** *CA Cheuvreux provides extensive market access to* ***100 execution platforms worldwide*** *including all major MTFs and Dark Pools. Ranked* ***No. 1 in Sales Trading Client Service****, CA Cheuvreux's execution specialists offer a wide spectrum of* ***first-class products****. CA Cheuvreux has 13 offices worldwide: Amsterdam, Athens, Frankfurt, Istanbul, London, Madrid, Milan, Paris, Stockholm, Zurich, New York, San Francisco and Tokyo.*
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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?

The technological developments referred to have led Cheuvreux to industrialise the core function of a broker: to match a buyer with a seller. As a broker, our willingness to participate in the lit market has not changed, and in the best interests of our clients we source liquidity where we have to. Internal crossing is the most efficient way to reduce market impact and to trade on the dark venues allows us to compensate for some of the deficiencies of the lit venues (see as reference our Contribution to the MiFID debate: https://www.cheuvreux.com/pdf/NOTE%20MIFID%20Cheuvreux%20UK.pdf).

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?

All entities involved in the markets should be regulated and supervised.
We consider that any proprietary trading activities should be segregated from the broking business.

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?

The question of pre-trade risk controls has risen because the markets are not robust enough to absorb the orders generated by a computer going berserk. Were the markets robust enough, the potential losses (in capital and reputation) should be a strong enough incentive for the market players to develop and implement sufficient control of their computers.
The controls and limitations put in place must be a reflection of the maximum losses that a market participant is not only liable for but also able to honour.

Market structure must be changed: circuit breakers should be mandatory and similar for all venues. The most efficient way to adjust the market structure is in giving the regulators the means to adjust 'friction' when required.

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)?

Market structure must be changed: circuit breakers should be mandatory and similar for all venues. This should help to reduce the effects of specific strategies interacting and feeding off one another (see the Flash Crash where the market downward movement stopped only when the sell order fuelling the momentum was complete).
Another way of adjusting the market structure must be given to the regulators: 'friction', through the changing of the tick size (see our contribution to CESR Call for Evidence on micro-structural issues of the European equity markets: https://www.cheuvreux.com/pdf/CESR.pdf) or the charging of modifications and cancellations on orders on a case by case basis (see Q11).

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 believe that market-maker agreements should be bilateral, under the regulators overview.

If the market structure was sound enough, "stub quotes" would become irrelevant. For the time being, they should be prohibited.

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.

Pre-trade: given the current structure, it is unrealistic to consider that a pre-trade consolidated quote can be reconstructed accurately from various venues post-trade, as there will always be uncertainty around the reconciliation of time-stamping of orders on the different venues. Given the current market structure, any surveillance must hence be done at the venue level and standards must be set.

Post-trade: we have been advocating a consolidated tape in Europe for some time. We believe that the consensus built around the consolidated tape has not lead to anything tangible as yet because the commercial interest of the various participants favours the status quo.
We suggested to the European Commission that they take the lead in outsourcing the consolidated tape with a very strict Service Level Agreement (in French, "Délégation de Service Public"). That SLA should include the operation and supervision of market surveillance, the consolidated tape being the optimal situation. The costs would then be borne by the organisation running the consolidated tape and the data transmitted to local regulators for more specific needs.
This principle can be extended to any market where the data is consolidated.

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 consider settlement indiscipline is fuelled by discrepancies between countries / markets. In some situations, it is easier or cheaper to fail rather than to borrow the stock. Settlement buy-ins should be harmonised and enforced.

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.

As stated in Q1, we consider that proprietary trading activities should be segregated from intermediation activities.
In regard to the trading destination; investment firms should remain free to route their proprietary flows to whatever destination they choose. Agency flows must be routed according to the Execution Policy of the intermediary. The responsibility of the intermediary is a commercial one and clients are expressing their satisfaction with the intermediary's policy by giving them orders.

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?

Yes, and rather than changing the existing laws to adapt them to the market micro-structure, we would favour enforcing the current laws and changing the market micro-structure to reinforce the value of time priority.

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

Strategies employed by HFT firms are in principle the same as those employed by non-HFT traders, but on a much shorter time-scale and the concerns raised are in essence the same as have always been raised by trading. The extremely short time scale, combined with the fact that orders can be sent on multiple venues, makes the regulators task difficult. Investing in whatever is necessary to monitor properly these activities may prove extremely costly, very quickly outdated and difficult to maintain.
The choice left to the regulators is to decide whether HFT constitutes market abuse organised on a scale that is hardly discernable and is not worth controlling or to change the market micro-structure.
The nature of the differing HFT strategies means that the majority will be as close as possible to the limits of the market's ecosystem. Increasing the fluidity of that ecosystem will only allow HFT to determine new boundaries. It would be better not to change these boundaries but to adjust the ecosystem so that regulators and public opinion have a satisfactory view on what is happening.

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?

We consider that a charge put on order modifications and cancellations should be in force from the very first modification. This charge would be perfectly suited to adjust, along with the tick size, the viscosity of the markets. The possibility to add/remove or adjust the charge from one day to another would give the authorities very strong control over market structure.
It should be small, be charged at every modification on a per order basis, with a possible derogation for orders sent in respect of strict market-making obligations.
This charge should be part of the financing of the regulatory bodies.

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

Yes.
However, it should be noted that the more value given to time priority by the market structure, the less value found in co-location.

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?

Participants are and should be responsible for stress testing their own algorithms. The bigger the participant, the more likely they have built a market simulator to test the algorithms.
A fully functional testing environment provided by a market operator, which was mandatory and free, would help any clients without a market simulator, particularly the smaller market players.
This is currently purely a commercial decision left to the market operators in providing tools to their clients.

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?

The recent volatility on the equity markets has seen all market infrastructures tested to their maximum capacities, during which most venues have experienced resilience and latency issues. This will again prompt them to increase their data handling and processing capacities. Due to the nature of HFT efficiency (i.e. trading at boundaries where no one can be faster), we will see these new capacities tested to their limits during the next period of extreme volatility.

Rather than continually investing in trying to improve the market's infrastructures, it is time to revise the market's structure.