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

Werner Bijkerk
IOSCO
Calle Oquendo 12
28006 Madrid
Spain
market-integrity@iosco.org

Chris Barnard
Germany

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- **Public comment on IOSCO's Consultation Report on Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency**

Dear Mr. Bijkerk.

Thank you for giving us the opportunity to comment on your Consultation Report on Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency.

This report raises a debate concerning the regulatory approaches we need to promote to cater for the impact of technological change on markets. Regulators have been slow to react to the rapid technological developments in financial markets, including for example their facilitation of algorithmic trading and high frequency trading. I would specifically like to comment on the issues of high frequency trading and dark liquidity in this regulatory context. For my comments on dark liquidity, please refer to your final report on Principles for Dark Liquidity, and my comment letter thereon.[1]

High frequency trading[2]

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

[1] See Principles for Dark Liquidity, Final Report, IOSCO, May 2011 available at: http://www.iosco.org/library/pubdocs/pdf/IOSCOPD353.pdf
[2] HFT is really a subset of algorithmic trading generally.

HFT has received a lot of bad press recently, some of it well-deserved.[3] However, we must be careful to act discriminately here, and recognise that HFT does bring some benefits to market efficiency, as well as detrimental costs. For example, HFT can increase liquidity and reduce spreads, which is generally beneficial to market efficiency. However, it can also act to increase volatility and retard the price discovery process, which is detrimental to market efficiency.

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 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 times[6] 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.

Yours sincerely

C.R. Barnard

Chris Barnard

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[3] 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.

[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