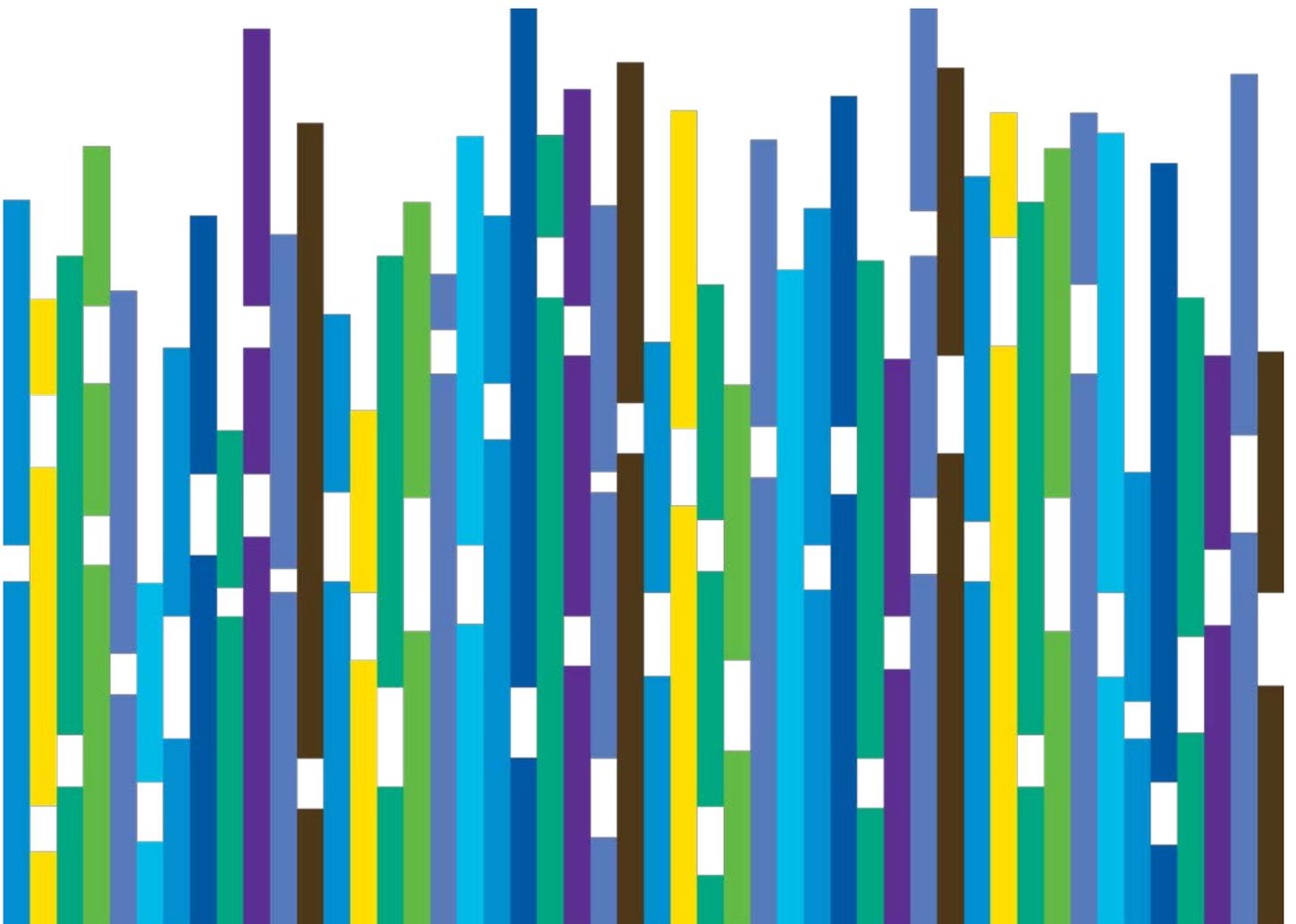


POLICY BRIEF

# HIGH-FREQUENCY TRADING

Investor Issues and Perspectives



# HIGH-FREQUENCY TRADING

## Investor Issues and Perspectives

CFA Institute staff have tracked the evolution of high-frequency trading (HFT) in global capital markets over the last five years, with a view toward understanding potential impacts on market integrity and efficiency, to avoid potential unintended consequences, as well as to inform our perspectives on public policy and regulatory initiatives. The primary issues of focus have been:

- Does HFT potentially harm the resilience of markets due to the speed and automated character of such trading, as in the “flash crash?”
- Does HFT sacrifice the integrity of markets by using preferred access to order information to inform trading and disadvantage other market participants?
- To what extent does HFT improve market depth and supply liquidity?
- Does HFT improve the price discovery process?
- What is the appropriate regulatory framework for HFT?

### Policy Positions

The policy positions we have adopted that are relevant to HFT are:

- HFT improves price discovery across multiple platforms and enhances the informational efficiency of markets. The weight of academic evidence suggests a benign to positive effect on markets
- HFT firms should be well capitalized in line with other market-making firms to support the proprietary nature of their activities and should be subject to the same sorts of registration/authorization requirements that apply to other regulated investment firms.
- There is a need for robust internal risk management procedures and controls over the algorithms and strategies employed by HFT firms. Controls also are needed at the broker/dealer level (to prohibit unfiltered sponsored access) and at exchanges (circuit breakers/harmonized trading halts).
- HFT firms are not to be provided privileged access to exchange servers or other mechanisms that allow them to see order flow before other participants, unless such access is available to other market participants as well on a non-discriminatory basis and on reasonable commercial terms. We do not support minimum resting times or maximum order-to-trade ratios as we feel that such limits might cause adverse effects to investors engaged in statistical arbitrage (a significant source of liquidity) who seek to adjust their orders as new information becomes available. Limit orders provide a free trading option to liquidity takers. Measures to extend the time length of that free trading option, or to restrict the ability to modify that option, imply a higher cost to providing the option. To compensate, liquidity suppliers would likely incorporate this cost into their limit order quotes, resulting in wider spreads and higher transaction costs for investors. Exchanges should be left to determine whether order-to-trade ratios should be restricted or taxed to reflect bandwidth consumption.
- Co-location is a legitimate commercial arrangement between trading firms and exchanges/market centers — provided that the service is made available to all market participants wishing to pay for it and that the service is offered on non-discriminatory commercial terms.
- Trading venues should disclose their fee structure to all market participants.
- CFA Institute believes that trying to curb HFT activity through direct, targeted, and punitive regulation is inappropriate and would likely have unintended consequences. In our view, it would be more effective for regulators to address market manipulation and other threats to the integrity of markets, regardless of the underlying mechanism and focus on risk management (pre- and post-trade risk controls), rather than try to intervene in the trading process or to restrict certain types of trading activities via fees or charges.

**POLICY BRIEF****Recent Developments**

Despite the details recapped by the [Michael Lewis book \*Flash Boys\*](#), we believe that HFT has proven to be neither unambiguously positive nor negative as a feature of current capital market structure, a position that is echoed by several academic studies and many practitioners. The underlying issues are difficult to separate from other relevant market structure issues (such as the trend away from lit markets to dark venues and overall fragmentation of equity markets and the introduction of payment-for-order-flow and “maker-taker” compensation systems).

The regulatory agenda relevant to HFT has proceeded slowly: the recently concluded MiFID II reforms in Europe address HFT by introducing trading controls, regulating the provision of direct electronic market access, and imposing a liquidity provision obligation on high-frequency traders. The US Securities and Exchange Commission (SEC) has reported that it has been studying the implications of HFT for some time, and the SEC’s 2014 Strategic Plan indicates that examination of algorithmic and automated trading remains a key initiative.

**CFA Institute Commentary**

We have spoken out on issues related to HFT. In addition to several meetings since 2010 with SEC staff on this issue, we have published the following:

- Research Paper: [The Structure, Regulation, and Transparency of European Equity Markets Under MiFID](#)
- [2010 Comment letter to SEC on US Equity Market Structure Concept Release](#)
- [2010 Comment letter to CESR on Microstructural Issues of the Equity Markets](#)
- [2011 Comment letter to IOSCO on Regulatory Issues Raised by the Impact of Technological Changes on Market Integrity and Efficiency](#)
- [2012 Comment letter to European Commission ECON Committee on MiFID Rule Reforms](#) (question 8)
- [“Debating Michael Lewis’ “Flash Boys”: High-Frequency Trading Not All Bad”](#) (“Market Integrity Insights” blog post)
- [“HFT Tame The Beast”](#) (“Market Integrity Insights” blog post)
- [“Three Lessons from the Failed BATS IPO”](#) (“Market Integrity Insights” blog post)
- [“Automated Trading Debate Intensifies”](#) (“Market Integrity Insights” blog post)
- [“ECB Report on Impact of HFT on Price Efficiency”](#) (“Market Integrity Insights” blog post)
- [“Views on MiFID II”](#) (“Market Integrity Insights” blog post)
- [“High-Frequency Trading: How It’s Changing the Market”](#) (“Enterprising Investor” blog post)
- [“Duct Tape and Circuit Breakers”](#) (“Market Integrity Insights” blog post)