

Response to CESR Call for Evidence: Micro-structural Issues of The European equity markets

High Frequency Trading:

Q1

The above (I.5.) summarises our understanding of HFT strategies in general. There are a variety of strategies with a variety of **adverse impacts** (for us) as follows:

Front Running: **adverse price impact**;

Execution Timing (takes our liquidity prior to short-term adverse price movement):

Poor execution performance

Adverse Selection (liquidity only provided when adverse price move is expected):

Poor execution performance

Pennying (continually steps ahead of our order in book): **Information leakage, opportunity cost.**

Manipulation (placing of orders with no intention to trade but to move prices or bait algorithms): **poor execution performance.**

Q2

- a) Not known but seems to be a significant amount (40%) of volumes transacted on MTFs, less on Primary Exchanges.
- b) Not known
- c) Getco, Citadel, Knight
- d) Cash equities and listed derivatives

Q3

HFT has grown since the exchange fees have dropped and exchange latency has improved. These and the interoperability between venues is key to the development of HFT as we understand it.

Q4

Market structure: **no change**

Liquidity, spreads etc: **beneficial** but only in small size

Volatility and price formation: **detrimental**

Efficiency and orderliness of market: **mixed**

Evidence: look at Bloomberg screen prices (MQ) of LGEN (Legal & General) on BATs (EB) and Chi-X (IX) date 19th February 2010.

HFT can be seen in the repetition of the order size on both sides of the book. The proliferation is clear.

Q5

We would see the benefits of HFT as increasing liquidity and to some extent reducing spreads. These would not be beneficial in the case of all strategies.

Q6

We think the regulatory focus on HFT is justified and needs to mitigate these risks.

Q7

We would summarise that HFT is opportunistic and can cause short-term distortion to natural market forces and prices. Furthermore it is not activity that serves the interests of investors but the HFTs themselves. However liquidity is increased as a result of their participation and this is beneficial.

Q8

We expect exchange/MTF fees to reduce further as interoperability is driven through and this is likely to increase the commercial opportunities for HFT.

Q9

We would see regulation as desirable but will only be efficient if applied discriminately.

II Sponsored Access:

Q1

Benefits would be as follow:

Trading Platforms: more liquidity which then attracts further liquidity;

Sponsoring Firms: fees and able to advertise higher volumes in their name;

Their Clients: no restrictions on their activity;

Wider market: more liquidity if this would not be available without SA.

Q2

Manipulation easier. Risks would be mitigated if it was banned.

Q3

Reputation/Credit Risk. Sponsoring Firms should be forced to apply strict (self-?)regulation.

Q4

Yes, in all cases additional regulatory requirements are needed.

Q5

Co-location

III. Co-location

Summary to answer the questions:

The fact that co-location is seen as so desirable by some market participants highlights that it creates an advantage to some. This is against what MiFID was intending to promote and serves no benefit to the wider market. In fact it enhances short-term price volatility and reduces visibility of normal market activity.

IV. Fee Structure

Q1

As stated there are a variety of fee structures offered at different times by different venues. There is a promotional dimension to the period for which special fees are offered. These promotional periods are intended to attract new business which the venues hope will be retained when normal fee structures are then implemented.

Q2

New venues are able to attract business with a competitive and flexible fee structure; they may encourage participants to be more transparent with their flow if they are rewarded for posting liquidity.

Q3

From our perspective (as a buy-side investor) we want our brokers to be venue neutral in deciding where to best execute our orders but the maker/taker fee structure incentivises them to post our flow passively more than to be aggressive in taking liquidity. This may distort their approach to targeting best execution as any fee savings they benefit from are not passed onto us.

Q4

Market participants are incentivised to change the routing of activity as fee structures are changed. This generates a transitional element to the market share of each venue and reduces the effectiveness of any post trade analysis of venue efficiency. This adversely impacts both smart-order routing which looks at historic venue activity and also our own monitoring of venue selection by our brokers.

Q5

We do not connect to platforms directly so it is a question for our brokers.

Q6

Transparency of fees would help us assess the effectiveness of our brokers to choose venues neutrally.

Q7

It would help if regulation obliged brokers to disclose their participation levels on different venues in order to provide transparency to investors of their ability to access all significant liquidity.

V. Tick Size

As an Institutional (long-only) investor tick size is not a big issue for us and we do not see it as a regulatory priority.

VI. Indications of Interest (IOIs)

Q1

Our interaction with IOIs is only around the advertisements of activity by our brokers. This is used to attract more activity in those particular stocks either to unwind positions, match up natural business or coordinate the activity of a number of participants who are the same direction.

We are not aware of any use of IOIs by RMs or MTFs but would be strongly opposed to such activity.

Q2

The key benefit for us is to be able to seek natural liquidity which may not be fully posted on a lit venue. This enables us to transact large orders without adverse market impact by sourcing liquidity from the right broker. The only downside of IOIs is where participants use them to 'fish' for flow (i.e. advertise their own activity which is not genuine in order to front-run others' genuine activity on enquiry of the order.

Q3

No, we feel that actionable IOIs and attempts to regulate them are not important.

Q4

We think that IOIs and who they are shown to are at the discretion of the broker who is incentivised to keep toxic participants outside of this information.