

Baden-Württembergische Wertpapierbörse
Postfach 10 06 43 | 70005 Stuttgart

European Securities and Markets Authority (ESMA)
103 rue de Grenelle

75007 Paris - France

www.esma.europa.eu

Baden-Württembergische
Wertpapierbörse
Dr. Christoph Boschan
Tel +49 711 222985-510
Fax +49 711 222985-545
christoph.boschan@boerse-stuttgart.de

Stuttgart, 3. Oktober 2011

Börse Stuttgart's response to the ESMA consultation paper "Guidelines on systems and controls in a highly automated trading environment for trading platforms, investment firms and competent authorities"

Dear Sir or Madam,

We hereby thank the European Securities and Markets Authority for the opportunity to respond to its consultation paper.

In principle, we welcome ESMA's recommendations, provided that the new regulations will be consistent with the upcoming revision of the Markets in Financial Instruments Directive and that they apply not only to Regulated Markets but also to Multilateral Trading Facilities and Organized Trading Facilities as both fulfill the identical secondary market function as Regulated Markets.

In particular, we welcome ESMA's recommendations as this is the first time regulators are looking more narrowly at the relatively small group of investment firms largely responsible for the phenomenon of high frequency trading.

Our comments here are limited to three questions (questions 4, 8, and 10).

Questions 4 and 10: Do you have additional comments on the draft guidelines on organizational requirements for trading platforms' electronic trading systems? Do you have additional

comments on the draft guidelines on organizational requirements for trading platforms to promote fair and orderly trading?

In our opinion, the following two points require further clarification in any discussion going forward:

- I. Any regulatory response must be modulated to reflect the fact that different trading platforms target different user-groups.
- II. Consequently, any changes in regulation need to explicitly grant operators of Regulated Markets the right to introduce regulations as appropriate for dealing with high frequency trading.

We therefore recommend the following statement be included in the proposed guidelines:

“Regulated markets are free to set limits for their trading systems as well as to introduce measures to ensure compliance with those limits.”

Regarding I.

Trading systems are tailored to the needs of a specific group of users. Every trading system differs from the others inasmuch as it targets a different group of users. The providers of electronic trading systems have long since begun to match the specializations offered by the stock exchanges. The choice of trading systems is becoming increasingly specialized.¹

The Stuttgart Stock Exchange is mainly oriented towards the needs of the private investor. Due to the exceptional quality of order execution at the exchange, it is the market leader in Germany

¹ Cf. the palette of offerings from Cinnober, whose applications are currently in use at over 50 markets worldwide; <http://www.cinnober.se/tradexpress-trading-system> (accessed on 23.08.2011). Besides the trading system “TradeExpress,” Cinnober also offers the product “TradeExpress-Ultra” for HFT oriented markets; <http://www.cinnober.se/newsletter/cinnober-launches-world%E2%80%99s-fastest-matching-engine> (accessed on 23.08.2011).

among this client group. The Stuttgart Exchange has been able to ensure this quality through a unique combination of fully electronic trading and individual management of orders by traders. Since private investors require greater assistance than institutional investors, the human factor continues to play a significant role in trading at our exchange. In almost all cases, “execution price” is a more important factor for our clients than “execution speed.” The private investor is not interested in a “race to zero.” Clearly, such a market requires a different regulatory approach than one that mainly serves institutional investors.²

Regarding II.

Any new regulation urgently needs to take this reality into account. It needs to grant institutional recognition in that it clarifies the right of Regulated Markets to enact rules to regulate high frequency trading as required by their respective market model.

This has been the case so far in Germany inasmuch as exchanges are semi-public authorities and hence free to determine their own regulatory arrangements within the broader legal framework. As a consequence of the responsibility arising from this legal situation, we already introduced rules for dealing with high frequency trading in our exchange bylaws some time back:

Section 12 of the Exchange Rules³ **Participation in Electronic Trading**

(2) The Board of Management can measure the load generated by individual trading participants within the XONTRO system and, in the case of abuse, may exclude individual trading participants after prior notice (requiring such trading participants to reduce the upload of machine-generated electronic orders without undue delay) from using XONTRO where this is necessary for reasons of system safety or other serious reasons.

Section 51a Measures to Ensure Orderly Trading in the EUWAX Trading Segment

(1) Where orderly trading in the EUWAX trading segment – as defined by the provisions of this section – is under threat, or there is a possibility for such a threat, the Board of Management is authorized to

² The average ratio of recalled orders and changes to orders to completed orders in private investor trading at our exchange is approximately 6 to 1, whereas trade participants who flood us with HFT can reach ratios of 700 to 1. Consequently, it is unacceptable that an elite group of HFT participants is permitted to place an excessive and disproportionate strain on trading infrastructure—at the cost of private investors.

³ <https://www.boerse-stuttgart.de/en/aboutboersestuttgart/rulesregulations/rulesregulations.html>

take any and all measures which are appropriate and necessary to preserve orderly trading in the EUWAX trading segment pursuant to the provisions of this section.

(2) In particular, pursuant to sub-section 1 above, in the event of orders being potentially executable in several securities at the same time, the Board of Management is authorized to determine the sequence of price determination in the various securities. Specifically, the Board of Management is authorized to defer the priority of price determination in a security if potentially executable orders in such security were exclusively submitted by trading participants, threatening the operability of the electronic trading system or abusing market-making obligations pursuant to section 47 that are designed to meet the needs of retail investors; the same shall apply in the event of any potential threat or abuse.

(3) Abuse pursuant to sub-section 2 above is deemed to be present, in any case, if a trading participant transmits to the Exchange more than 20 modifications or deletions regarding orders to buy or sell securities traded in the EUWAX trading segment within a five-minute period on more than three occasions during the same trading day.

(4) Abuse within the meaning of sub-section 2 above is deemed to be present, in any case, if a trading participant has abused market-making obligations pursuant to section 47 on more than three trading days, as set out in sub-section 3 above.

(5) The Board of Management shall publicly announce any measures taken under subsection 2 against a trading participant where that trading participant's order execution priority has been deferred pursuant to sub-section 2 above. The Board of Management shall give, as a minimum, a one-off two weeks' notice of any measures to be taken under sub-section 2 above against a trading participant, whose order execution priority would, for the first time, be deferred pursuant to sub-section 2.

The rules above are an example of highly successful regulation to guarantee the visibility and operability of private investor orders drawn from praxis. We have a strong commitment to ensuring that any future European regulation would strengthen our ability to enact such rules. We therefore recommend that ESMA consider introducing a statement to this effect as suggested above.

Question 8: Do the draft guidelines on organizational requirements for trading platforms to promote fair and orderly trading offer a sufficiently comprehensive list of the necessary controls on order entry?

While we welcome the proposed organizational guidelines, we also recommend their phrasing be modified to encompass price-stability. So far, discussions regarding price-stability have been restricted merely to the issue of so-called circuit breakers. However, circuit breakers are merely the traditional means of ensuring price-stability at fully electronic exchanges. Hence, the guidelines must be modified to encompass mixed systems as well, that is, systems that are primarily electronic but nonetheless include a number of manual elements (e.g., for managing

larger orders or complex trading situations, as is the case in our trading system). We therefore recommend that this rule be interpreted more comprehensively and that the ESMA formulate a rule to the effect that “irrespective of whether they are electronic and automatic or partly automatic or manual, trading systems must contain procedures to slow down or halt trading insofar as this is necessary in the interests of proper market functioning.”

Yours sincerely,



Dr. Christoph Boschan
Board of Management
Baden-Württembergische
Wertpapierbörse



Oliver Hans
Board of Management
Baden-Württembergische
Wertpapierbörse