European Principal Traders Association

Position paper for the legislative proposal "Avoidance of dangers and abuse in high-frequency trading"

1. FIA EPTA principles

The European Principal Traders Association, FIA EPTA, supports transparent, robust and safe markets with a level playing field for all market participants. FIA EPTA therefore supports the stated goal of the legislative proposal of the German Federal Government to maintain the efficient functioning and integrity of financial markets in presence of new technological advancements and increased competition in form of electronic trading and new trading venues.

FIA EPTA generally endorses the proposal of the German Federal Government and is supportive of an appropriate regulation of high frequency trading activities. There are, however, considerable concerns as regards the authorisation requirement included in the current proposal. FIA EPTA believes that the authorisation requirement as currently scoped out is anti-competitive and fundamentally undermines the European Single Market framework. It pre-empts MiFID II in this regard and will prove detrimental to the quality of German financial markets.

We have set out below several specific comments which clarify our position and reasoning.

2. Regulation within Securities Exchange Act ("Börsengesetz")

- FIA EPTA strongly supports the opinion of the Bundesrat to regulate high frequency trading within the Börsengesetz. This guarantees a high quality of supervision from the BaFin as well as from the exchange's market surveillance. Furthermore, by doing so it is ensured that the whole trading activities taking place on German markets by all trading participants is covered in a very effective and efficient way as it doesn't matter where in the world the trading firm is located and whether the firm is a direct or an indirect member of an exchange.

- FIA EPTA strongly opposes to introduce any authorisation requirements for high frequency trading firms before MiFID II becomes effective. Pre-empting MiFID II and thereby abolish the level playing field which was established under MiFID I would not only have a detrimental effect on trading firms that are currently not MiFID authorised but would also negatively impact upon German financial markets in general. The foreseen authorisation requirement would heavily distort competition and create an uneven playing field throughout Europe. It would undermine the European Single Market as some trading firms would no longer be able to access German markets at reasonable costs.

- The legal framework in several countries, including European Member States, currently does not include an authorisation for high-frequency trading firms[1]. As such, firms based in these jurisdictions would not have access to the authorisation from their home regulator and can therefore not attain a MiFID passport[2]. As long as these firms would not open a German branch (which would give rise to considerable administrative and set up costs), they would simply disappear from German markets and could no longer provide liquidity in Germany. They would need to focus on trading venues based outside of Germany which would move market share and thus liquidity from the "original home market" thereby making it more expensive for the German

[1] MiFID does not include any authorisation for proprietary traders. Therefore, in some Member States firms trading their own capital are not able to achieve the necessary regulatory status.
[2] In the U.K. there are trading firms which are only authorised as "local firms". While they have an authorisation to conduct their activities they do not have access to the MiFID passport.

investors to trade at the best price. Reduced liquidity levels will also impact in form of increased volatility.

- FIA EPTA also objects to the unilateral German authorisation requirement as the Banking Act (*Kreditwesengesetz)* lacks a comprehensive third country regime. This would mean that authorisation in the U.S. and other countries would not be recognised; again creating an uneven playing field for all market participants. We note that this issue would not arise for U.S. based high frequency trading firms in the context of an authorisation requirement brought into force via MiFID II given the Directive's provisions in respect of a third country regime. The effect of essentially excluding in particular U.S. trading firms from German markets should not be underestimated given that they are major participants of German markets.

- In the event of the final legislative proposal containing an authorisation requirement we would urge that a much longer transition period (twelve months as a minimum) be implemented. Both from the perspective of firms and BaFin we view three months to be entirely insufficient given the administrative complexities entailed in any such authorisation process.. By way of an example, the regulatory reporting systems enshrined in the Banking Act cannot be designed and made operational within such a short time frame. Timing constraints such as this would not occur when regulating HFT via the Börsengesetz which is a further reason why FIA EPTA favours this type of regulatory approach.

3. Minimum tick sizes

- FIA EPTA supports the proposal to set minimum tick sizes so as to minimise the negative effects to market integrity and liquidity.

- FIA EPTA is, however, of the opinion that exchanges already handle the setting of minimum tick sizes responsibly through the self-regulatory approach of the „Federation of European Securities Exchanges"(FESE) which ensures an efficient price finding process already today.

4. Transparency

- FIA EPTA welcomes the dialogue with national regulators and agrees that firms which are members of regulated markets or MTFs and engage in algorithmic trading should disclose the general principle of the functioning of their trading systems upon request of the regulator.

- Furthermore, FIA EPTA supports the identification marker for high-frequency trading orders as proposed by the German Federal Government in order to effectively counter market manipulation. It should, however, be explicitly mentioned that market manipulation should not be associated with algorithmic trading and that market abuse must be pursued irrespective of the type of trading that is utilised.

5. Order to trade ratios

- FIA EPTA welcomes the proposed changes to the Securities Trading Act whereby trading participants need to adhere to appropriate order to trade ratios set on the basis of respective classes of financial instruments.

- FIA EPTA is equally in favour of the proposal that the order to trade ratios be set by relevant the exchange regulation. This ensures that exchange operators maintain the necessary flexibility to set parameters based on classes of financial instruments, their liquidity and bid/ask spreads.

6. Market Manipulation

- FIA EPTA endorses fair and transparent markets and tries to actively counter fraudulent and manipulative behaviour. For this purpose FIA EPTA has developed a „Best Practices"-guidance for its membership which is aimed at supporting trading firms in detecting and preventing manipulative behaviour.

- Consequently, we support the proposal of the German Federal Government to stem market manipulation and to set clearly defined rules for accepted trading practices. It should again, however, be reiterated that these rules should not make specific reference to algorithmic trading and are applicable to all market participants / trading strategies.

7. Exemption from the investor compensation scheme

- FIA EPTA welcomes the proposal to exempt firms which pursue algorithmic trading from payments to the investor compensation scheme given their proprietary trading basis and lack of customers.

- In addition, FIA EPTA is of the opinion that, for the same reason, such an exemption should also be valid for market makers.

8. Final remarks

- Algorithmic trading has made considerable contributions over the past years to improve the quality of financial markets in terms of liquidity and efficiency.

    - There have been several independent academic studies which explain the benefits of HFT and why the practice has improved market quality. The most notable recent study includes the U.K. Foresight Report,, which was commissioned by the UK government and included input from over 100 academics worldwide. More studies can be found on our website: http://www.futuresindustry.org/epta/

- In the absence of high-frequency trading the original MiFID legislation enacted in 2007 would have never been as successful in achieving:

    - opening markets previously dominated by exchange monopolies to new providers, thereby reducing explicit as well as implicit trading costs; and
    - making trading in shares a pan-European activity and enabling private as well as institutional investors to trade on exchanges outside of their domestic market at fair prices.

- Given its liquidity improving function, algorithmic trading has facilitated the efficient access to capital for companies at low costs.

- These positive aspects should be taken into account when determining the appropriate scope for regulation of high-frequency trading firms.