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October 10, 2012

Teresa Rodriguez Arias  
International Organization of Securities Commission (IOSCO)  
Calle Oquendo 12  
28006 Madrid

Dear Ms. Rodriguez Arias,

The Futures Industry Association (FIA) Principal Traders Group and FIA European Principal Traders Association appreciate the opportunity to comment on the IOSCO Consultation Report on *Technological Challenges to Effective Market Surveillance Issues and Regulatory Tools* (the "Consultation Report").

IOSCO's principles establish minimum expectations for Market Authorities with regard to market surveillance and audit trail capabilities. The goal of this Consultation Report is to review existing market surveillance capabilities and audit trail quality, and to consider appropriate additional international guidance that may be helpful to improve surveillance capabilities, in light of technological developments. FIA Principal Traders Group<sup>1</sup> and the FIA European Principal Traders Association<sup>2</sup> (collectively "FIA PTG/EPTA") supports this effort and is jointly submitting this response.

FIA PTG/EPTA membership includes more than 40 European and U.S. principal trading firms that represent a major part of the volume on listed markets globally. FIA PTG/EPTA believes that well-regulated markets provide stability, promote competition, and create efficiencies – all

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<sup>1</sup> FIA Principal Traders Group was founded in January 2010 and is comprised of 34 principal trading firms. The purpose of the organization is to provide a forum for firms trading their own capital to identify and discuss issues confronting the PTG community; define common positions on public policy issues and advance the group's collective interests through the FIA; improve public understanding of the constructive role played by the wide variety of individual trading groups in the exchange-traded derivatives markets; and promote cost-effective, transparent access to U.S. and non-U.S. markets.

<sup>2</sup> The FIA European Principal Traders Association was founded in June 2011 and is comprised of 23 principal trading firms. The mission of the FIA EPTA is to support transparent, robust and safe markets with a level playing field for all market participants. The group will work to define common positions on public policy issues, improve the public's understanding of the constructive role played by principal trading groups in the exchange-traded markets and promote cost-effective, equal and transparent access to European markets.

of which contribute to investor confidence. Moreover, as major providers of liquidity to the regulated markets and as counterparties to a large percentage of trades, our members have a vested interest in markets that are free from fraudulent and manipulative behavior.

Our members experience in the market is that there has not been an increase in illegal behaviour as markets have become more automated. In fact, fully automated markets are highly transparent, providing fewer opportunities for illegal activity than in historically, manual markets. Nevertheless, we strongly believe that Market Authorities need effective surveillance tools. As the markets become highly automated, Market Authorities' surveillance tools need to change to remain effective. For these reasons, FIA PTG/EPTA supports IOSCO's review.

Finally, because IOSCO's final recommendations are intended to assist Market Authorities in addressing surveillance challenges, it is important that the issues and challenges that IOSCO identifies are based on fact, rather than perception. For this reason, FIA PTG/EPTA respectively asks that the final report by IOSCO include support its statement that “[r]isks posed to markets by illegal or otherwise inappropriate conduct can be substantially increased by automation, as market participants have the ability to trade numerous products and enormous volume in fractions of a second.”

Thank you for the opportunity to comment on this important topic. FIA PTG/EPTA provides responses to selected questions posed by IOSCO in the attachment to its letter.

We would be happy to provide additional information as needed.

Respectfully submitted,

Donald Wilson  
Chairman  
FIA Principal Traders Group

Remco Lenterman  
Chairman  
FIA European Principal Traders Association

## Attachment

1. What regulatory capabilities are, in general, needed in order for Market Authorities to survey for and detect market abuse that occurs on a cross-asset and cross-market basis? How can such abuse be best detected and combated?

We believe that it is important for Market Authorities to be empowered to collect specific trade and order data and be able to identify which market participants are operating specific trading strategies on a post-trade basis. In particular, we believe that the exchanges are closest to the activity and the best equipped to collect and review data and can provide access to regulators. We also believe that Market Authorities need to be able to hire appropriate staff that is able to analyze and research market behavior on a post-trade basis, and they need to be able to invest appropriate amounts in technology to ensure that they have adequate data to survey activity. Market Authorities should work together to standardize and facilitate sharing information across markets.

2. Do you think existing systems (e.g., audit trail systems) in your jurisdiction monitor effectively electronic trading (both cross-market and cross-asset), i.e., are they able to ensure the fair and orderly functioning of Trading Venues and to promote market integrity? Please explain and describe any enhancements that you believe are necessary. Are the necessary resources for effective systems available?

We believe that there is wide variability in the comprehensiveness of audit trails both within a specific trading venue and across markets. We also believe that there is little consistency across assets in the types of data being collected and the relation of the data to similar assets. We think that work should be performed to create standards on the type of data that is included in any audit trail as well as specific identifiers that enable the review of the data in a meaningful way across markets, asset classes, and market participants. Where possible, we believe that existing audit trails should be enhanced and standardized.

3. To be able to perform effectively market surveillance, to what extent should Market Authorities have the ability to reconstruct and analyse order books? Why or why not?

We think that wherever possible, Market Authorities should be able to reconstruct the order book on a post trade basis, recognizing that there are expensive challenges in reconstructing order books across multiple venues and multiple asset classes. As stated in response to question 2, it is important to enrich and standardize existing audit trail data across markets in such a way as to make it easier to relate data to specific market participants and to related assets classes.

4. Do you think that developments in technology have impacted Market Authorities' ability to monitor markets? If so, how?
5. Are there specific developments that have impacted this ability more than others? If so, which ones?

In response to questions 4 and 5, FIA PTG/EPTA believes that developments in technology have impacted Market Authorities' ability to monitor markets in a positive way. Technology provides the ability to immediately and accurately capture all the information about an order sent to, or a trade executed on, a market.

In addition, technology provides Market Authorities with tools to monitor quoting and trading activity more closely than ever before. Technology can be incorporated into surveillance systems to monitor the markets in a more complete and consistent manner than ever before. Technology also can aid in the analysis and investigation of suspected market abuse.

6. To what extent have you identified instances of market abuse or possible market abuse, including inappropriate activity that could (or has) lead to disorderly markets, which you feel is directly related to the misuse of automated trading technology? Please provide details. For example: Do you believe your jurisdiction has experienced market infrastructure disruptions caused by automated trading, including HFT/algorithm use, that have caused network traffic or processing to exceed the capacity of Trading Venues, key market information providers or large market participants? If so, please describe.

Members of FIA PTG/EPTA and other market participants have an important role to play in preventing market abuse and detecting and identifying to Market Authorities instances of possible market abuse<sup>3</sup>. An individual market participant, however, does not have full information about other market participants' trading and thus any observed unusual activity is only *possible* market abuse. Only Market Authorities with access to full audit trail data and the authority to ask market participants for additional information can investigate and determine whether possible market abuse is actual market abuse.

FIA PTG/EPTA believes that market abuse is caused by the misuse of trading *strategies*, rather than trading technology. Whether a market abuse is effectuated through manual or automated means is irrelevant to its impact on market integrity.

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<sup>3</sup> To assist firms in their efforts to prevent and detect market abuse and mitigate risks, FIA European Principal Traders Association ("FIA EPTA") developed best practices that build upon existing European regulation in general and *ESMA's guidelines on systems and controls in an automated trading environment*. FIA EPTA Market Integrity Framework: Best Practices to Preserve Market Integrity (July 2012) is available at: [http://www.futuresindustry.org/epta/downloads/EPTA-Market-Integrity-Framework\\_072012.pdf](http://www.futuresindustry.org/epta/downloads/EPTA-Market-Integrity-Framework_072012.pdf)

For this reason, to avoid gaps in detection of market abuse, we believe that Market Authorities' surveillance systems should be designed to detect, analyze and stop market abuse whether the trade was generated by a computer or by a human.

Manipulative practices, unfortunately, are not uniquely employed by market participants that use automated trading technology. Rather, such practices have been employed by participants for many years, whether by means of automated trading techniques or not. Thus, FIA PTG/EPTA believes that Market Authorities surveillance efforts should be designed to detect abusive strategies, rather than on the technology used by participants.

There have been recent, highly-publicized instances of market disruption. In response, Market Authorities and market participants have, or are considering, implementing a range of risk management and automated volatility controls. FIA PTG/EPTA strongly supports these initiatives, commenting in support of regulatory proposals<sup>4</sup> and developing best practice recommendations.<sup>5</sup> However, it is important for IOSCO to clearly distinguish between market abuse, which is illegal, and market disruptions. Question 6 conflates these two issues by referring to "market infrastructure disruptions caused by automated trading" as an example of market abuse. Market disruptions occur in manual markets and in technology-reliant markets. As markets change, the nature of these disruptions and risk management and volatility controls employed by market participants needs to be adapted to new, technology-dependent markets.

7. Have there been any developments other than technology that have impacted Market Authorities' ability to monitor the markets? Please provide details.

One of the byproducts of technology is the growing globalization of financial and other markets. Cross-border activities and the trading of related products on markets subject to the jurisdiction of different Market Authorities increases the importance of coordination and information sharing among these Market Authorities.

In addition, the volume of trading has grown over the last decade. This trend increases the amount of data that Market Authorities must have the capacity to analyze in order to understand and effectively surveil financial markets.

Also, as noted by IOSCO, regulatory changes in some jurisdictions have facilitated the trading of certain securities – principally cash equities -- across multiple markets. This fragmentation increases the challenge to Market Authorities and the need to develop improved coordination and information sharing arrangements.

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<sup>4</sup> Cite comment letter on ESMA guidelines. Anything else?

<sup>5</sup> See FIA Principal Traders Group, Recommendations for Risk Controls for Trading Firms (November 2010) at: [http://www.futuresindustry.org/downloads/Trading\\_Best\\_Practices.pdf](http://www.futuresindustry.org/downloads/Trading_Best_Practices.pdf)

See FIA Market Access Risk Management Recommendations (April 2010) at:  
[http://www.futuresindustry.org/downloads/Market\\_Access-6.pdf](http://www.futuresindustry.org/downloads/Market_Access-6.pdf)

Finally, the growth in over-the-counter (“OTC”) markets magnifies the impact of other developments. For example, OTC markets make it easier to conduct trading on a cross-border basis. In addition, products traded in the OTC market are economically equivalent or related to exchange-traded instruments, often by design, which further fragments trading activity.

8. To what extent do you think that a Central Reporting Point is necessary within a domestic market in order to conduct surveillance effectively, particularly across markets and/or assets? In other words, to what extent would the development of audit trail systems that are able to consolidate pre- and post-trade data across Trading Venues within a domestic market be beneficial? Please explain your answer.

We believe that current audit trail information should be standardized and enhanced with identifiers that enable meaningful review as opposed to trying to create a Central Reporting Point for all asset classes. The cost of consolidating such disparate data in real-time and storing and analyzing voluminous data would outweigh the benefit of having it in a central repository. Rather, ensuring that data is collected in a consistent manner with sufficient identification would enable Market Authorities and regulators to conduct cost-effective and tailored investigations. A first step might be to standardize the type of data collected and the identifiers in use and then create a common reporting point for a specific asset class within a specific set of markets.

- a. To the degree that you advocate a Central Reporting Point, what kind of data would be needed for your respective surveillance tasks, e.g., order data/transactions data, both? What are the impediments to introducing these systems? What are the benefits?

We recommend that audit trails, provided by the Trading Venues, include both order data and transaction data with granular and synchronized timestamps, as near actual time as possible, given current technical limitations of even the most state-of-the-art clock synchronization methods. We also advocate identifying Market Participants in a way that makes cross asset and cross market consolidation simple and cost effective. To create a complex standard for the above or a new comprehensive data base of market participant identifiers is going to be costly and difficult to implement. We think that efforts should be made to impose minimal data collection standards on market places and then utilize existing market participant reporting mechanisms (e.g., Large Trader Reporting to the CFTC) to identify market participants.

b. What are the potential costs associated with the establishment of a Central Reporting Point?

Creating a Central Reporting Point for all order books across all asset classes and exchanges would represent tremendous costs from the complex data mapping tables that would need to be created and maintained to the enormous storage costs that would be required, particular if the data is to be kept in readily accessible formats. We know from our own efforts to create comprehensive back-testing systems across exchanges that the storage amounts to dozens of terabytes of data per day, and this would only be for a small subset of the data that would be required for a Central Reporting Point. Rather Central Reporting Points should be targeted at specific markets and specific asset classes, with standardization and identifiers enabling sharing of data across reporting points.

9. Are there alternatives to a Central Reporting Point that can achieve the same end? Please explain.

We believe that existing audit trails can be enhanced to collect consistent types of data and that certain identifiers could be added to audit trails to facilitate aggregation in more targeted surveillance investigations. This will be more cost effective and more targeted to specific investigations.

10. To what extent should market surveillance systems or audit tails require the provision of customer identifiers? What are the impediments to providing customer identifiers in audit trail data?

We believe that it is important to tie specific trade activity across markets and across asset classes to the relevant market participant. We think this can best be accomplished by utilizing existing market authority customer identification systems and selectively creating cross-market and cross asset class mapping systems where appropriate. The creation of a Legal Entity Identification system will enable market authorities to tie existing customer identification systems such as operator ID's and account numbers to a single global identifier for aggregation purposes rather than a wholesale recreation of a global customer identification standard that require relabeling customers across trading platforms and bookkeeping systems.

11. What regulatory steps, if any, should Market Authorities take in order to help ensure that any data reported to them for use and storage is in a usable format?

FIA PTG/EPTA believes that in order for Market Authorities to be able to fulfill their oversight roles, data provided to them must be in a usable format.

Accordingly, Market Authorities should offer guidance to industry participants regarding the type of data to be captured and stored and the manner in which it needs to be provided. Such guidance should include identifying acceptable means of providing data in a usable, electronic format. Usability, in turn, should be judged in terms of whether the data provided is sufficiently standardized so that meaningful analysis can be performed on data from different sources. The FIA PTG / EPTA cautions that selecting solely one acceptable method is likely not a reasonable approach; instead, the critical consideration should be identifying several methods that each ensure the completeness and usability of the data provided.

In addition to offering guidance, FIA PTG / EPTA believe that Market Authorities should periodically test the quality of data provided. Quality checks should include both internal checks on the systems of the Market Authorities themselves, as well as checks performed of participants by Market Authorities as part of periodic compliance reviews. Of course, these checks should provide participants with sufficient guidance where deficiencies are identified, as well as a reasonable opportunity to rectify any inadvertent issues.

Finally, Market authorities should also continue to maintain strict protocols designed to ensure the confidentiality of all data provided by market participants. Confidence in the confidentiality forms the bedrock of a commitment by all participants to provide complete, accurate and usable data.

12. To what extent are you concerned about the ability of Market Authorities to reconstruct and analyze order book(s) in the correct sequence? What tools are necessary to do so?

The FIA PTG / EPTA believe that audit trail data should be collected in a way that enables meaningful aggregation, reconstruction, and analysis. Central to this goal is the ability of Market Authorities to accurately sequence order books. Presently, we are concerned that the prevalence of non-standard data collection and storage processes, as well as material differences in time-stamps across trading venues, may be impeding the ability of regulators to properly sequence participant activity. This inability, unfortunately, impedes regulators ability to properly identify abusive behavior and may also lead regulators to misidentify otherwise reasonable behavior. Critical tools to enhancing regulators' ability to reconstruct and properly sequence activity include: uniform market participant identifiers, consistent approaches to the type of data to be collected, and the use of accurate time-stamp mechanisms. Of these, time-stamping is critical to reconstructing and accurately sequencing market events. Accordingly, we support efforts to promote precise time-stamps and to

standardize mechanisms or sources for clock synchronization across Trading Venues.

AND

15. To what extent do you think there would be value in requiring Trading Venues and market participants to attach a synchronized time-stamp to their orders reflecting when that order was sent?

The FIA PTG / EPTA believe that audit trail data should be collected in a way that enables meaningful reconstruction, and analysis. Central to this goal is the ability of Market Authorities to accurately sequence order books. Presently, we are concerned that the prevalence of non-standard data collection and storage processes, as well as material differences in time-stamps across trading venues, may be impeding the ability of regulators to properly sequence participant activity. Current state-of-the-art methods of clock synchronization still result in material differences versus actual time. Server clocks are inaccurate, and even after synchronization, they drift. This poses a significant hurdle in efforts to coalesce data that has been time stamped by multiple clocks, across multiple Trading Venues. Unfortunately, this impedes regulators ability to properly identify abusive behavior and may also lead regulators to misidentify otherwise reasonable behavior.

Critical tools to enhancing regulators' ability to reconstruct and properly sequence activity include: uniform market participant identifiers, consistent approaches to the type of data to be collected, and the use of precise and sufficiently granular time-stamp mechanisms. Of these, time-stamping at the trading venue is critical to reconstructing and accurately sequencing market events. Time stamping an order at the participant location and then again at the Trading Venue using two independent clocks would not produce meaningful statistics and is therefore, of little value. Audit trails produced by Trading Venues are time stamped and we believe efforts should be made to provide higher precision time stamps and to better synchronize server clocks at the Trading Venues to improve cross market data analysis. Accordingly, we support efforts to promote precise and sufficiently granular time-stamps and to standardize mechanisms or sources for clock synchronization across Trading Venues.

16. What steps, if any, should Market Authorities take to facilitate cross-border surveillance? Are the current processes sufficient?

In our opinion, currently, regulators do have insufficient overview of trading behavior outside their own jurisdiction. Market authorities should be able to quickly exchange information on remarkable market behavior. The geographical area where they can obtain this information from should not be limited by jurisdictions.

Ideally, Regulators should be able to asses trading behavior on a global scale. For this purpose they should have efficient access to order and transaction data, preferably in a global control room. In our opinion, current supervision is too much fragmented among regulators mutually, but also among regulators and regulated markets. Therefore trading data cannot be adequately and comprehensively assessed.

17. What regulatory capabilities are, in general, needed in order for Market Authorities to survey for and detect market abuse that occurs on a cross-border basis? How can such abuse be best detected and combated?

First of all, abusive scenarios should be consistently defined across the board, so it's clear for everybody engaged what constitute abuse and what not. In that case it becomes also easier for the market participants to take these definitions into account when programming their algorithms.

Regulators should have robust and consistent software tools in place that are "fed" with consistent data. Regulators should have sufficient, experienced and well trained staff that is able to assess market abuse alerts in a professional manner. Regulators should use their powers to have exchanges implement pre-trade controls on clear undesired behavior.