

HFT: HEDGING, FEEDS AND TRANSPARENCY

Ever since the May 6, 2010, “Flash Crash” — in which the Dow Jones plunged 700 points only to sharply rebound within minutes — debate has raged over what role High Frequency Trading (HFT) played in the incident and whether or not HFT technology has turned the market into an unlevel playing field. Reports of preferential data feeds and broker rebates have shifted the focus to one of fundamental fairness. Both the chair of the SEC and the chair of the Senate Permanent Subcommittee on Investigations have weighed in on the controversy.

The Need for Speed

By employing algorithms on their computers, traders could make buy/sell decisions within a fraction of a second thereby giving those who had invested millions of dollars in the new technology a significant edge over the competition. Traders across the board rushed to acquire the holy grail of HFT. But the issue then became one of “who is faster?” The stock market morphed into a financial drag strip pitting milliseconds against microseconds. Suddenly the quant — a quantum physicist trained to tweak algorithms — became more important than the Harvard MBA.

Trading — With No Buy or Sell

A side benefit of HFT allowed traders to engage in “quote stuffing” by which huge numbers of orders were placed — but then canceled — before a trade was actually executed, with the confusion serving to generate humongous profits. To the layperson this may sound like a form of market manipulation that should be illegal, but thus far, no regulatory oversight prohibits this practice.

SEC to Modernize Rules

Two weeks ago, Mary Jo White, chair of the SEC, announced sweeping changes for rules that had originally been formulated for manual trading: “Many market structure rules and industry practices were developed with manual markets in mind. They cannot be expected to optimally address all of today’s market practices.” Although acknowledging the advantages of electronic trading, she proposed safeguards against what she called “aggressive, destabilizing trading strategies in vulnerable market conditions.”

A Congressional Critic

On June 17, Senator Carl Levin (D-Michigan) convened two panels before the Senate Permanent Subcommittee on Investigations, one of which addressed HFT and the other that responded to allegations of ethical conflicts between a broker’s obligation to best serve customers and the concomitant receipt of rebates and order flow payments from certain trading channels. According to Senator Levin, “The current structure gives brokers an incentive to place their own interests ahead of the interests of their clients.”

Although Ms. White has stressed that the stock market “is not fundamentally broken” and “not rigged,” the smaller entrepreneurial investors perceive a lack of transparency and serious improprieties. Unless the greed-speed continuum is addressed, these impressions will likely persist.

CONTACT US

DAVID T. KINNEAR
O: 212.913.0500 x565
M: 917.886.3222
E: DAVID.KINNEAR@GREENPOINTGLOBAL.COM

WILLIAM H. ANDERSON, ESQ
O: 212.913.0500 x586
M: 914.672.4975
E: WILLIAM.ANDERSON@GREENPOINTGLOBAL.COM

PETER K. OVERZAT, ESQ
O: 212.913.0500 x557
M: 917.807.1321
E: PETER.OVERZAT@GREENPOINTGLOBAL.COM

WWW.GREENPOINTLEGAL.COM