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DUTCH PROPRIETARY TRADING INDUSTRY VIEW
FCA's Occasional Paper
"Quantifying the High-Frequency Trading "Arms Race"

Valuable analysis of market dynamics, but conclusions incorrect

The FCA's Occasional Paper is valuable in describing current market dynamics and provides interesting information on how frequently traders "race" and how fast those races are (coming down to a couple of microseconds). The Paper thus contributes to discussions about the speed of trading and the effect on liquidity going on within the industry and amongst exchanges and regulators. The Paper also makes an analysis of the supposed impact for the end-user. We believe the impact on the end investor is the right prism through which to look at problems of market structure.

Despite the value of the Paper in describing market dynamics, the conclusions of the Paper that there is a $5 billion per annum "Latency Arbitrage Tax" being paid by investors worldwide and that eliminating latency arbitrage would reduce investors' cost of liquidity by 17%, are questionable:

- These conclusions ignore the positive effect market makers have had on costs by being present in the market. Without liquidity providing market makers there would be less volume and wider bid ask spreads. End investors benefit if this spread, the difference between the purchase and selling price of a financial instrument, is minimal. In that case, an investor pays less when buying and gets a higher price when selling.
- Due to market makers spreads have decreased exponentially in recent decades while the liquidity of the market has increased accordingly. Liquidity providers not being present would cause a significant increase in cost of liquidity for the end-user, much bigger than the 17% assumed *decrease* in cost.
- The idea of a "tax" is misleading. This price is not "imposed" directly on ordinary investors; a market maker making a profit does not mean that the end investor loses a corresponding amount.
- The study does not take into account realized gains, but takes midpoint shifts at certain time intervals as "realized" profits. That is flawed, as actual tradable prices and quantities should be taken into account when looking at realizing gains from trading. Furthermore, the figure of $5 billion of assumed *gains* amounts to a multitude of global trading income of the whole market structure combined.

Further research into HFT and Market Making is encouraged

To get a better picture of both the negative and positive effects of High Frequency Trading and Market Making we encourage further research into this topic, which also encompasses effects on liquidity and the bid ask spread.

Association of Proprietary Traders

APT represents 23 independent proprietary trading firms based in the Netherlands, mostly operating as market makers on exchanges. Market makers are professional traders who constantly quote bids and offers to buy or sell financial instruments, such as shares, options, futures and ETFs. Market makers commit to providing liquidity to the market under all circumstances, which enables end investors to trade at reasonable prices.

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APT supports evidence based market structure initiatives that would improve the liquidity picture and attract more volume to the screen, lead to tighter pricing and more order book depth to the benefit of the investing public. Specific measures that are being considered (such as speedbumps, or periodic auctions) need to be assessed on a case-by-case basis. F.e. a market structure/functionality change that seems to benefit the option market in Europe might not work on the equity market in the US. Side effects, positive or negative, need to be taken into careful consideration as well.

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