High Frequency Trades may Hit Speed breaker-SEBI

Bumpy Ride Ahead? Sebi taking feedbacks on slowing down HFT; curbs may hit volumes, shift trading activity abroad

Will India be among the first markets to put speed-breakers in the way of high-frequency trading (HFT) -a system accused of giving some traders undue advantage because of its capability to execute transactions at lightening speed?

With markets regulator Securities and Exchange Board of India (Sebi) taking feedback from exchanges and select institutions on possible steps that could slow down the world of black-box trading, there is a growing feeling among sections in the market that some curbs on HFT may come before the year ends.

Many foreign institutions and large proprietary desks use sophisticated software programmes and place servers on the premises of stock exchange to enjoy an advantage over smaller brokers and traders. Even though HFT comprises a big slice of trading volumes and restricting them could be an unprecedented measure, Sebi is internally considering steps to bring in a level playing field between HFT and non-HFT users, according to people familiar with the matter. One of the proposals the regulator has asked for suggestions on is `randomisation' of orders, which means doing away with the priority that HFT users enjoy . Under randomisation, orders would be bunched in the exchange system and run on a random basis. This will put HFT users at a huge disadvantage because the first order that hits the system need not be the one that hits the queue first.

"Bringing in randomisation will almost kill the HFT business as there is no advantage," said Nithin Kamath, chief executive of Zerodha. Since the last few years many foreign portfolio investors using HFT models have been trading on Indian bourses as either a member or client. Better known as algo traders, they use expensive and superior software models to get the best price at a super-fast pace.

BATCH AUCTIONS

Sebi is also considering batch auctions of trades, an idea introduced by a bunch of US academics, to eliminate the race of being the first in the order queue. Under this system, exchanges would collect all the orders within frequent auction windows, match bids and execute them. Thus, high-frequency traders will not have the first mover's advantage.

The regulator is also considering barring exchanges from giving tick-by-tick data to HFT users. Tick data contains all buy and sell trades in a trading day .

Normal traders, who use Net to connect to the trading platform, gain access to four ticks at best. In case of HFT, traders are privy to as much as 300 ticks in a blink of the eye.Though it is impossible for the human eye to detect trends at that pace, high frequency traders create advanced programs on their computers designed to read trends and execute trades on the basis of these ticks. Absence of availability of a higher number ticks takes away the advantage of HFT systems.

MINIMUM RESTING TIME

Further, the regulator is planning to introduce a minimum resting time for orders, a move that will prevent “spoofing“ aimed at deceiving other market participants. Under this proposal, orders that are placed cannot be cancelled be fore a gap. Spoofers place a flurry of orders with an intention of attracting the attention of other traders, including high frequency, to the stock. They cancel the orders as the activity builds up. Global financial regulators have frowned upon this practice as it amounts to manipulation.

“A minimum resting time for orders will be a great move.We have seen several instances of spoofers walking away by misleading others,“ said the chief executive of a leading brokerage, which actively does algorithmic trading.

Global regulators have been talking about restricting HFT for a while but few have taken meaningfully action. If Sebi decided to implement all these proposals, India could probably be among the first to rein in high-frequency traders. While the biggest impact of a clamp down on high frequency trading would be on NSE, brokers said aggressive restrictions would impact trading volumes in cash and equity derivatives with HFT traders contributing over 30% of the volumes. “There is a high chance that severe restrictions will squeeze trading volumes in a big way,“ said Zerodha's Kamath.

Institutional brokers worry this could lead to a flight of activity to Singapore, where Nifty futures are actively traded by foreign investors.

(Economic Times)