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Responses to the high-speed challenge

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Published: November 16 2010 14:42 | Last updated: November 16 2010 14:42

A few weeks ago Jeremy Grant, editor of FT Trading Room, offered **readers a high-speed challenge:**

The arms race in trading speed is now absurd.

Of course, we know that it all has to do with high-frequency trading strategies. But to the average punter it beggars belief that trading at these speeds a) matters and b) is good for capital formation generally.

I have yet to hear a decent explanation from an industry practitioner for this

A number of industry experts responded – and thanks to everyone for taking the time to send them in.

After an exhaustive, latency-sensitive analysis of the responses, the best reaction received was from Tim Edwards, Remco Lenterman and Robin van Boxsel at IMC Financial Markets in the Netherlands. Here's what they had to say:

"Essentially, a market maker provides liquidity, which we believe is positive within financial markets, if not a fundamental condition of them. Speed is an essential tool for market makers to manage risk by controlling the amount of time that their quotes are placed on an exchange. This is commonly referred to as exposure time.

For every quote in the market that a market maker provides, they are exposed to that quote for the time it takes for a cancellation to be processed, or the time it takes to remove the exposure following a market move or a move in a related instrument.

Basically the higher the speed, the lower the time between when information is received and the time when such information is incorporated into prices. For any given order, the value of this fraction of a second exposure is very low. However, across an entire market venue, this adds up to very large numbers.

In the cases where exchange speeds are high, it enables market makers to manage their risk better and therefore they are willing to quote narrower spreads and for bigger size. The relationship between speed, spread and liquidity is evident on many exchanges and clearly adds value to all participants.

It is clear that in the past 10 years, major markets have become substantially more liquid with narrower spreads and lower transactions costs. Speed has played an essential role in this development.

A case in point is that markets that continue to have slow systems and/or low bandwidth have very little displayed liquidity (Hong Kong, Australia, Osaka Stock Exchange) and that in order to facilitate increased liquidity, they need to change these systems, which is happening.

The role of an exchange is to supply a venue for buyers and sellers to access securities. This is the core of capital formation, spreading risk from those who cannot bear it to those who seek it. Market makers even out the distribution of risk through portfolio management, and give liquidity where there is not a natural counterparty. Exchanges are providing exactly the service we expect of them by increasing speeds and lowering order acknowledgement times, aiding market participants to provide the liquidity we expect to be available in a market centre.

We hope we have been able to shed some light on this subject."

Tim Edwards, Remco Lenterman and Robin van Boxsel at IMC Financial Markets.

We also have a couple of runners-up, from Hirander Misra, chief executive of Algo Technologies and Giles Nelson, deputy chief technology officer at Progress Software.

Here are some edited excerpts:

"Fast trading technology is being used to level the playing field by providing transparency and efficiency to a public market. A faster exchange-matching engine acts as an enabler and assuming the business model stands up, liquidity providers will be more attracted to the fastest platform as it reacts quicker to price movements when they update their quotes. As a result, they also have less chance of being picked off by arbitrageurs than those on a slower platform when the same instrument is traded across platforms. This is one of the primary reasons why Chi-X Europe gained market share from the LSE and fared better than Turquoise and now with the LSE Group upgrading their systems the scenario could play out in reverse." **Hirander Misra, chief executive of Algo Technologies**

"I would suggest that you think of high frequency trading as being just the latest stage in the evolution of electronic trading. And this, as you know, has evolved very rapidly over the past decade because of cheaper and faster computers and networks. It's led to many innovations and benefits: electronic crossing networks, algorithmic trading, online retail trading, smaller order sizes, the overall increase in trading volume, more price transparency, greater trader productivity, more accessible liquidity, spreads between buy and sell prices tightening, broker

commissions reducing, competition between exchanges and so smaller exchange fees – none of these things would have happened without electronic trading. Mifid couldn't have happened; it simply wouldn't have been financially viable for the many alternative European equity-trading venues to launch without cheap access to networks and computers. Without these we would still have greedy, monopolistic exchanges with high transaction prices." **Giles Nelson, chief technology officer, Progress Software**

Click here to read Giles Nelson's full reply

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