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Regulators Continue To Address High-Frequency Trading

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Regulators across markets continue to show interest in high frequency trading and algorithmic trading generally. Recent developments in this area include:

- On October, 16, 2014, the SEC imposed a $1 million sanction on a high frequency trading firm, Athena Capital Research, which allegedly placed large numbers of rapid-fire orders in the final two seconds of trading to manipulate the closing prices of thousands of NASDAQ-listed stocks. According to the settlement documents, the trading algorithm, code-named "Gravy," purportedly allowed Athena to overwhelm the market's available liquidity at the close, and artificially move the market in Athena's favor.

- A high-frequency commodities trader was indicted in the Northern District of Illinois on October 1, 2014, and charged with using high-speed computerized trading algorithms to manipulate the market in various commodities. This appears to be the first criminal prosecution involving electronic "spoofing," i.e. the practice of placing bids or offers with the intent to cancel the bids or offers before execution. In *US v. Cosica*, the government alleges that the defendant implemented a high frequency trading strategy in which he entered large-volume orders that he intended to immediately cancel before they could be filled by other traders. 14-cr-0051 (N.D. Ill. filed Oct. 1, 2014). The government further alleges that the defendant devised this strategy to create a false impression regarding the number of contracts available in the market and to fraudulently induce other market participants to react to the deceptive market information.

- The CFTC obtained a Consent Order imposing a $1.56 million civil monetary penalty and trading and registration restrictions on a high-frequency trader accused of attempting to manipulate the market for wheat futures. *CFTC v. Moncada*, 12-cv-8791 (S.D.N.Y. Oct. 1, 2014). The Consent Order states that the defendant electronically entered and then immediately cancelled large-lot orders for CBOT wheat futures that he did not intend to fill in order to create a misleading impression of rising liquidity in the market. The Consent Order also states that defendant would seek to take advantage of the price movements resulting from this allegedly manipulative scheme by placing smaller orders, which he hoped to fill at beneficial prices, on the opposite side of the market.

- On September 19, 2014, FINRA announced that its Board of Governors had approved a number of new rule initiatives aimed primarily at algorithmic trading and market transparency related issues. In particular, FINRA stated that it will solicit comments on a potential registration requirement for all associated persons of member firms that (1) are primarily responsible for the design, development, or significant modification of an algorithmic strategy, or (2) are responsible for supervising such.

- FINRA also announced on September 19 that it intends to provide member firms with guidance on their supervisory obligations for the development and deployment of algorithmic trading strategies. The guidance is intended to clarify member firms' duties when utilizing algorithmic strategies and to offer suggested controls and practices to help prevent adverse market impacts.

- Briefing on the motion to dismiss has now been completed in the New York Attorney General's lawsuit against Barclays. *People of the State of New York v. Barclays Capital*, Index No. 451391/2014 (N.Y. Sup. Ct., N.Y. Cty. Oct. 7, 2014). In that case, the Attorney General alleges violations of New York law related to Barclays' Alternative Trading System (ATS) and the use of the Barclays ATS by high frequency traders.

The actions described above reflect on-going regulatory interest in at least three areas involving high frequency trading. First, regulators appear to be focused on the use of high-frequency trading to manipulate the market though fictitious trading or similar activity. Although high frequency trading seems to be the headline, the real issue appears to be whether the trading activity at issue was fictitious or manipulative.

Second, regulators appear to be focused on the level of supervision and controls applied to the design, development and modification of electronic trading algorithms. Regulators may seek to strengthen the system of supervision and controls so as to provide better regulatory assurance that electronic trading activity will be consistent with the applicable laws and rules governing securities and commodities trading.

Third, it appears that certain regulators continue to devote attention to whether high frequency trading provides some market participants with unfair information advantages over others. It should be emphasized, however, that there has been no determination that non-manipulative high frequency trading violates existing laws or rules.

For the foreseeable future, the financial community can continue to expect additional regulatory interest in high-frequency and other algorithmic trading.

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