Senate Standing Committee on Economics

ANSWERS TO QUESTIONS ON NOTICE

Treasury Portfolio

Supplementary Budget Estimates

17 October – 18 October 2012

Question: SBT 1791

Topic: High-Frequency Trading

Hansard Page: pg 94, Thursday 18 October 2012

Senator CAMERON asked:

Senator CORMANN: What are you doing at present in the context of the issue of high-frequency trading, dark pools and the way high-frequency trading and dark pools are undermining the integrity of the market?

Mr Murphy: We are working closely with ASIC on high-frequency trading. Again, high-frequency trading is quite a debate internationally and domestically. At the moment, we do not think it is harming the market.

Senator CORMANN: It does lessen the transparency of information in the market place, though, does it not?

Mr Murphy: It does, to some extent, but at least it is traded on the market. It gives market players a better price and, to some extent, it reduces volatility.

Senator CORMANN: Whereas dark pools are off the market?

Mr Murphy: Correct. Whereas dark pools are off the market and, at the moment, are possibly quite manageable. What we are really looking at—and ASIC can probably talk to you further tonight about this—is whether we have got enough market regulatory arrangements in place to ensure that these dark pools are appropriately regulated. ASIC has looked at making sure that, before you go into dark pools, there has to be meaningful price improvement. In other words, you should stay on the lit market unless you are on the organised market and that you can demonstrate that you are going to benefit people. There are also questions as to whether there should be a minimum size as to what could be traded in dark pools.

These are all issues that ASIC made some pronouncements about. A major market survey is being conducted and ASIC is looking in depth at this. These are international things. We cannot be Canute, and say, 'We are not going to be involved in these things.'

Senator CORMANN: Thank you very much, Chair.

CHAIR: Thank you. Senator Cameron wants to put a question on notice.

Senator CAMERON: Mr Murphy, I like the idea that we cannot be Canute on some of this stuff, so could you give us some details on notice of the financial transaction taxis that are trying to deal with some of this high- frequency trading around the world and give us details of what is happening?

Answer:

Only eleven out of 27 EU countries have agreed to the implementation of a financial transactions tax: Austria, Belguim, Estonia, France, Germany, Greece, Italy, Portugal, Slovakia, Slovenia and Spain. The precise arrangements of this tax have not yet been decided, although the European Commission has recommended a 0.1 per cent transaction tax for trades in bonds and stocks, and 0.01 per cent for trades in derivatives. These countries say they intend to have a financial transactions tax in place from the start of 2014.

The French Government moved unilaterally to the introduction of a financial transactions tax, which was implemented in August. The French approach includes a 0.2 per cent transaction tax on all trades, as well as an HFT-specific element. The HFT tax applies to traders that use computer algorithms to automatically determine price, quantity and timing of trades, and alter or cancel orders within half an second of their being placed. If more than 80 per cent of trades by an operator are modified or cancelled within this half second timeframe (that is, if the order-to-trade ratio is above 5:1), a tax of 0.01 per cent is imposed upon the value by which the modified or cancelled trade rate exceeds 80 per cent.

Those who advocate for financial transactions taxes as a response to HFT argue that it would reduce the volume of HFT activity by making the cost of trading more expensive. However some analysts anticipate that HFTs would simply widen the spread between their bid and offer prices, with other traders bearing the cost impact.

Further, a 2003 IMF staff paper found that financial transactions taxes may in fact contribute to increased market volatility[1], potentially exacerbating one of the key concerns with HFT activity in financial markets. For this and other reasons, a number of EU members, including the United Kingdom, strongly oppose the introduction of a financial transactions tax and will not be participating.

In Australia cost recovery arrangements for ASIC are in place. These arrangements charge fees on orders, messages and trades to cover the cost of ASIC's market surveillance activities. Unlike the ad valorem arrangements used overseas, where the fee is charged as a proportion of the transaction value, the cost recovery fees are a fixed rate for each message and each trade.

[1] http://www.imf.org/external/pubs/ft/wp/2001/wp0151.pdf