ICI VIEWPOINTS

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SEC Chairman: SEC Examining Role of High Frequency Traders

On the first anniversary of the 2010 "flash crash," Securities and Exchange Commission (SEC) Chairman Mary Schapiro highlighted the role of high frequency traders that day and said there is cause for the SEC to examine their role.

In a speech to the ICI General Membership Meeting, Schapiro said that May 6, 2010, was a "very profitable day" for high frequency traders, who accounted for half of the market volume and were net sellers that day. Their actions took liquidity from the market, rather than providing it, she said. During the flash crash, the Dow Jones Industrial Average suddenly plunged 1,000 points, then rebounded quickly by 600 points, setting off a liquidity crisis in hundreds of individual securities, more than 20,000 broken trades, and severe market volatility.

The behavior of high-frequency traders means that further examination of their role as market participants and their effect on the markets is not only desirable but a necessity for conscientious regulators, Schapiro said. The goal of the SEC is to ensure that the markets operate in as fair and orderly a fashion as possible, on good days and bad days alike, Schapiro said.

The SEC has responded to the flash crash with various rules addressing trading—including those eliminating stub quotes, implementing circuit breakers, and clarifying clearly erroneous trades—and is considering other market structure changes. For example, as part of a "volatility plan" recently proposed by the exchanges and the Financial Industry Regulatory Authority (FINRA), the agency is also considering expanding the circuit breaker pilot program to include all U.S.-listed equities and to cover the market opening and closing periods; imposing a limit up-limit down regime; and cutting by half the price parameters that would trigger a market pause, from 10 percent to 5 percent.

Other issues still to be addressed by the SEC include the regulation of so-called dark pools—where trading occurs outside the public market—to appropriately reflect their market role, Schapiro said. The Commission is also considering whether to set standards for the capacity of automated trading systems, which would affect a range of market centers, including exchanges and alternative trading systems.

Further, the SEC, Schapiro said, is considering possible regulatory approaches to high frequency traders, including the imposition of market maker obligations and measures to address the "entire regulatory structure" surrounding high frequency traders and their algorithms. Other changes in the offing may well offer a measure of protection to investors in the near term, she said. For example, the “volatility plan” would have made a “real difference” during the flash crash by providing a 15-second “limit state” designed to permit markets to correct naturally, so that minor liquidity imbalances would not trigger a trading pause.

In a question and answer period, Schapiro said the Commission plans to return this summer to its proposal on reforming Rule 12b-1 and its related mutual fund fees. She said she continues to believe the current 12b-1 regime “really can’t be left to stand.” The Commission will look at this reform in tandem with a forthcoming proposal to harmonize the customer obligations of broker-dealers with those of investment advisers around a fiduciary standard, because there is “clearly a relationship” between the duties of intermediaries and the compensation provided by 12b-1 fees.
