

Bundesanstalt für Finanzdienstleistungsaufsicht
Wertpapieraufsicht / Asset-Management
Referat WA 11
Marie-Curie-Str. 24-28
60439 Frankfurt

By email to hft@bafin.de

17 May 2013

Dear Sirs,

AIMA-MFA submission to BaFin on the Interpretation of the German HFT law

The Alternative Investment Management Association (AIMA) and Managed Funds Association (MFA) (together, the Associations) appreciate the efforts of the *Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin) to provide guidance on the *Gesetz zur Vermeidung von Gefahren und Missbräuchen im Hochfrequenzhandel*¹ (hereafter: “HFT law”). We would like to take this opportunity to set out a number of issues in respect of the HFT law that we believe could helpfully be addressed by BaFin, either in the course of developing implementing rules or through the publication of Frequently Asked Questions (FAQs)². In Annex 1 we have provided suggested FAQs and set out a number of points that we believe BaFin should address.

The Associations represent the views of investment managers whose fund investors include pensions, endowments, foundations and insurance companies, as well as certain individuals. An investment manager, a distinct legal entity, is a fiduciary responsible for implementing a fund’s investment strategy and trading securities on a fund’s behalf. The investment manager trades securities as a customer of an intermediary; accordingly, the investment manager is the indirect member of a trading venue.

Our members treat regulatory obligations very seriously and want to ensure that they are in compliance with all applicable regulations at all times. We believe market participants would benefit from greater guidance with respect to terms used pursuant to the HFT law. This is especially important in the context of the definition of high-frequency trading. We respectfully suggest that BaFin should clarify that where an investment management firm trades on a German organized market or multi-lateral trading facility on behalf of funds that it manages, neither the investment management firm nor the funds on whose behalf it trades are dealing on own account, meaning that they are therefore not subject to the definition of HFT and the associated licensing regime.

¹ <http://dipbt.bundestag.de/dip21/brd/2013/0156-13.pdf>

² We refer to BaFin’s existing FAQs, which provide a useful template: http://www.bafin.de/EN/DataDocuments/FAQ/HFT-Gesetz/hft-gesetz_node.html

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We would be happy to discuss further any of the points raised in this submission. Please feel free to contact Jiří Król, Deputy Chief Executive Officer, of AIMA, at 44 20 7822 8380, or Stuart J. Kaswell, Executive Vice President & Managing Director, General Counsel, of MFA, at (202) 730-2600.

Yours sincerely,

/s/ Jiří Król

Deputy Chief Executive Officer
Alternative Investment Management Association

/s/ Stuart J. Kaswell

Executive Vice President & Managing Director, General Counsel
Managed Funds Association

cc: Hessisches Ministerium für Wirtschaft, Verkehr und Landesentwicklung

About the associations

Founded in 1990, **AIMA** is the global representative of the hedge fund industry. We represent all practitioners in the alternative investment management industry - including hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. Our membership is corporate and comprises over 1,300 firms (with over 6,000 individual contacts) in more than 50 countries.

Managed Funds Association represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent and fair capital markets. MFA, based in Washington, DC, is an advocacy, education and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and all other regions where MFA members are market participants.

Annex 1: Suggested FAQs and points for clarification in the context of the HFT law

1. High Frequency Algorithmic Trading

Q: The HFT law adds a definition of high frequency trading to § 1 subsection 1a of the German Banking Act (Kreditwesengesetz - KWG). Does this definition - and the associated licensing requirement - apply to investment management firms and/or the funds on whose behalf they trade?³

A: To the extent that investment firms or investment managers only trade on behalf of funds they manage, neither those firms nor the funds on whose behalf they trade are covered by the definition of HFT under § 1 subsection 1a no. 4 of the German Banking Act (KWG). Rather, such investment firms fall under the definition of portfolio management, which is defined as the administration of individual portfolios of financial instruments for others on a discretionary basis, § 1 subsection 1a no.3 KWG.

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Q: What is meant by “infrastructure intended to minimise latency times”?

A: Infrastructure intended to minimise latency is characterised by a fulfilment of all of the following features:

- either co-location or proximity hosting;⁴
- high speed electronic access;
- use of a data connection to the matching machine of the market with the largest bandwidth offered; and
- a high intraday message rate.

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Q: How does BaFin interpret the formulation “high intraday message rate” as included in the definition of HFT?

A: BaFin considers a “high intraday message rate” to cover any individual algorithm, as defined by the firm using the algorithm, that generates an average of at least 75,000 messages per trading day, excluding market orders and “status” messages sent by a trading venue (e.g., a message from a trading venue confirming partial execution of an order) to a German exchange or multilateral trading facility over the course of a rolling 12 month period. The focus with respect to message rate, consistent with MiFID (*i.e.*, high order-to-trade ratio), is on the level of cancellations by the direct or indirect participant of a German regulated market.

³ A fund is typically administered by a distinct legal person, the investment manager. The investment manager will be an indirect member of one or more trading venues and trades securities on behalf of the fund, which would not itself be a member of the trading venue. In the context of the German legal framework, the investment manager is undertaking portfolio management.

⁴ We would welcome further detail from BaFin on the definition of both co-location and proximity hosting.

2. Definition of algorithmic trading

Q: How does BaFin interpret the formulation “without human intervention” as included in the definition of algorithmic trading in § 33 paragraph 1a sentence 1 of the Securities Trading Act?

A: Examples of human intervention include, but are not limited to:

- a decision by a trader whether and when to transmit orders that have been generated by an algorithm;
- a decision by a trader whether and when to switch an algorithm on or off from trading, or adjust its trading parameters;
- pre-trade review of algorithmically generated orders by a compliance officer or trader;
- real-time oversight by a trader of orders whilst they are being executed, regardless of whether the algorithm has sent the orders to the market without human intervention.

To the extent that a firm’s trading strategy involves human intervention, then it will not be classified as algorithmic trading.

3. Requirements in respect of algorithmic trading

Q: Do the requirements of the Securities Trading Act apply to firms established outside of Germany?

A: The requirements of the Securities Trading Act, including those under § 33 paragraph 1a and § 4 paragraph 3a, apply only to firms who hold a licence under the KWG.

4. Flagging of algorithmic orders

Given that German trading venues are in the process of developing flagging requirements, we believe that the following should be addressed in developing those requirements:

- whether it is appropriate for order execution algorithms to be subject to the flagging requirement;
- which algorithm should be flagged where a trade is the result of the interaction of two or more algorithms;
- how to implement the flagging requirement in a manner that respects commercial confidentiality, e.g. daily rotation of flags and conditions on how data should be stored and accessed by authorities; and
- the phase-in of flagging requirements for market participants.