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Comment from Anonymous Anonymous

This is a Comment on the **Department of the Treasury** (TREAS) Notice: **RFI on U.S. Treasury Market Structure**

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Comment

Response to question 2.3:

Question: "2.3 What types of algorithmic trading strategies are commonly used by participants in the U.S. Treasury market? What features do those strategies have in common, and what features differ across strategies? What are the potential benefits and risks to an effective U.S. Treasury market functioning resulting from certain algorithmic trading strategies, certain order types, and/or particular trading venue policies or practices."

Response: Sell-side and hedge fund traders in the interdealer market have reported concerns around the interplay of high-frequency traders and 'work-up' order type. As reported on Risk.net - http://www.risk.net/risk-magazine/news/2426923/client-list-reveals-hft-dominance-on-brokertec - high-frequency traders are dominant in the interdealer markets.

The work-up order type allows an order's size to be negotiated while the order is frozen. That was of considerable value when firms were trying to reduce the market impact of a large trade as they did not have to show the market the size of their trade.

However since the early- to mid-2000s firms began to co-locate at the eSpeed and Brokertec data centers, which gave them the capacity to see data at a very high speed across the cash and futures market and that has changed the effect of work-up according to press reports - http://www.fi-desk.com/government-municipal-bonds-treasuries/.

High-frequency trading firms provide valuable if shallow liquidity to the market. However the ability of their systems to look across the different IDB markets and futures markets in anywhere between from microseconds to milliseconds allows them to use the work-up protocol to freeze trades for

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seconds while they assess whether or not to trade. Consequently non-HFT traders find prices move against them. That negates the defence against information leakage that work-up initially provided.

In the review of the October 2014 spike/crash in Treasuries, the Fed reported that work-up accounted for the majority of orders and that these were largely placed by HFT firms. For firms that place and cancel hundreds of orders a second in to get the right price, placing an order that will not complete for a matter of seconds appears counter-intuitive. Executing at small size and in microseconds is the norm for HFT firms in most markets. Work-up is more advantageous than rapid execution.

The business model that supports an investment in high-frequency trading technology does not exist for every market participant so firms cannot level the playing field themselves. HFT firms are a very useful source of liquidity. Consequently this review of market structure ought to consider how the market can retain a diversity of participants without allowing one a structural advantage over another.

In this instance it seems that the use of order types can push away some market participants even as it draws others in. A similar situation occurred in the equity markets with controversial payment for order flow via the 'maker-taker' model. It was used by market operators to attract HFT firms who increased trading volumes.

HFT flow should not be pushed away, but it should not be given a structural advantage that reduces market diversity. Market operators naturally want to see higher volumes of trading, but that should not be at the expense of market quality.