SEC fines exchange over ‘queue-jumping’ orders

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WASHINGTON (MarketWatch) – BATS Global Markets Inc. agreed to a $14 million settlement with federal regulators over charges that two exchanges it acquired last year did not accurately describe order types to customers, officials said Monday.

The Securities and Exchange Commission found that the two exchanges, formerly owned by Direct Edge, did not properly disclose the existence of an order type called “hide not slide” which allows the orders of some high-frequency traders to jump ahead of other orders.

The SEC claimed the two exchanges, EDGA and EDGX had three different variations of price sliding order types while operating under rules that claimed only one type. It also said the exchanges failed to describe the execution priority of three order types relative to each other and other order types.

The $14 million penalty is the SEC’s largest against a national securities exchange and the first principally focusing on stock exchange order types.

In addition, the SEC order said the two exchanges only gave accurate information to some members, including certain high-frequency trading firms that Direct Edge sought input from on how “hide not slide” should operate.

“They [high-frequency traders] worked with Direct Edge to design a queue jumping order,” said Haim Bodek, founder of Decimus Capital Markets, LLC, who filed a whistleblower complaint about his concerns with order types like “hide not slide.”

Under current SEC market rules, to prevent locked markets, which occur when a stock’s bid and ask prices are the same, orders have to “slide back” by one minimum price variation before the trade is executed. For example, if a buyer and seller both want to trade a stock at one price, the buyer might typically have to “slide down” one cent, while the seller stays at their original offer, according to an explainer by the Wall Street Journal.

But this rule only applies to displayed orders while “hide not slide” orders are hidden from other investors on an exchange. As a result, they do not have to “slide back,” allowing them to jump ahead when a market is unlocked and display at the original price before the original order that was initially displayed.

“It allows an order that allows a price that’s hidden to jump ahead of visible orders,” said Joe Saluzzi, co-founder of Themis Trading.

BATS Global Markets released a statement after the announcement saying it had entered into the agreement with the SEC to put the matter behind it. “The SEC does not allege that there was anything inherently inappropriate about the order type functionality,” the statement said. “Rather, the SEC alleged that the price sliding functionality was not completely and accurately disclosed in Direct Edge’s rules.”