Could Russia use high-frequency trading to crash the markets?

By Eric Garcia
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WASHINGTON (MarketWatch) — The allegations were as explosive as they were seemingly ridiculous — that a wiretap intercepted by the Federal Bureau of Investigation overheard a Russian plot to learn more about high-frequency trading to cause instability in markets.

As part of allegations made against a Russian spy ring, the FBI says it heard of a plot to use journalists to ask the New York Stock Exchange about exchange-traded funds and “trading robots.”

See: Russia tried to learn how to use high-speed trading to rock market, U.S. says
Dave Lauer, president and managing partner of market-structure research firm KOR Group, described a possible situation where a country could start a high-frequency trading firm, give it an air of legitimacy by making it have plenty of capital as well as conducting trading for awhile, before submitting a massive amount of sell orders which could lead to a flash crash.

“A flash crash would need to be set off by sell orders,” Lauer said in an email. “Manipulation in general can be in either direction.”

The scenario sounds similar to the May 2010 flash crash or when Knight Capital made a series of accidental orders that ultimately cost the company hundreds of millions of dollars.

But Lauer added it would be difficult to execute a plan.

“A lot of things would have to fall into the right place at the right time,” Lauer said.

Eric Hunsader, founder of market activity tracking firm Nanex, agreed it was possible. Lending to the instability is the fragmented nature of stock trading, where the same stock is traded in several different venues.

“Each exchange is an island and only watches what’s going on in their island,” he said.

Still, Hunsader said it would be a matter of whether Russia or possibly another country had the money to do so. And he also pointed out that any loss in activity would be temporary.

“If the market’s not trading for a day, the world isn’t going to end,” he said. “To me it looks like a big expense for not much gain.”

Joe Saluzzi, cofounder of Themis Trading, said while cybersecurity is a concern, an attempt to conduct what the Russians were discussing is not likely.

“It doesn’t seem sophisticated,” he said. “It looked like a couple of guys trying to look for buzzwords.”