The Underground Trading Community

FRONT RUNNING

www.the-utc.com

Front running is the practice of entering into a trade based on advance knowledge of pending orders, typically to capitalize on the price movement those orders may cause.

Key Points

1. Often considered unethical or illegal, especially when done by market makers or brokers

2. Can affect market liquidity and fairness

3. Different from legitimate anticipatory trading based on public information

Types of Front Running

1. Classical Front Running:

- Trading ahead of a known client order

2. Electronic Front Running:

- Using high-speed systems to detect and act on order flow information

3. Insider Trading (a form of front running):

- Trading based on non-public material information

How Front Running Works

1. Obtain information about pending large orders

2. Enter a position in the same direction before the large order is executed

3. Exit the position after the large order moves the market

Impact on Markets

1. Can lead to worse execution prices for large orders
2. May reduce market liquidity
3. Erodes trust in market fairness

Detection and Prevention

1. Regulatory surveillance:
Monitoring trading patterns for suspicious activity

2. Time-stamping of orders:
To track the sequence of trade executions

3. Ethical guidelines and compliance training for market professionals

4. Use of algorithmic trading to disguise large orders

Legal and Ethical Considerations

- Front running is illegal when done by brokers with client order information

- It's a grey area for traders using publicly available information

- Ethical traders should avoid any practices that unfairly disadvantage other market participants

Tips for Traders

Be aware of potential front running when placing large orders

Consider using algorithms or splitting large orders to minimize impact

Report any suspicious trading activity to regulatory authorities