

E-TRADING GOVERNANCE UPS THE PACE

ALGORITHMIC TRADING GOVERNANCE GOES MAINSTREAM

From January 2018 MiFID2's RTS 6 - the HFT and Algo Trading Governance requirements that stipulate investment firms' risk controls, audit and operational rigour will apply to a very broad audience of electronic trading participants.

1 Document all aspects of the behaviour of Strategies including Quoting Engines, ALGO's and SOR's

2 Train ALL associated Compliance staff on ALGOs

3 Real-time order & trade surveillance, cross asset

4 Document all Risk Controls and associated Trading Limits.

5 Review the entity's IT Business Continuity, Business, Operational and Cyber Risk

6 'Kill Switch' functionality with respect to regulatory obligations



Greyspark Partners has a tried & tested methodology, governance framework and skilled resources to execute an audit against ALL of the above, and to produce all of the necessary documentation, process and controls to meet the RTS6 obligations both on a one off and ongoing basis

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High-performance algorithmic trading is no longer the privilege of a few high-tech trading firms leveraging cutting-edge, specialised infrastructure. Low-latency trading services are now commoditised, allowing a broader audience of market participants to access this 'F1 e-trading world.' However, trading firms also need to invest in more than just straight-line performance; it is now just as important to have the right 'pit crew' supporting the business, certifying the controls and governance of the algorithms being used on the trading platform to ensure the safety of the financial stability of the firm and of the firm's clients.

To that end, the EU's Markets in Financial Instruments Directive (MiFID II) regulatory technical standard (RTS) 6 states that: "The final draft RTS ...under Article 17(7)(a) of MiFID II further specifies the organisational requirements to be met by all investment firms engaging in algorithmic trading, providing direct electronic access (DEA) or acting as general clearing members in a manner appropriate to the nature, scale and complexity of their business model, addressing the potential impact of algorithms on the overall market."

Consequently, under the scope of RTS 6, a wide variety of execution services are affected by MiFID II, including high-frequency trading (HFT) systems, quoting engines, algorithmic trading systems and smart-order routers (SOR) irrespective of whether those services are run by the regulated entity or outsourced to a third-party provider. Simply put, the regulations mean that even those entities offering or accessing what appears to be the most simple and innocuous of DEA services must adhere to the same level of audit and governance that is required of their HFT counterparts. These DEA mandates include the use by trading firms of smart routers, quoting engines and benchmark algorithms as either stand-alone or packaged execution services for their clients.

Greyspark Partners believes that there are 10 things that trading firms must have in place for MiFID II RTS 6 compliance by January 2018. Specifically, the firms must:

1. Notify their local EU National Competent Authority (NCA) that their execution services are within the scope of the regulations.
2. Document all aspects of their behaviour within certain trading strategies, including the use of quoting engines, algorithms and SORs.
3. Review and document all risk controls and associated trading limits.
4. Store all orders and quotes, where applicable, for 5 years to 1 microsecond accuracy.
5. Train all compliance staff on algorithm usage, and ensure the allocation of sufficient resources to meet the ongoing compliance obligations.
6. Accommodate kill switch functionality with respect to regulatory obligations.
7. Have real-time order and trade surveillance on a cross-asset basis with full case management.
8. Review the trading firm's IT business continuity, business, operational and cyber risk documentation on an annual basis and demonstrate that suitable levels of testing on the standards were performed.
9. Review, evidence and document all related trading capacity, thresholds and limits and have ability to document and test those methodologies as required.
10. Be prepared to be audited by the local regulator on items 1-9 on an annual basis irrespective of whether those services are delivered directly by the regulated entity or by the client's nominated outsource provider.

Greyspark Partners has a tried and tested methodology, governance framework and skilled resources to execute an audit against all of the above, and to produce all of the necessary documentation, process and controls to meet the RTS 6 obligations both on a one-off and ongoing basis. By defining all aspects of the strategies and by auditing the kill switch functions and business continuity procedures, this documentation can then be used to train the relevant compliance and operational staff while being used as a framework for annual audits.

About Greyspark Partners:

Founded in 2009, GreySpark Partners is a niche capital markets e-commerce, e-trading, risk and risk management consulting firm that specialises in providing advisory and consulting services to a wide range of Tier I and Tier II investment banks in Europe, Asia-Pacific, the US and globally. GreySpark consultants also work with asset management firms, hedge funds, institutional investors, private banks and wealth management companies – as well as exchange operators, fintech providers and trading technology companies – to facilitate change and deliver technology to broader financial markets community.

GreySpark's specific areas of expertise include pre-trade risk management and algo documentation, cybersecurity, research-based IP creation and advisory, regulatory implementation and change management and software development services across a range of traditional and bespoke business, management and technology consulting services. ■