

BEST PRACTICES IN PRE-TRADE RISK CONTROLS 2014



In 2014, **flash crashes** occur on stock exchanges worldwide, ranging in size and significance from multi-platform events to **'mini-flash crashes'** in which a single stock or a small group of stocks on one or more exchanges suffer rapid, unexpected declines in value as a result of problems related to the design and implementation of automated trading systems.



The malfunctioning of the **Knight Capital Group** equities trading system in 2012 along with the continued occurrence of 'fat finger' human errors demonstrates how the majority of the global equities market operates on autopilot. In 2014, the e-trading landscape is growing to include more asset classes as many markets increasingly become ever-more automated.



This report outlines a set of pre-trade risk controls developed by **GreySpark Partners** that are tailored for sellside market-making institutions. These pre-trade risk controls are a set of best practices that can be used to mitigate potential risks on the path toward trade execution.

Market events like **the 2012 Knight Capital Group** stock trading incident are symptomatic of the need for banks to be careful when creating or expanding algorithmic or high-frequency trading capital markets trading businesses.

This report provides banks involved in the evolution of the e-trading industry with guidelines on how to most effectively take responsibility for the design of their systems so that the systems do not negatively disrupt the orderly functioning of the bank or the marketplace.

SEC Rule 611, the Order Protection or 'Trade Through' Rule in Reg NMS, goes into effect in the US for a pilot program of 250 securities. The start of SEC enforcement of this rule effectively brings Reg NMS into full implementation.



2007

Implementation of Reg NMS

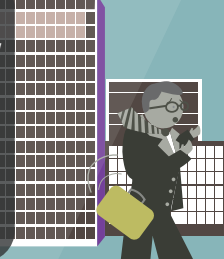
The Dow Jones Industrial Average (DJIA) lost 600 points over the course of a few minutes and then quickly recovered in **what became known as a 'flash crash'** event. Other major market indices in the US and globally dropped by similar amounts during and after the collapse of the DJIA and its recovery.



2010

The DJIA 'Flash Crash'

Knight Capital Group announced that it lost USD 440mn when it accidentally sold all of the stocks that it accidentally bought after a test algorithm designed to ensure that the 10% up/down limit movements on stocks traded on the NYSE were functioning correctly malfunctioned.



2012

Knight Capital Group

As complexity has become the **hallmark** of e-trading landscape, bank clients **are increasingly demanding** more from their electronic execution systems including access to a wide range of dark pools, smart-order routing, low and ultra-low latency market access, sophisticated algorithms and comprehensive internal and regulatory compliance and activity surveillance controls.

GreySpark Partners has developed a unique set of pre-trade risk controls practices **into a service offering** available for use by the capital markets business of an investment bank, its clients – either independently or in concert with their business with a bank – and by other types of market participants.

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