Don't Be Killed by your Brokers' Market Access Kill Switches

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The SEC Enforcement Order against Knight calls for Brokers to institute fully automated 'lock downs', prohibiting orders from entering the market if risk thresholds are reached. Called 'kill switches', are you aware of the conditions that could trigger a lock down and how it would affect your orders and position?

Implementing 'reasonable' trading controls

The first SEC enforcement action of the Market Access Rule 15c3-5, was issued last month against Knight Capital. The rule, also known as the Naked Access Rule, was adopted in 2010. It is written broadly, asking for Brokers to institute '*reasonable'* risk controls across proprietary, sponsored, and client trading. With this first enforcement order (SEC vs. Knight October 16, 2013, violation of 15(b) and 21C), we now have a clearer definition of 'reasonable'.

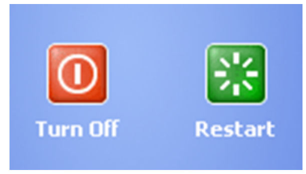
Not just risk monitoring, but hard-coded order stops

The Enforcement Order indicates that humans monitoring risk systems are not good enough. It sets the expectation for Brokers to **establish fully automated order halts** or kill switches around algos, clients and the aggregate brokerage firm. These order stops must be triggered upon a variety of pre-determined credit, compliance and technology incidents.

Hard-coded kill switches will affect you. But how?

Sounds simple: but it's not

Many hedge funds have dozens of Broker relationships. Imagine each with different communication procedures, limit enforcements and shut down controls. You can always re-direct order flow from one Broker to another. But when facing a Broker-controlled shut down, will you know what's been filled, and what your open position is? Will you know how to re-start your trading in an orderly fashion?



What are the questions to ask your Broker?

Don't wait for an incident.   Have a detailed conversation with your Broker. Look carefully how they are evolving their market access controls and ask the following questions:

- *Review market events, your trading parameters and aggregated Broker triggers: What are the conditions that could halt your trades?*

Your Trading Parameters

- *Does the Broker have warning zones before you meet position thresholds?*
- *Has the Broker implemented 'close only' capabilities so that you can unwind a position orderly?*
- *How does the Broker calculate your open order exposure?*
- *When a control point is triggered, how is this communicated and how quickly are you notified?*
- *Can your broker provide you with a real-time view of your trading risk?*

Controls across Clients

- *Do you share exchange sessions or routers with other clients that could affect you in the event that **their** orders need to be stopped?*
- *What would happen if your Broker reached a firm-wide pre-set capital threshold?*
- *How does the Broker calculate open order exposures across the firm?*

Market Events

- *In the event of a significant market event (black swan) how will the market access controls react to your outstanding orders?*

The area of market access risk controls is evolving rapidly. So too will your Brokers' implementation and supervisory procedures evolve.   Review your situation periodically. Once you see the details, it may be a more complicated situation than you anticipate.