What are the key challenges?

As electronic trading has become the dominant way to execute trades on several markets, many firms are looking to enhance governance, systems and controls to overcome the following key challenges:

**Managing Conduct Risk**
Firms need to adapt and enhance their conduct risk frameworks to provide effective controls for electronic trading business.

Examples of higher risk features include last look and smart order routing where rapidly evolving practices have exposed firms to an inherently high risk profile.

**Evolving Regulation**
Firms need to adopt a substantial number of new regulatory requirements for algorithmic and high frequency trading.

With growing regulatory expectations and MiFID II implementation, firms are considering how best to enhance their governance, policies and controls.

**Preventing Financial Losses**
Firms need to ensure their systems are robust and resilient, support effective functioning of markets and prevent financial losses.

Past events that led to market flash crashes or bankruptcy are driving risk management priorities across the industry.

**Evolving Market Standards**
Firms need to stay on top of fast evolving industry standards on managing risk in electronic trading environment.

Immature risk management practices are still catching up with the fast pace of developments in electronic trading.
Electronic trading control framework

Firms need to develop a comprehensive electronic trading control framework to identify, measure and control their exposure to risks. Firms should assess the effectiveness of these arrangements within each of the following areas:

**Algo development**
Establish an algo development lifecycle to test, approve and deploy software as well as maintain transparent records.

**Pre-trade checks**
Strong pre-trade controls to manage orders within predefined risk limits.

**Governance**
Accountability and effective oversight arrangements to ensure ongoing adherence to the requirements.

**Trade execution**
Real-time monitoring of trade execution with reliable system logs, manual override procedures and kill switch functionality.

**Internal audit**
Conduct periodic reviews of electronic trading controls framework. Self assessments may need to be submitted to the regulator.

**Post-trade monitoring**
Granular post-trade data collection for risk monitoring and reconciliation with third parties.

**Monitoring and surveillance**
Transaction monitoring and communication surveillance procedures, as well as second line responsibilities should be clearly defined.

**Resilience and recovery**
Testing the resilience of systems to cyber attacks and internal stress. Ensure prevention of disorderly markets in the event of system failure.
How can KPMG help?

We support firms in a number of ways in their journey to compliance with electronic trading rules, helping them to reduce exposure to risks and improve business processes. We also perform industry benchmarking to help firms understand their market position.

**Design of a governance and controls framework**
- Help to design a framework to identify, assess and manage risks arising from electronic trading activities.

**Industry benchmarking and best practice**
- Insights into industry standards and leading market practice.
- Identification of potential gaps and areas for improvement.

**MiFID II implementation support**
- SME support with the implementation of the electronic trading compliance framework.
- Working alongside the business to carry out an assessment of internal risks.
- Designing remediation programmes to enhance the culture, governance, policies, procedures and controls.

**Risk and controls assessment**
- Identification and assessment of inherent risk.
- Control effectiveness review to assess residual risk exposure.

**Historical outcome testing of conduct scenarios**
- Testing historical trade data to check that client outcomes were in line with the firm’s minimum standards of accepted practice.
- Provide firms with a set of repeatable tests to be run on a periodic basis, even if algo logic and code change in the future.

**Regulatory impact assessment**
- Identification of gaps between existing practices and regulatory expectations.
- Highlighting vulnerabilities and opportunities for improvement.

**Assurance review**
- Assessment of the design effectiveness of key front to back electronic trading controls.
- Walkthrough of key controls with control owners to assess implementation effectiveness.
- Testing the operating effectiveness of controls through sampling and identifying areas for improvement.
KPMG experience and capabilities

**Skilled and experienced team:** our people have experience delivering a number of electronic trading engagements for a range of clients. Our team members have been involved in supporting the design and diagnostics of electronic trading governance and control frameworks, regulatory impact assessments, implementation and assurance reviews.

**Strong track record:** our team has successfully delivered a wide range of electronic trading projects across multiple jurisdiction. We have helped firms to meet regulatory requirements and to assess performance against industry standards.

**Regulatory insight:** we participate in the FMSB initiative to help establish electronic trading standards and have invested in a Regulatory Centre of Excellence. We have built strong relationships with global regulators, providing us with insights into their expectations.

**Established frameworks:** through our extensive experience in regulatory change and wholesale conduct engagements, we have developed a number of tools, methodologies and reference standards. These capabilities can be deployed on electronic trading projects and reflect our view of good market practice and understanding of regulatory standards.

**Industry comparison:** we can bring market insight and peer group comparison as part of our review. Our reviews not only identify gaps in processes and controls but are also useful to our client’s understanding of their position in the wider market.

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