

SEC Rule 15c3-5 Market Access Rule

Christy Oeth
Director
KCG Holdings, Inc.



Agenda

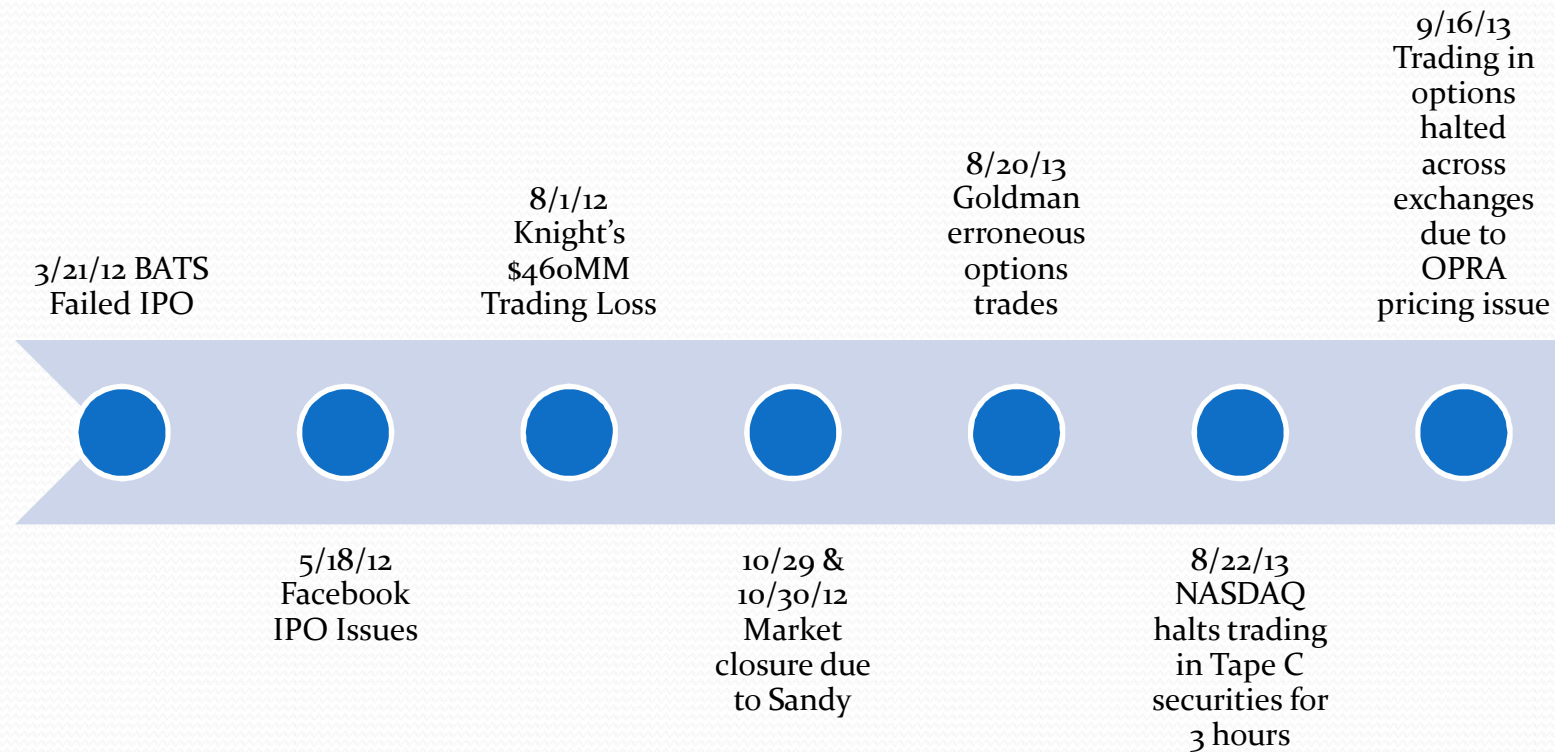
- Market Structure Backdrop
- Overview of Market Access Rule
- Key Considerations
- Questions



Market Structure

- Post NMS Market Structure
 - Cross Market Connectivity
 - High Speed and Algorithmic Trading
 - Rise of Direct and Sponsored Access Arrangements

Significant Automated Trading/System Failures





Benefits and Costs

- **Benefits:** Technology Provides Investors with Advantages
 - ✓ *Increased Execution Speed*
 - ✓ *Lowers Transaction Handling Costs*
 - ✓ *Realize Market Pricing Efficiencies*

- **Cost/Risk Implication:** Technology Exposure
 - ✓ *Programing Problems Increase Speed and Volume of Trade Errors*
 - ✓ *Technology Complexities Increases Errors in Trading Assumptions, Programing, Deployment, and Maintenance.*
 - ✓ *Detective Controls are Generally Rendered Ineffective*



Rule Making Response

- Elimination of Stub Quotes
- Single Stock Circuit Breakers => Limit Up / Limit Down
- Market Access Rule
- Large Trader / CAT



Core Elements of Market Access Rule

- Establish, document and maintain a system of risk management controls and supervisory procedures **reasonably designed** to manage the financial, regulatory and other risks associated with market access
- Must be under the direct & exclusive control of the BD
- Annual review of system of controls and supervisory procedures in the context of the BD's business model
- CEO Certification



Who is impacted?

- BDs that access the markets through exchange memberships or as subscribers to alternative trading systems (“ATS”)
- BDs that provide customers with access to exchanges or ATSs via the BD’s membership / MPID
 - Sponsored Access
 - Direct Market Access (DMA)
- BDs that operate ATS(s) and provide non-broker-dealers with access to trade on the ATS



What is in scope?

- All securities traded on an exchange and/or ATS
 - Equities and ETFs
 - Options
 - Fixed income securities
 - Security-based swaps
- Sponsored and Direct Market Access
- Proprietary Trading
- Agency routing



Financial Risk Management Controls and Supervisory Procedures

- Controls to systematically limit the financial exposure of the broker-dealer that could arise as a result of market access
 - Pre-set credit or capital thresholds in the aggregate for each customer and the BD
 - Prevent erroneous orders, including potential duplicative orders
 - Must be automated and applied pre-trade
 - Ongoing monitoring for appropriate adjustments



Regulatory Risk Management Controls and Supervisory Procedures

1. Assure compliance with “all federal securities laws, rules and regulations and rules of self-regulatory organizations, that are applicable **in connection with market access**”
 - Pre-trade and automated
 - Examples – order marking, locates, order types & trading halts
2. Prevent orders that the BD or its customers are restricted from trading
3. Restrict market access technology to authorized persons and accounts
4. Ensure availability of post-trade surveillance reports



Direct & Exclusive Control

- Vendor / Exchange-based tools can be used
 - BD must maintain exclusive control over setting limits
 - Vendor cannot be a market access customer or affiliated with one
 - After appropriate due diligence
- Responsibility for certain controls can be allocated to another BD
 - Regulatory controls; not financial controls
 - Pursuant to a written contract
 - After thorough due diligence
 - Conduct regular review of effectiveness of allocated controls



Review and Certification

- Establish, document and maintain a system for regularly reviewing effectiveness
- Annual review
 - Conducted pursuant to procedures
 - Documented and retained as books & records
- CEO Certification
 - Annual requirement
 - Risk management controls and supervisory procedures comply with the Rule and that annual review has been conducted



Where does Internal Audit fit in?

- Periodic testing of controls / Annual review process
- Entitlement Review
 - Must have effective process for granting / reviewing entitlements
 - Maintaining technology in a physically secure location
 - Effective mechanisms for authentication
- Allocation Provisions
 - Assist with due diligence / initial testing
 - Assist/perform periodic testing as part of ongoing review process



Key Considerations

- Current Market Trends will continue
 - Continued focus on speed and reducing transaction costs
 - Increased complexity and sophistication of system
 - Heightened IT and Operational Risk
- Focus on risk mitigation:
 - ✓ *Quality Assurance and Continuous Improvement*
 - ✓ *Controlled Testing and User Acceptance,*
 - ✓ *Process Measuring, Management and Control,*
 - ✓ *Regular and Rigorous Review of Regulatory Compliance*
 - ✓ *Strong Independent Audit Process*



Key Considerations

- Technology expertise in Compliance, Risk Management and Internal Audit



Questions?