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News release

12 February 2018

PRA consults on the framework for the risk management and governance of algorithmic trading

Today the PRA publishes a consultation paper (CP) on expectations regarding firms' governance and risk management of algorithmic trading.

Algorithmic trading is a type of trading where a computer automatically determines order initiation, generation, routing or execution without human intervention. It can occur at rapid speeds, which means that existing risks could be amplified if risk management and other controls are not effective or are poorly aligned with the firm's risk appetite and governance arrangements. Consequently, it is crucial that appropriate governance and risk management arrangements are in place.

The CP sets out proposed expectations in respect of a firm's algorithmic trading activities in a number of areas:

- **Governance:** A firm's governing body is expected to explicitly approve the governance framework for algorithmic trading and its management body should identify the relevant Senior Management Function(s) with responsibility for algorithmic trading.
- **Approval process (by firms):** Firms should have a robust algorithm approval process and a minimum set of risk controls.
- **Testing and deployment:** Algorithm testing should involve all relevant risk and control functions and be carried out at a frequency, and with a level of rigour, commensurate with the risks the firm could be exposed to.
- **Inventories and documentation:** Firms should have and maintain algorithm and risk control inventories.
- **Risk Management and Other Systems and Control functions:** These functions should understand and have oversight over the risks of algorithmic trading. Risk Management should have the authority to challenge existing risk controls and impose additional risk controls on algorithmic trading where appropriate.

The CP is relevant to PRA firms in the scope of the Capital Requirements Regulation (CRR) that engage in algorithmic trading and are already subject to the rules in the algorithmic trading part of the PRA rule book.

It applies to all algorithmic trading activities of a firm, including in respect of unregulated financial instruments such as spot foreign exchange. The PRA is also proposing amendments to the existing framework under SS10/14 “Supervising international banks: the Prudential Regulation Authority’s approach to branch supervision”. These will allow the PRA to set similar algorithmic trading expectations for third country branches.

The Financial Conduct Authority (FCA) has today also published a report on algorithmic trading which summarises their key areas of supervisory focus in relation to MIFID II and highlights areas of good and bad practice observed within previous cross-firm reviews.

The consultation period ends on 7 May 2018.

ENDS

Notes to Editors

1. Consultation Paper 5/18: “Algorithmic trading”. <https://www.bankofengland.co.uk/prudential-regulation/publication/2018/algorithmic-trading>
2. FCA Report on Algorithmic trading: <https://www.fca.org.uk/publications/multi-firm-reviews/algorithmic-trading-compliance-wholesale-markets>
3. Financial Stability Report, November 2017 Issue No.42. Box 5: Developments in ‘fast markets’ <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2017/november-2017.pdf?la=en&hash=F6D65F714A7DC28394BC4FCC9909CCD39E28AD10>
4. Financial Stability Report, November 2016 Issue No. 40 Box 3: Issues around the sterling flash event <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2016/november-2016.pdf>
5. Financial Stability Report, December 2015 Issue No. 38 Box 4: Implications of algorithmic trading for risk management and controls <https://www.bankofengland.co.uk/-/media/boe/files/financial-stability-report/2015/december-2015.pdf>
6. Speech by Chris Salmon, 6 October 2017: “Keeping up with fast markets”: <https://www.bankofengland.co.uk/-/media/boe/files/speech/2017/keeping-up-with-fast-markets.pdf>