

## DROP COPIES VS. KILL SWITCHES: WHAT'S NEXT FOR HIGH-FREQUENCY TRADING?

Posted by Elan Mendel on Oct 18, 2012 | Comments (0)



Opposition is growing against the CFTC's preference for using the kill switch as a way to prevent mistakes caused by high-frequency trading.

In several recent speeches, CFTC commissioner Bart Chilton has praised kill switch technology as a way of thwarting large-scale "market events" caused by high-frequency trading, like the kind seen when Knight Capital lost more than \$400 million in a "flash crash" in August.

Kill switch technology would terminate erroneous trades, at which time exchanges and brokers could discuss the nature of the trading errors. Yet kill switches could potentially come in different forms, with widely varying response times.

Now, criticism is mounting against kill switches as a catch-all option—or even an option at all—for reining in aberrations in high-frequency trading.

Bernard Donefer, professor of Trading Technology and Risk Management at Baruch College and NYU's Stern School of Business, says that kill switches come with their own serious problems, including the issue of when it's appropriate for exchanges and regulators to halt trading.

"None of them pulled the trigger because nobody could say this really was a problem," Donefer said. "These kill switches while they sound good, the implementation becomes very problematic in terms of when there is a problem no one wants to pull the trigger."

### Drop Copies for High-Frequency Trading

Industry participants and analysts are now suggesting an alternative to the kill switch: drop copies. This technology, supported especially by large market maker GETCO, would require exchanges to send electronic files called "drop copies" to brokers showing their most recent trades. It's then the responsibility of the firm to reconcile the data, eliminate erroneous trades, or else face regulatory penalties.

Jonathan Ross, chief technology officer at GETCO, believes this should be best practice for trading institutions even without regulation. "Any institution worth its salt spends the resources to build that independent view of the impact they are having on the market in real time."

So far there has been no widespread commentary on the "drop copy" option by the SEC or the CFTC.

Read more. And more.