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December 23, 2010

Commodity Futures Trading Commission
c/o David A. Stawick, Secretary
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act. RIN No. 3038-AD26.

Dear Mr. Stawick:

The Futures Industry Association ("FIA")[1] submits these comments in response to the Commodity Futures Trading Commission's (the "Commission") Advance Notice of Proposed Rulemaking and Request for Comments ("ANPR") on Antidisruptive Practices Authority Contained in Section 747 of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). FIA appreciates the opportunity to comment on Section 747 and the Commission's ANPR questions. FIA and its members share the Commission's commitment to open, fair and competitive markets.

However, in Section 747 of Dodd-Frank, Congress has passed an overly vague provision that is not clearly defined and prohibits activities that are also not subject to clear definition. While we are mindful of the adverse impacts of disorderly markets, we are at the same time concerned that there are no clear standards under Section 747. The terms "disruption" or "disruptive" are not sufficiently descriptive to have operational meaning, nor have they been defined.

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[1] FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 30 of the largest futures commission merchants ("FCMs") in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States designated contract markets.

I. Summary.

FIA recommends the following to the Commission:

- The Commission should clearly identify the specific characteristics, problems or concerns which would be subject to the additional enforcement authority in connection with disruptive trading practices, and should fashion any rules to specifically address those identified characteristics, problems and concerns.[2] The Commission should take into account the vagueness of Section 747's amendments to the Commodity Exchange Act ("CEA") and the lack of any definition of other identified "trading practice that is disruptive of fair and equitable trading."[3]

- The statute is impermissibly vague and unenforceable. Definitions such as "orderly execution," "violates bids or offers" and "spoofing" require refinement and clarification by the Commission so that their meanings relate to specific and measureable characteristics that can guide market participants in their conduct. These definitions should take into account the distinct structures, practices and assumptions of the futures and derivatives markets. The Commission should also clarify that manipulative intent is required to breach these prohibitions.

- The rulemaking must reinforce the distinct and complementary roles of the Commission and of the exchanges. Under "core principle" number four in Section 5 of the CEA, as amended by Dodd-Frank, the exchanges have duties to oversee trading activities, and the Commission should be assured that the exchanges have the requisite tools and procedures to address and prevent disruptive trading practices.[4] The exchanges should establish policies and procedures for market users and executing and clearing brokers to address possible market disruption concerns.

- Executing brokers must be given a safe harbor from customer liability if they choose not to execute a customer trade after having implemented policies and procedures reasonably designed to prevent market disruptions. Consistent with the above, market users should also receive similar protections if they adopt policies and procedures reasonably designed to prevent market disruptions. The Commission should not impose liability on executing brokers who unintentionally cause market disruptions while executing a customer trade as long as the proper policies and procedures reasonably designed to prevent market disruptions were in place.

- The Commission must clarify that CEA Section 4c(a)(7) (entitled "Use of Swaps to Defraud") will only be violated if a party violates a pre-existing duty arising

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2 *See* Section II, *infra*.

3 CEA § 4c(a)(6).

4 7 U.S.C. § 7(d)(4).

under contract, by operation of common law or under some other non-CEA source.

- Commission Regulation 166.3 already applies to supervision relating to disruptive trading practices and should be sufficiently effective without enumerating additional specific duties.

- The Commission should carefully consider the potential of any proposed rule to stifle liquidity and financial innovation.

II. The Commission Should Clearly Identify the Problems or Concerns Which Necessitate Additional Enforcement Authority.

The Commission has not identified specific problems or concerns where its pre-Dodd-Frank enforcement authority was lacking. Because the language of Section 747 came from the Commission itself, it is incumbent upon the Commission to identify past or ongoing problems that Section 747 is targeted to address.[5] Absent identification of such problems, FIA urges the Commission to seek repeal of this provision. Section 747's language is vague and potentially broad enough to capture many legitimate trading activities. The language has the very real potential to harm market quality by chilling market participation, stifling liquidity and increasing spreads. As such, to the extent the provision is not repealed, the Commission should clarify how it intends to use this authority in a manner that is both focused and clearly understood by all market participants. Any potential rulemaking that falls short of this will cause unintended consequences, including a detrimental impact on price discovery and quality of the futures and derivatives markets.

III. Section 747 Is Impermissibly Vague and Unenforceable.

Section 747, as written, is extremely vague and vulnerable to constitutional challenge by market participants. Due process precludes the Commission from penalizing a private party for violating a rule without first providing adequate notice of the substance of the rule.[6] Market participants have expressed legitimate concerns of unpredictable and fundamentally unfair enforcement actions. The breadth of the statute has the potential to capture many legitimate trading activities, and therefore to chill permissible market participation.

Definitions such as "orderly execution," "violates bids or offers" and "spoofing" in Sections 4c(a)(5)(A), (B) and (C), respectively, require refinement and clarification by the Commission so that their meanings relate to specific and measurable characteristics that can guide market participants in their conduct. The Commission should clarify that manipulative

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[5] In a floor statement, Senator Blanche Lincoln stated that the "[Commission] requested, and received, enforcement authority with respect to . . . disruptive trading practices," but failed to elaborate on the new authority's meaning. 107 Cong. Rec. S5922 (2010).

[6] *Satellite Broad. Co.* v. *FCC*, 824 F.2d 1, 3 (D.C. Cir. 1987); *see also DiPlacido* v. *CFTC*, No. 08-5559-ag, 2009 WL 3326624, at *1 (2d Cir. Oct. 16, 2009); *In re Collins*, [1986-87 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶23,401 (Nov. 26, 1986).

intent is required to breach these prohibitions. Additionally, the Commission's clarifications must be done in a manner that takes into account the distinct structures, practices and customs of the futures and derivatives market.

A. "Violates Bids or Offers" in 5(A) Is Unclear in the Futures and Derivatives Markets.

Violating bids or offers does not have a clear meaning in the futures and derivatives markets. The ANPR requests comments on how the term is to be applied "in the context of electronic trading platforms with pre-determined order-matching algorithms that preclude a trader from executing an order against a quote other than the best one available." Matching engines make it impossible to sell or buy except at the best available quote. Simply stated, the statute is not appropriate in the electronic markets.

Furthermore, the Commission should clarify that the prohibition on violating bids or offers does not apply in the over-the-counter markets. Traders with large positions may seek to privately negotiate a trade with a counterparty, and the negotiated price may very well be outside the range of current bids or offers. Credit, size of the trade or other factors may cause the parties to negotiate terms outside the bid or offer. Executing outside the bid-offer spread should not be a violation without manipulative or disruptive intent. Markets that are thinly traded may not have clear parameters on bids or offers but may depend on a multitude of other factors when discovering price. Simply focusing on a violation of a bid or offer is placing too narrow a focus in defining a disruptive practice and offers little guidance to market participants. The Commission must therefore clarify that legitimate trading practices such as these, which have no manipulative intent, are not captured by Section 4c(a)(5)(A).

The Commission should clarify that manipulative intent to create an artificial price is required to violate 5(A)'s prohibition on violating bids or offers. Most striking about the violating bids or offers prohibition is its lack of any required mental state. While 5(B)'s prohibition on the intentional or reckless disregard for orderly execution and 5(C)'s prohibition on "spoofing" both reference some level of intent, 5(A)'s prohibition does not establish the requisite level of intent. The Supreme Court has pointed to the lack of a *mens rea* requirement in a vague statute as a sign of unconstitutionality:

> [T]he constitutionality of a vague statutory standard is closely related to whether that standard incorporates a requirement of *mens rea*. Because of the absence of a scienter requirement in the provision [in question], the statute is little more than 'a trap for those who act in good faith.'[7]

The disruptive practice definition in 5(A) is both vague and lacking in any *mens rea*. To remedy this, the Commission must follow judicial precedent and its own past enforcement practices and clarify that violations of bids or offers are prohibited only if undertaken with specific

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[7] *Colautti* v. *Franklin*, 439 U.S. 379, 395 (1979) (citations omitted); *see also DiPlacido*, 2009 WL 3326624 at *2 (citing *Colautti*).

manipulative intent. In *DiPlacido*, the Second Circuit upheld the Commission's enforcement action only because the Commission required manipulative intent:

> DiPlacido further challenges the Commission's standard on the ground that the elements of the four-part test 'collapse[]' into one-uneconomic-trading-so [sic] that a violation exists wherever bids and offers are violated, and even lawful hedging may constitute manipulation. We are not persuaded. The Commission stated that 'violating bids and offers—*in order to influence prices*' was 'sufficient to show manipulative intent.' Its finding of intent thus depended not merely on DiPlacido's having violated bids and offers, but also on taped conversations signaling manipulative intent . . .[8]

Without clarifying the types of bids or offers that are prohibited disruptive practices and requiring manipulative intent, the statute is vulnerable to constitutional challenge and will not serve the purposes of Congress or the Commission. FIA urges the Commission to clarify these issues.

B. "Orderly Execution of Transactions During the Closing Period" Is Impermissibly Vague and Will Chill Many Legitimate Trading Practices.

The proposal does not offer any explanation as to what "orderly execution" in 5(B) actually means, nor is there a commonly understood meaning among futures and derivatives market participants. The Commission should clarify that traditionally accepted types of market manipulation, such as "banging the close," "marking the close" and pricing window manipulation fall under the prohibition of 5(B). Beyond these, the Commission must identify the other practices, if any, that will be deemed to constitute an "intentional or reckless disregard for the orderly execution of transactions during the closing period." It is incumbent on the Commission to do so in order to provide adequate notice to market participants.

The Commission should clarify that manipulative intent is necessary under 5(B)'s prohibition. The Commission should not engage in *post hoc* judgments of disruptive practices without a finding of manipulative intent. Any particular trade has the potential to be disruptive given unpredictable market conditions. Indeed, trades that are not in and of themselves disruptive may end up causing a disruption for reasons no single market participant can reasonably foresee, as the May 6 "flash crash" demonstrated. Market participants that create isolated disruptions through *bona fide* trading activities should not be sanctioned absent manipulative intent. Should the Commission decline to require a showing of manipulative intent, many market participants will decide that the regulatory risk of engaging in legitimate trading in thin, volatile or unpredictable markets is simply too great and will pull out of those markets. This will only create or exacerbate illiquidity and volatility in the markets, to the detriment of all market participants.

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[8] *DiPlacido*, 2009 WL 3326624 at *3 (2d Cir. Oct. 16, 2009) (citations omitted; emphasis original).

C. The Commission Must Define and Clarify What Entails "Spoofing" in the Context of the Futures and Derivatives Markets.

The term "spoofing" is not one that has been commonly used in the futures and derivatives markets and there is no generally understood or accepted meaning of the term in this context, or of the conduct that would be prohibited by reference to this term. In the securities markets, the Securities and Exchange Commission (the "SEC") has initiated enforcement actions on alleged "spoofing" practices. Spoofing in the securities markets is a form of price manipulation of the national best bid or offer ("NBBO") through the use of limit orders in order to increase profits on subsequent market orders. The SEC's Limit Order Display Rule requires that market makers display customer limit orders of 100 shares or more, and if the customer limit order is better than the previously displayed NBBO it will change the NBBO by either raising the bid side or lowering the offer side. Once the trader executes a market trade at the artificial NBBO price, he or she subsequently cancels the original limit order.[9] Thus, the practice entails "bidding or offering with the intent to cancel the bid or offer before execution."[10] The Commission should not simply import this definition into its rules, for two reasons. First, these interpretations and enforcement proceedings have not proceeded past the settlement phase at administrative levels, and thus they have not been the subject of judicial scrutiny. Second, it is unclear how the practice can be defined adequately given the substantial differences between the securities markets and the futures and derivatives markets.

Moreover, executing similar trade practices in the futures and derivatives markets does not carry with it a reliable indication of manipulative intent. The placing of large orders consistent with market practice and for *bona fide* business reasons, with no intent to affect prices, is a legitimate commercial practice that provides an important source of liquidity. A trader may put in a much larger order than is anticipated to be filled in order to ensure its needs are met.[11] Because of the probabilistic nature of the futures and derivatives settlement process, traders must engage in practices that might fall under the cloud of the "spoofing" prohibition. Spoofing is also difficult to distinguish from market makers' order and cancel activity or active trading orders when they are "chasing a market" that is linked to other active markets. As such, any disruptive practice defined as "spoofing" must require a manipulative intent to influence price in order to impose some boundaries on the vague statutory prohibition.

As a general matter, the adoption of regulations based on the foregoing principles would recognize that there are many "ordinary course of business" situations in which a market participant places an order with the intention and expectation that it will be filled and, as the result of subsequent market conditions or other external factors, withdraws all or a portion of the

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9 *See, e.g., In re Fishman*, Exchange Act Release No. 40115 (June 24, 1998); *In re Monski*, Exchange Act Release No. 44250 (May 3, 2001); *In re Shenker*, Exchange Act Release No. 45017 (Nov. 5, 2001); *In re Blackwell*, Exchange Act Release No. 45018 (Nov. 5, 2001); *In re Frazee*, Exchange Act Release No. 47522 (Mar. 18, 2003).

10 CEA § 4c(a)(5)(C).

11 *See* Antidisruptive Practices Authority Contained in the Dodd-Frank Wall Street Reform and Consumer Protection Act, 75 Fed. Reg. 67,301, 67,302 (Nov. 2, 2010) (question eight).

order before it is filled. The ability for market participants to fine-tune their risk and exposure in this manner improves market quality with tighter spreads and deeper liquidity. Limitations on this ability would adversely affect market quality.

Finally, when it comes to prohibiting "any other trading practice that is disruptive of fair and equitable trading," the Commission should define what other practices might fall under this generic term.[12] Because the preceding list of disruptive practices does not lend itself to a limited or plausibly bounded set of potential practices, statutory interpretation tools such as *noscitur a sociis* are simply of no utility.[13] This term provides no guidance whatsoever to market participants. Consequently, FIA believes that it is necessary to elaborate on this clause given the Commission's ample authority in Sections 5(A)-(C) and other provisions of its statute, including CEA Sections 4b, 6(c)(1), 6(c)(3) and 9(a)(2).

Given the difficulties outlined above, the Commission should recommend to Congress that this provision be repealed.

IV. Section 747 Rulemaking Must Reinforce the Distinct and Complementary Roles of the Commission and of the Exchanges.

The Commission should issue principles-based guidance that reinforces the traditional approach to regulating disruptive practices. Historically, there have been distinct and complementary roles of the Commission in its exercise of its anti-manipulation authority and the exchanges' own mechanisms for maintaining market discipline. The Commission has long embraced principles-based regulation to reinforce this structure, and the role of the self-regulatory organization ("SRO") to leverage supervision in the markets.

The CEA recognizes the important role that exchanges play in preventing market disruptions. The CEA mandates that boards of trade comply with certain "core principles" but gives them flexibility by affording them reasonable discretion in the manner in which they comply.[14] Core principle number four, as amended by Dodd-Frank, mandates that the boards of trade "have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash-settlement process."[15] Similarly, Dodd-Frank imposes the same mandate of preventing manipulation, price distortion and disruptions on Swap Execution Facilities ("SEFs").[16] FIA urges that this important role of exchanges be reaffirmed through principles-based guidelines that afford exchanges reasonable discretion.

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12 7 U.S.C. § 6c(a)(6).

13 *Noscitur a sociis* holds that a word is known by the company it keeps. *See Babbitt* v. *Sweet Home Chapter of Communities for a Great Oregon*, 515 U.S. 687, 693 (1995).

14 7 U.S.C. § 7(d).

15 7 U.S.C. § 7(d)(4).

16 Dodd-Frank § 733.

Engaging the exchanges to police the markets is also consistent with Dodd-Frank. Specifically, Dodd-Frank Section 735 changes core principle number four by enhancing the role of the exchanges. Instead of merely being required to *monitor* trading, a board of trade will now be required to "have the *capacity and responsibility*" to prevent manipulation, price distortion and disruptions through market surveillance, compliance and enforcement practices and procedures.[17] Dodd-Frank specifies that appropriate policies and procedures include "methods for conducting real-time monitoring of trading" and "comprehensive and accurate trade reconstructions."[18] These policies and procedures, already implemented at many of the leading exchanges, have proven effective at mitigating market disruptions. Most recently, Chicago Mercantile Exchange ("CME") Stop Logic Functionality played a pivotal role during the May 6, 2010 "flash crash." The Commission and the SEC recognized its effectiveness as a lesson learned:

> As demonstrated by the CME's Stop Logic Functionality that triggered a halt in E-Mini trading, pausing a market can be an effective way of providing time for market participants to reassess their strategies, for algorithms to reset their parameters, and for an orderly market to be re-established.[19]

To upend this traditional structure by creating vague obligations at the Commission enforcement level and to preempt the roles of the exchanges is unnecessary and unwarranted. Exchanges must be given the flexibility to adapt in constantly changing markets in order to address new dangers of market disruption. A prescriptive rules-based approach would weigh down the exchanges' efforts and create greater uncertainty among market participants.

FIA believes that these distinct roles have served the market well. However, to the extent the Commission is able to identify a supervisory gap between the Commission's enforcement authority with respect to anti-manipulation, and the exchanges' role of preventing disruptions, the Commission should clarify the authority and responsibilities of the exchanges, in keeping with the exchanges' historic role. In doing so, the Commission would be able to leverage the vast resources of the exchanges to increase oversight, subject to the general supervision of the Commission. By confining itself to monitoring and deterring market manipulation, the Commission can focus its resources and capitalize on its enforcement expertise. Limiting itself to manipulation investigations is also appropriate because market disruptions are not used by market participants to gain illicit profits through unfair advantages. Federal enforcement and sanctions are inappropriate tools because, unlike manipulative conduct, market participants do not gain from market disruptions.

V. Section 4c(a)(7) Must Be Clarified and Made Consistent with Other Commission Guidance.

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[17] Dodd-Frank § 735(b).

[18] *Id.*

[19] CFTC and SEC Joint Advisory Committee on Emerging Regulatory Issues, *Findings Regarding the Market Events of May 6, 2010*, at 6 (2010).

FIA urges the Commission to clarify that Section 747 does not impose any new duties of disclosure, inquiry or diligence. Section 747 of Dodd-Frank makes it "unlawful for any person to enter into a swap knowing, or acting in reckless disregard of the fact, that its counterparty will use the swap as part of a device, scheme or artifice to defraud any third party" under the new Section 4c(a)(7) of the CEA. Futures and derivatives markets participants have not traditionally been subject to these types of duties. Without this clarification, market participants will face increased compliance and operational costs, as well as greater uncertainty, in connection with their legitimate trading activities.

FIA believes that Section 4c(a)(7) should only be deemed to have been violated if a party breaches a pre-existing duty arising under contract, by operation of common law or under some other non-CEA source. FIA supports the application to Section 747 of the Commission's clarification in its proposed rules on market manipulation that:

> Nothing in [the proposed rule] shall be construed to require any person to disclose to another person nonpublic information that may be material to the market price, rate, or level of the commodity transaction, except as necessary to make any statement made to the other person in or in connection with the transaction not misleading in any material respect.[20]

FIA urges caution in interpreting and applying this new provision, given its potential to alter long-standing and legitimate trading practices.

VI. Executing Brokers Are Not in a Position to Adequately Supervise.

The Commission has asked whether executing brokers should have an obligation to ensure that customer trades are not disruptive practices. FIA urges that the Commission be guided by a policies and procedures approach in this area, as it allows for adequate enforcement and recognizes the practical difficulties brokers face. The exchanges and the Commission may take weeks, if not months, to identify a disruptive trade practice or manipulation. It would be unreasonable for the Commission to require executing brokers to make similar determinations, pre-trade. Executing brokers are not equipped to discern intent, given that they are not in a position to see a pattern or practice which might lead to an inference of manipulative intent. The responsibilities of executing brokers, particularly in electronic trading environments, should be carefully prescribed, since there is even less of an opportunity to evaluate a trade besides implementing pre-trade checks in the software itself.

Executing brokers should be deemed to have satisfied their responsibilities if they design appropriate structural safeguards to ensure that that their clients have appropriate checks against entering orders likely to lead to market disruptions. These safeguards should recognize the rapid changes in electronic markets and should be applied at the exchange level in accordance with principles-based regulation. The CME Group currently has in place risk management Rule 982 which requires clearing members to have written risk management

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[20] Prohibition of Market Manipulation, 75 Fed. Reg. 67657, 67662 (2010).

policies and procedures in place to ensure that they are able to perform certain basic risk and operation functions at all times. Similar requirements should apply to executing brokers who accept orders. They should adopt and enforce written procedures and controls reasonably designed to screen, and prevent customers from engaging in, trades that create undue risks of market disruptions.

FIA's Market Access Working Group ("MAWG"), comprised of representatives from clearing firms, proprietary trading firms and exchanges, has developed recommendations for executing brokers on managing the risks of direct access while striking an appropriate balance between guiding principles and prescriptive mandates.[21] Pre-trade diligence procedures and controls should include:

- access to a "kill button" to disable trading and cancel all resting orders;
- pre-trade and post-trade risk and position limits and controls;
- fat-finger quantity limits; and
- repeated automated execution throttles.

Given the spectrum of clients, executing brokers should be allowed to tailor pre-trade controls to the specific client based on a diligence review on the customer's trading practices, past dealings, sophistication and internal trade systems and controls in place. Prescriptive rulemaking simply does not allow for this kind of flexibility. The Commission must therefore allow for a principles-based approach and direct the exchanges to adopt appropriate standards.

Executing brokers that conform to these principles-based guidelines should be afforded safe harbor protection from customer liability when they choose not to execute a customer trade and from Commission enforcement actions when, despite good faith and the exercise of reasonable controls, a market disruption actually occurs. Because these decisions are made real-time and without the benefit of hindsight, executing brokers cannot be reasonably expected to eliminate all market disruption risk. At the same time, however, they face substantial liability if they choose not to execute a customer order based on a judgment that such execution would be disruptive. This places executing brokers in a difficult position of trying to meet customer needs, while being responsible in choosing to permit the execution of market trades.

FIA strongly believes that a multi-layered enforcement approach, which implements policies and procedures at the firm, exchange and clearing level, will most effectively mitigate the risk of market disruptions.

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[21] FIA, *Market Access Risk Management Recommendations* (2010) (available online at http://www.futuresindustry.org/downloads/Market_Access-6.pdf). On May 6, 2010, FIA submitted the report in a comment letter to the SEC in connection Rule 15c3-5 (available online at http://www.futuresindustry.org/downloads/ SEC_Risk_Management_Controls_for_Brokers_or_Dealers_with_Market_Access_050610.pdf).

VII. The Commission Should Not Articulate Any Other Specific Duties of Supervision Relating to the Prohibited Trading Practices in Section 4c(a)(5) Since Regulation 166.3 Is Sufficiently Effective.

Question 14 of the ANPR asks whether the Commission should articulate specific duties of supervision to supplement the general duty to supervise contained in Commission Regulation 166.3. Regulation 166.3 already imposes a substantial, expansive and meaningful general supervisory duty on Commission registrants:

> Each Commission registrant . . . must diligently supervise the handling by its partners, officers, employees and agents . . . of all commodity interest accounts carried, operated, advised or introduced by the registrant and all other activities of its partners, officers, employees and agents (or persons occupying a similar status or performing a similar function) relating to its business as a Commission registrant.[22]

It is unnecessary to add any new duties of supervision in light of this requirement. The Commission should instead rely on Regulation 166.3.

VIII. Antidisruptive Practices Authority in the Context of Algorithmic and Automated Trading Systems.

The use of automated and algorithmic trading systems is widespread in the industry, from the professional to the retail trader. Trade automation is used by market makers to update their quotes. Professional traders use automation to limit risk and trade on short-term opportunities. Corporate and retail customers use automated trading systems to trade where client software and web-driven trading applications yield diverse market information.

Similarly, algorithmic systems are not new to the futures and derivatives markets. Program and system trading, as well as computerized contingent logic orders, have been an important part of these markets for decades. Both automated and algorithmic trading mechanisms are tools that market participants use to implement trading strategies, but are not trading strategies in themselves. Market participants who use these tools are already subject to supervision under conduct and marketplace rules.

Automation has played a critical role in the U.S. futures markets, improving the effectiveness of the market for all participants (short-term, long-term, institutional and retail investors, as well as commercial hedgers). These benefits include:

- Lower trading costs — The intense competition in these automated markets significantly contributes to narrower bid-ask spreads and consequently lowers trading costs for all participants.

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[22] 17 C.F.R. § 166.3.

- Fairer prices — Diverse automated trading strategies improve price discovery, ensuring prices track fair value and rapidly reflect all relevant market information.

- Resilient markets — Having a large, diverse, competitive set of automated traders ensures liquidity and efficient price discovery, even during market shocks.

- Increased liquidity — Automated trading activity provides substantial liquidity to all market participants, helping to bridge temporary gaps in supply and demand. This activity allows market participants to buy or sell with less impact on market price and dampens short-term market volatility.

Separate regulatory mandates regarding automated systems that are broadly or vaguely defined would create regulatory uncertainty and would have a negative impact on brokers' and market makers' ability to provide liquid markets. The impossibility of knowing how to avoid violating a vaguely defined prohibition in the course of ordinary market activity may deter many current market participants from trading. The deterrence of legitimate trading activity, in turn, may lead to wider spreads.

The markets have order entry and volatility controls in place to limit disruptive trading without deterring legitimate trading activity. Broadly construed, disruptions occur on a daily basis in every market, but exchanges already have a variety of mechanisms to address disruptive trading. For example, rules on price banding, limit up/limit down, and stop logic, along with continuous monitoring, are all effective tools to prevent disruptions.

Even in the context of "buying the board" or buying all the liquidity, unless there is intent to manipulate price, this should not be defined as a disruptive trading practice subject to Commission enforcement. For example, CME Stop Logic Functionality protects against cascading stop orders—the domino effect of one stop order triggering others—from precipitating a material market decline because of a transitory dearth of liquidity by giving a ten-second delay so that market participants have the opportunity to determine if the value is not artificial. If the price does not come back in line, it would indicate market value is changing. As stated previously, this functionality worked as designed on May 6. With these safeguards in place, practices, such as buying the board, that may be considered disruptive should not be deemed to violate bids or offers unless there is manipulative intent. Then, and only then, should the Commission use its anti-manipulation authority to address disruptive practices.

In addition, the technology behind both trading automation and trading algorithms is specialized software that is often proprietary and complex in nature. Testing and monitoring such technically demanding systems requires knowledge of the intricacies of software and hardware, which can be unrelated to financial markets or economics and is often outside of the proficiency of most marketplace professionals. For this reason, it is important for regulators to clearly define the activities that are prohibited so that firms can program their systems to avoid such activities. A regulatory environment where any price correction, cancelled trade or market

halt could lead to a federal enforcement action as a disruptive trading practice would deter trading by firms and their customers.

Trade-related technology and automation are fundamentally connected to the current market environment, and have become essential to its efficient functioning. The external behavior and affect of this technology are based on the instructions of the firms and individuals that implemented them and are already regulated through the same conduct rules and principles applicable to non-automated trading.

The Commission must recognize that any additional rules are likely to stifle financial innovation currently in everyday use with more technically advanced automation software that has in the last few decades broadly transformed the entire financial industry. The importance of financial innovation should not be underestimated when considering the substantial competitive advantages that technology has given the industry. Improved price discovery, reduced bid-ask spreads, reduced commissions and transaction costs, faster execution speeds, greater liquidity and increased market depth have all resulted from the use of technology in the financial industry. Technological innovation has also enhanced risk management, through the implementation of controls such as those highlighted by FIA's MAWG. For these reasons, the Commission should carefully consider whether any proposed rulemaking will negatively impact future innovation in the futures and derivatives markets.

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We appreciate the opportunity to provide comments to the Commission regarding Dodd-Frank Section 747, and we would be pleased to discuss any questions the Commission might have with respect to this letter. Any questions about this letter may be directed to Barbara Wierzynski, Executive Vice President and General Counsel at bwierzynski@futuresindustry.org or 202/466-5460.

Sincerely,

John M. Damgard
President

cc: Honorable Gary Gensler, Chairman
Honorable Michael Dunn, Commissioner
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner

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