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May 17, 2011

Via Electronic Mail

Mr. David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Comment on Proposed Interpretive Order, "Antidisruptive Practices Authority"; 76 Fed .Reg. 14943 (March 18, 2011)

Dear Mr. Stawick:

The Commodity Markets Council ("CMC") welcomes the opportunity to submit the following comments to the Commodity Futures Trading Commission ("CFTC" or "Commission") regarding its Proposed Interpretive Order ("Order") on "Antidisruptive Practices Authority".

CMC is a trade association bringing together exchanges and their industry counterparts. The activities of our members represent the complete spectrum of commercial users of all futures markets including energy and agriculture. Specifically, our industry member firms are regular users of the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Kansas City Board of Trade, Minneapolis Grain Exchange and the New York Mercantile Exchange. CMC is uniquely positioned to provide the consensus views of commercial and end users of derivatives. Our comments represent the collective view of CMC members.

<u>Introduction</u>

The businesses of all our member firms depend upon the efficient and competitive functioning of the risk management products traded on U.S. futures exchanges. Through the Commission's diligent oversight efforts that have fostered exchange innovation and technology adoption, we have seen the commodity markets grow and prosper. They have become deeper and more liquid, narrowing bid/ask spreads and improving hedging effectiveness and price discovery. Meanwhile, liquidity, technology, clearing quality, price and customer service have driven market selection. All of these developments serve the interests of the trade as well as the public.

The new rules outlined in the Dodd-Frank Act ("Dodd-Frank" or "Act") are intended to protect fair and equitable trading, and while the legislative goals are certainly laudable and strongly shared by CMC, the means to achieve them must be fair and clear for all market participants. We believe doing so will serve the interests of the trade, lawmakers, regulators and the general public. Clearly, there is a shared interest among market participants, exchanges, and regulators in having market and regulatory infrastructures that promote fair, transparent and efficient markets and that mitigate exposure to risks that threaten the integrity and stability of markets. However, market participants deserve clarity with respect to their obligations under the rules and fairness and consistency with regard to their enforcement.

<u>CMC's Overall Concerns with the Proposed Interpretive Order</u>

As such, CMC is concerned the statutory language is overly broad and if not implemented with precision could discourage market participation. Section 747 of the Act is vague and susceptible to constitutional

challenge because due process precludes the government from penalizing a private party for violating a rule without first providing adequate notice that his contemplated conduct is forbidden by the rule. Failure to provide clarity with respect to the types of conduct and trading practices that constitute violations of the statute will have a chilling effect on market participation because of exposure to uncertain regulatory risks and the possibility that legitimate trading practices will be arbitrarily construed, after the fact, to be unlawful.

From an end-user perspective, imposing unnecessary regulation on derivatives end-users, who did not contribute to the financial crisis, would create more economic instability, restrict job growth, decrease productive investment, and hamper U.S. competitiveness in the global economy.

As mentioned in our comment letter dated January 3, 2011 in response to the CFTC's Advance Notice of Proposed Rulemaking ("ANPR") on this subject, there are three guiding principles CMC would use in responding to a future rulemaking:

1. All implementing rules should provide precision and clarity in order to facilitate legitimate trading activity.
2. Definitions of key terms need to be precisely crafted and the scope of application narrow.
3. The standard applied to "disruptive trade practices" should be intentional, deliberate or extreme recklessness.

We are appreciative of the fact that the Order makes some of the changes recommended in the comments submitted in response to the Commission's ANPR -- such as refining the definitions of key terms such as "violates bids or offers," "orderly," "closing period," and "spoofing," adding *scienter* requirements for specific sections, and providing some parameters regarding the scope of the provisions -- but we do not believe that the Order offers sufficient guidance to market participants; it is still unclear in several important respects as to what conduct is prohibited by Section 747.

Effectiveness of Self-Regulatory Organizations

Self-regulatory organizations ("SROs") already have rules that prohibit conduct inconsistent with just and equitable principles of trade, as well as numerous other rules that address disruptive market conduct, and as required by the Core Principles are well equipped to investigate and take enforcement action against parties who violate these rules.

In this regard, SROs and the Commission historically have served distinct but largely complementary roles - roles which recognize that the goals of the Commodities Exchange Act ("CEA") are best served if the SROs' resources and expertise are relied upon, subject to proactive Commission oversight, for conducting frontline trade practice and market surveillance and for enforcing market conduct rules, while reserving the Commission's enforcement resources and expertise for prosecuting particularly egregious offenses and matters beyond the SROs' jurisdiction. Indeed, nothing in Section 747, or any other provision of Dodd-Frank, evidences Congressional intent to disrupt these distinct and complementary roles. In fact, the CEA, as amended by Dodd-Frank, maintains a principles-based regulatory regime that, among other things, obligates exchanges to establish and enforce rules to protect their markets from manipulation, price distortions, abusive practices and any other activities contrary to fair and equitable trading.

Violating Bids and Offers

In open outcry trading environments, exchange rules require members to honor the best available bids and offers in the open outcry market at the time of the trade, subject to exceptions in certain markets that permit orders above a certain quantity threshold to be executed on an All-or-None basis at a single price that may be through the best bid/offer in the regular market. Open outcry markets have proved to operate efficiently for well over a century, but it is also well understood that in such markets it cannot be absolutely assured, as in electronic markets with pre-determined matching algorithms, that all bids and offers will be honored according to their priority, particularly in volatile or exceptionally

active market conditions. However, the statute effectively imposes a strict liability standard that makes it unlawful, irrespective of any element of intent, to violate any bid or offer. Contrary to the Commission's assertion, this broad construction is *not* consistent with exchange rules, which only proscribe market participants' intentional violation of bids and offers. Therefore, the Commission should clarify that only intentional or extremely reckless action to violate transparent bids or offers contravenes this prohibition.

As far as end-users are concerned, the application of the Order — and particularly the Commission's interpretation of "*violating bids or offers*" — could adversely impact their ability to exercise important discretion in the execution of their transactions. In some cases, the absence of such discretion could require an end-user to ignore factors that are important in assessing the most suitable party with whom to transact.

To understand the impact of applying the Order to non-cleared transactions executed off-facility, we have to understand how corporate treasurers have a fiduciary duty to optimize numerous factors in achieving "best execution" — not solely the transaction price of a particular derivative.

For one, in choosing which dealer counterparty with whom to execute, an end-user will consider the best combination of transaction price and transaction terms. An end-user does not focus on transaction price in isolation. Doing so could require an end-user to take on legal and credit risks, items that could ultimately subject the end-user to significant costs. It is critical that end-users retain the ability to select the bank that provides the best terms. We therefore urge the Commission to clarify that end-users are not required to focus exclusively on transaction price when determining the transaction with optimal terms.

Also, rather than focusing exclusively on transaction price of a derivative, end-users optimize across banking products when assessing which banking transactions, in combination, are most economically beneficial. End-users must examine the entire banking relationship including derivatives (e.g., clearing and trade execution) and non-derivatives transactions, (e.g., lending and other services). The Commission's Order could preclude end-users from considering the most economically beneficial combination of transactions, ultimately working at cross-purposes to the objective of maximizing efficiency for the end-user.

In light of these multi-faceted considerations, an interpretation that precludes end-users from exercising discretion in its counterparty selection could force end-users to make sub-optimal decisions when determining the most suitable swap counterparty on a given transaction. Indeed, such a prescriptive approach could create conditions for end-users that increase legal and credit risks and that could disrupt an end-user's ability to achieve best overall pricing.

As pertains to cleared end-user transactions executed on-facility, in most circumstances, end-users will execute at the best transaction price, and would only do otherwise in limited circumstances. Therefore, such transactions would constitute only a small part of the overall market. CMC believes that preserving end-user choice would not meaningfully skew or distort publicly available pricing information. Indeed, in a market that is expected to include many counterparties, the small quantity of transactions concerned should not prevent dealer counterparties from continuing to compete with their best bids and offers. However, we think this issue should be further examined after data submitted to swap data repositories has been evaluated and should be re-examined if significant quantities of transactions are not executed at the best transaction price.

Orderly Execution of Transactions During the Closing Period

We caution that the Commission must not conflate volatility with disorderly or disruptive trading, as market volatility is usually consistent with markets performing their price discovery function and only rarely attributable to nefarious conduct. Any market participant who has the ability to trade size relative to market liquidity at a particular moment in time has the ability to influence price - during the closing period or during any other period - and orders entered in good faith for legitimate purposes

during the closing period, or at any other time, cannot be construed, post-hoc, to have been disruptive simply because the execution of such orders affected the market price. Liquidity is obviously the best prevention against disorderly markets as deeper liquidity makes it more difficult and/or costly for a participant to intentionally or unintentionally disrupt the market. Therefore, the Commission, in the interest of protecting liquidity, should clarify in its final order that market participants are not under a duty to assess market conditions and consider how their trading practices and conduct affect the orderly execution of transactions during the closing period.

The Commission also asserts that "concepts applicable to the securities markets are useful in analyzing commodities markets because of similarities between the two areas." In support of this proposition, the Commission cites several cases discussing the obligations of specialists in certain securities markets, which obligations give context to the concepts of "orderliness". In contrast to such securities markets, futures markets do not have specialists who are obligated to maintain a "fair and orderly market" in return for specific privileges, and imposing comparable obligations on market-making participants in derivatives markets would be inappropriate. Indeed, for this reason the cases cited by the Commission in this regard are not useful for assessing orderliness in the derivatives markets. In light of these and other significant differences that exist in their respective market and regulatory structures, as well as the fundamental purposes of the markets, we caution the Commission against importing securities-based concepts to the derivatives markets.

Spoofing

CMC commends the Commission for attempting to provide market participants with further guidance as to what conduct and trading practices constitute spoofing. We believe, however, that the Order could be enhanced in this regard with respect to spoofing. Specifically, we believe that the distinguishing characteristic between "spoofing" that should be covered by Section 747(C) and the legitimate cancellation of other unfilled or partially filled orders is that "spoofing" involves the intent to enter non bona fide orders *for the purpose of misleading market participants and exploiting that deception for the spoofing entity's benefit*. We believe that this recommended language is consistent with the Congressional intent and further supports the Commission's interpretation as laid out in the Order. Importantly, we believe that including this suggested language in a final order will make it easier for market participants to distinguish between legitimate and violative conduct.

Moreover, we agree that the submitting or cancelling bids or offers to overload the quotation system of a registered entity and submitting or cancelling bids or offers to delay another person's execution of trades should be prohibited conduct. However, the Commission should make clear that bids and offers which create large accumulative quantities on the bid or offer, *absent other factors*, is not spoofing. As previously noted, "spoofing" should be clearly defined to cover non bona fide orders that are entered with the *intent* to mislead other participants and where that deception is exploited for the spoofing entity's benefit.

The CMC thanks the Commission for the opportunity to present its views on this important subject. If you have any questions or would like to discuss further, please do not hesitate to contact me via email at christine.cochran@commoditymkts.org or via phone at (202) 842-0400 – ext. 101. Thank you in anticipation of your attention to these comments.

Regards,

Christine M. Cochran
President