



Futures Industry Association

2001 Pennsylvania Ave. NW

Suite 600

Washington, DC 20006-1823

202.466.5460

202.296.3184 fax

www.futuresindustry.org

August 14, 2013

Via Electronic Submission

Commodity Futures Trading Commission
c/o Melissa Jurgens, Secretary
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: CME Group Market Regulation Advisory Notice RA1308-5
CME/CBOT/NYMEX/COMEX/KCBT Submission # 13-272

Dear Ms. Jurgens:

The Futures Industry Association (“FIA”)¹ appreciates the opportunity to comment on the Chicago Mercantile Exchange’s (“CME’s” or “Exchange’s”) proposed market regulation advisory notice regarding the CME’s wash trade prohibition (“Proposed MRAN”).² Market users are committed to preventing intentional wash trades, and we support advanced technology solutions, where available and appropriate under the circumstances, in order to facilitate prevention of intentional self-matches and other market abuses. We therefore support efforts to inform and educate market participants as to the applicable restrictions and welcome the Proposed MRAN, as it provides more clarity to market users.

¹ The Futures Industry Association is the leading trade organization for the futures, options and OTC cleared derivatives markets. It is the only association representative of all organizations that have an interest in the listed derivatives markets. Its membership includes the world’s largest derivatives clearing firms as well as leading derivatives exchanges from more than 20 countries. As the principal members of the derivatives clearinghouses, our member firms play a critical role in the reduction of systemic risk in the financial markets. They provide the majority of the funds that support these clearinghouses and commit a substantial amount of their own capital to guarantee customer transactions.

FIA’s core constituency consists of futures commission merchants, and the primary focus of the association is the global use of exchanges, trading systems and clearinghouses for derivatives transactions. FIA’s regular members, who act as the majority clearing members of the U.S. exchanges, handle more than 90% of the customer funds held for trading on U.S. futures exchanges. For more information, visit www.futuresindustry.org.

² See CME Group, Regulation 40.5(a) Rule Certification. Request for Approval: Chicago Mercantile Exchange Inc., The Board of Trade of the City of Chicago, Inc., New York Mercantile Exchange, Inc., Commodity Exchange, Inc. and Kansas City Board of Trade, Inc. Issuance of CME Group Market Regulation Advisory Notice RA1308-5 CME/CBOT/NYMEX/COMEX/KCBT Submission # 13-272 (July 9, 2013) *hereinafter* “Proposed MRAN.”

The FIA endorses in particular the CME's efforts to introduce the CME Globex Self-Match Prevention functionality ("SMP functionality") to assist in preventing wash trades where possible and encourages continuing developments to enhance functionality of the tools.³ The purpose of our comment letter is to support elements of the Proposed MRAN and to explain the basis for our view that use of the SMP functionality should remain optional, given the current account structures, technology and infrastructure in place at many Futures Commission Merchant ("FCMs"). We also note, as discussed below, that the Proposed MRAN should be consistent with prior case law in retaining an intent requirement as an element of a wash trading violation.

I. Use of the CME's SMP Functionality Should Remain Optional

The FIA welcomes the SMP functionality as an important advancement toward mitigating unintentional self-matches on the Exchange. We expect the SMP functionality to serve as a valuable tool for some market users as they attempt to address in-flight race conditions and other marketplace challenges that lead to inadvertent self-matches.⁴ However, we believe that the current SMP functionality raises certain issues regarding systems and account structures such that use of the functionality is presently infeasible in certain contexts, as described in more detail below. Additional flexibility in the functionality will be necessary before it can be used broadly in the market.

First, we support the CME's Proposed MRAN, which makes it clear that "use of the CME Group SMP functionality is optional." We believe that additional flexibility in the functionality will be necessary before it can be used more broadly in the market, and we encourage such further developments.⁵ A broad rule mandating across-the-board use by all market users would prove unduly disruptive to the legitimate trading practices of a number of market users by hindering order execution. Market users therefore require some flexibility with respect to the systems utilized. In this regard, we also note that, because the use of the SMP functionality is optional, a decision by a market participant not to rely on the system should not be construed as evidence of intent to execute a wash trade. To the contrary, optionality means that there may be a number of legitimate reasons for a decision not to rely on the functionality.

Second, it is important to recognize that certain account structures are not suitable candidates for the use of SMP functionality, such as omnibus accounts of futures commission merchants ("FCMs"), which represent the trading of many customers of the FCM and therefore necessarily include different beneficial owners. In particular, an FCM that is not itself a member of the relevant clearing houses often clears the transactions of its customers through omnibus accounts with affiliated or unaffiliated clearing members that are carried in the name of the introducing FCM. Under such circumstances, the clearing member cannot know the identities of

³ See CME Globex Self-Match Prevention Functionality FAQ *available at* <http://www.cmegroup.com/globex/resources/smpfaq.html>.

⁴ In-flight race conditions occur when orders and cancellations are processed asynchronously by the Exchange. This outcome may occur, for example, because CME rules require a cancellation to be sent through the same gateway as the original order. If that particular gateway is experiencing high load when the cancellation is submitted, then a subsequently submitted aggressing order may pass through a less load-burdened gateway and result in an inadvertent self-match.

⁵ Proposed MRAN at FAQ 16.

the underlying customers or, consequently, whether offsetting orders for the omnibus account are for the same or different beneficial owners.

In addition, many market users (*e.g.*, institutional clients and commodity trading advisors) do not connect directly to the CME GLOBEX platform and instead rely on brokers and third party vendors for access. These market users will require the FCM to pass the market user's self-match prevention identifier ("SMP identifier") through the FCM's infrastructure to the Exchange. This will require significant coordinated development and deployment across the FCM and vendor community. Specifically, the technology necessary to identify underlying clients, including systems with the appropriate data fields, does not yet exist and could require an extended period of time to develop.

Additional concerns arise in the normal course of business for certain market users with respect to their legitimate trading practices. For example, an account manager may submit an order to the Exchange and subsequently submit a second order on the opposite side of the market, for a different purpose and for a different account under separate beneficial ownership. Under these facts, the SMP functionality will apply the same SMP identifier to both trades and respond by cancelling the first order as a potential self-match. In this way, the SMP functionality could hinder the ability of account managers to fulfill their obligations to their clients. Similarly, if the SMP functionality were made mandatory, FCMs could be prevented from executing permissible cross trades in accordance with exchange rules, because the functionality might cancel one of the orders.

In addition, FCMs may face systems constraints when they accept voice orders for market users related to the timing required to work the order. A market user may call the FCM with a large voice order that requires considerable time to fill because the market is illiquid. While the broker is working the large order, a small order on the other side of the market would cause the unfilled part of the resting order to be cancelled under the current SMP functionality. Therefore, the fact that the current technology cancels the entire resting order may impede execution of voice orders, especially in illiquid markets.

Similar timing issues arise in the context of time-weighted or volume-weighted orders in which the FCM receives an order from a market user and works it over the course of minutes or hours by submitting portions of it to the Exchange.⁶ In this process, many FCMs use algorithms to gauge market conditions and determine the timing and size of the portions of the order to be submitted to the Exchange. Therefore, the algorithm's timing and size decisions are not known to the market user in advance. As with a voice order, a market user relying on time-weighted or volume-weighted order execution does not know how much of the order has been filled at any given point in time, so the market user may unwittingly submit a subsequent order that could cross the time-weighted or volume-weighted order, and the SMP functionality could result in the order's being cancelled.

⁶ In order to work a customer order more effectively, FCMs utilize various types of execution algorithms. "Time-weighted" and "volume-weighted" execution algorithms are two of the most common approaches, though there are others that will pose similar timing issues when used in conjunction with the SMP functionality.

For these reasons, the FIA supports the development of greater flexibility in the SMP functionality and would like to offer recommendations to address certain trading needs among market users. We understand that, currently, the SMP functionality only provides the ability to cancel a resting order; we believe it should also offer the option to reject an incoming order and should incorporate “decrement” technology.⁷ Decrement technology would cancel the smaller of the potentially self-matching orders and would reduce the larger order by the size of the smaller order. In addition, the SMP functionality should offer “queue priority,” which is technology that considers the depth of the queue and the relative location of the resting order before determining whether to cancel the incoming or the resting order.

II. The Intent Requirement in the Proposed MRAN Should be Read to be Consistent with the Existing MRAN and Longstanding CFTC Case Law

The FIA reads the Proposed MRAN to impose the same intent requirement that exists under the market regulation advisory notice currently in effect and to be consistent with longstanding CFTC case law.⁸ The text of CME Rule 534 remains unchanged and still requires that “the purpose of the orders is to avoid taking a bona fide market position exposed to market risk.”⁹ With regard to accounts with common beneficial ownership, there must be “intent to negate market risk or price competition” as a threshold matter.

Under CFTC case law dating as far back as 1948, courts have recognized that the “essential and identifying characteristic of a ‘wash sale’ seems to be the intent not to make a genuine, bona fide trading transaction....”¹⁰ Recent case law makes the point even more emphatically: the Commodity Futures Trading Commission “must prove intent to establish a violation of either Section 4b or 4c of the CEA.”¹¹ We do not read the Proposed MRAN to depart from the well-settled case law that market users rely on in the normal course of business.

* * *

⁷ We understand that other exchanges—including the IntercontinentalExchange and NASDAQ—either have implemented or are currently building decrement technology, and we support the CME in developing similar technology.

⁸ See CME Group, RA0913-5R (June 28, 2013) *reissuing* CME Group, Notice RA0913-5 (Nov. 3, 2009).

⁹ CME Group, Rule 534, Wash Trades Prohibited.

¹⁰ *In re Goldwurm*, 7 Agric.Dec. 265,274 (1948) (emphasis added).

¹¹ *Reddy v. CFTC*, 191 F.3d 109, 119 (2d Cir. 1999) (emphasis added).

Melissa Jurgens, Secretary

August 14, 2013

Page 5

We would like to express our appreciation to the Commission and the CME for giving us an opportunity to comment on the Proposed MRAN. We sincerely hope that the collective experience of our members will enhance the rulemaking process in a meaningful way. We would be pleased to discuss any questions the Commission or CME might have with respect to the 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. Thank you very much.

Sincerely,

A handwritten signature in cursive script that reads "Walt L. Lukken".

Walt Lukken

President

Futures Industry Association

cc: Honorable Gary Gensler, Chairman
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Mark Wetjen, Commissioner