

By Commission Website

December 9, 2013

Melissa D. Jurgens
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20651

Re: Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, RIN 3038-AD52

Dear Ms. Jurgens:

We represent Gelber Group, LLC (“Gelber”), which is a privately funded proprietary trading firm headquartered in Chicago, Illinois. On behalf of Gelber, we appreciate the opportunity to comment on the Commodity Futures Trading Commission’s (“CFTC” or the “Commission”) Concept Release on Risk Controls and System Safeguards for Automated Trading Environment (the “Concept Release”).¹ Founded in 1982, Gelber has grown to be one of the industry’s most successful and enduring trading firms. Gelber trades on major exchanges in the United States and worldwide, operating in a variety of asset classes, including foreign exchange, fixed income, equities and commodities. Gelber is a clearing member of the Chicago Mercantile Exchange (“CME”), the Chicago Board of Trade (“CBOT”), the Commodity Exchange (“COMEX”) and the New York Mercantile Exchange (“NYMEX”) (collectively, the “CME Group Exchanges”). Gelber’s traders enter orders both manually and via automated trading systems.

As stated in the Concept Release, “U.S. derivatives markets have experienced a fundamental evolution from human-centered trading venues to highly automated and inter-connected trading environments.”² The CFTC seeks comments on the proper scope and type of regulations to apply in this new environment. In general, it is Gelber’s position that the responsibility to establish

¹ The views expressed herein are Gelber’s and do not necessarily reflect the views of Katten Muchin Rosenman LLP or other clients of our firm.

² 78 Fed. Reg. 56542 (Sept. 12, 2013).

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rules governing electronic markets and regulating ATSS should continue to fall primarily under the scope and jurisdiction of the exchanges, with oversight from the CFTC.

The CFTC's core principles for designated contract markets ("DCMs"),³ as set forth in Section 5(d) of the Commodity Exchange Act ("CEA") and Part 38 regulations, contain extensive requirements for DCMs. As one key example, Core Principle 4 mandates that a DCM have the capacity to prevent market manipulation through market surveillance, compliance and enforcement practices and procedures. In Gelber's experience, the exchanges are in the best position to develop and implement appropriate risk controls and other market protections for use by their market participants, and to minimize costs and needless regulatory burdens that may develop in response to public misperceptions of market dynamics. Adopting detailed and prescriptive regulations at the federal level in connection with automated trading may result in stifling innovation at the exchange level, disregarding important differences between the various markets and products at each exchange, and locking in standards that become outdated as markets and technology continue to evolve.

In preparing this response, Gelber has focused on those questions in the Concept Release that it is well-placed to answer, given the nature of its business and its experience in the marketplace. Gelber appreciates Commissioner O'Malia's Statement of Concurrence to the Concept Release, which highlights the following areas in which it would be "particularly constructive" for the CFTC to receive comments: (1) "the definitions for high frequency trading and automated trading systems" that the Technology Advisory Committee ("TAC") has proposed; (2) "what current protections are in the market today and the extent to which the technology is deployed, as well as its effectiveness", and whether the CFTC should "federalize" any of those practices or standards; and (3) "the possibility of a registration requirement for firms operating automated trading systems and not otherwise required to register with the Commission."⁴ We have used the areas emphasized by Commissioner O'Malia as organizing principles for this letter.

I. Definitions of "Automated Trading Systems" and "High Frequency Trading"

As a starting point for any rules that may be applied to automated trading systems ("ATSS") and/or high frequency trading ("HFT"), the CFTC seeks comment on whether it should adopt definitions of each of those terms. In Gelber's view, a strong but appropriately flexible definition of ATS is desirable and sufficient. As further discussed below, ATSS have a particular need for specific pre-trade risk controls, DCM risk controls, price collars, trading pauses, kill switches and other important risk controls and system safeguards. A strong definition of ATS, coupled with useful guidelines on risk controls and system safeguards and proper application of rules

³ We use the terms "DCM" and "exchange" interchangeably throughout this letter.

⁴ 78 Fed. Reg. at 56574.

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governing trading practices, should suffice to minimize disruptive events in automated trading environments while continuing to support market growth and efficiency.

Many exchanges have appropriate definitions of “ATS” in place. The CME Group Exchanges define ATS as “a trading method in which a computer makes decisions and enters orders without a person entering those orders. This is a programmatic way of representing the trader.”⁵ ICE defines “ATS” as “any system that automates the generation and submission of orders to ICE.”⁶ Significantly, these definitions are not locked into current technology or current understandings of algorithmic trading, which are subject to change.⁷ Any CFTC definition of “ATS” should parallel the definitions that already exist at the exchange level.

Adopting a definition of HFT, on the other hand, is unnecessary and may be counter-productive. As stated in the Concept Release, “[e]ffectively, HFT is a form of automated trading, but not all automated trading is HFT.”⁸ Specific and proper rules establishing risk controls and acceptable trade practices for ATSs should apply to and include HFT. This will minimize chances of market disruptions in automated trading environments, regardless of such things as speed of market connections and rates of order entry.

Recent efforts to define HFT have resulted in arbitrary line drawing and descriptions that are both over- and under-inclusive. In Germany, for example, HFT has been defined as the use of infrastructures intended to minimize latency (specifically, servers placed within direct proximity of an exchange’s matching engine and using networks with a bandwidth of 10 gigabytes per second); the execution of orders without human intervention; and a high order-to-trade ratio (of at least 75,000 messages a day). The usefulness of such an inflexible definition, which is based on the existing state of technology and could be subject to gamesmanship, is at best questionable.

⁵ CME Group Glossary, available at <http://www.cmegroup.com/education/glossary.html>. See also CME Group Exchanges Market Regulation Advisory Notice RA0908-5, “Identification and Registration of Globex Operator IDs (Tag 50 IDs)” (Sept. 10, 2009), at p. 2 (an ATS “is a system that automates the generation and routing of orders to Globex”).

⁶ ICE Notice, “Revision to Authorized Trader Requirements” (Jan. 4, 2011).

⁷ An ATS may be; (a) fully automated (sometimes referred to as a “black box” strategy), in the sense that once it is activated, it trades pursuant to the predetermined strategy, without human intervention; or (b) semi-automated (sometimes referred to as a “gray box” strategy), in the sense that human input is required to decide, for example, when to enter or exit a market.

⁸ 78 Fed. Reg. at 56545.

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As is demonstrated by efforts emanating from Europe,⁹ attempts to define “HFT” might more accurately be described as collections of observations that apply to some but not all forms of high-speed trading activity. The same is true of the following draft definition developed by the TAC working group:

High frequency trading is a form of automated trading that employs:

- (a) algorithms for decision making, order initiation, generation, routing, or execution, for each individual transaction without human direction;
- (b) low-latency technology that is designed to minimize response times, including proximity and co-location services;
- (c) high-speed connections to markets for order entry; and
- (d) recurring high message rates (orders, quotes or cancellations) determined using one or more objective forms of measurement, including (i) cancel-to-fill ratios; (ii) participant-to-market ratios; or (iii) participant-to-market trade volume ratios.

This definition fails to take into account, for example, the fact that some manual traders can enter orders as rapidly as some automated systems,¹⁰ and some trading systems may involve manual trading with some functionality of the trade supported by automation. It does not address the situation of a manual trader executing trades with the speed of a fully automated system, using high-speed connections and order-entry patterns consistent with those described in subparts (c) and (d). As another example of the shortcomings of such definitions, registered market makers, required to quote a two-sided market throughout a trading session in an illiquid market, may not execute a single trade. Therefore, such things as cancel-to-fill ratios, participant-

⁹ As currently proposed, Markets in Financial Instruments Directives (“MiFID II”) would define “HFT” as algorithmic trading for a firm’s own account involving physical latency and at least two of the following five criteria:

- (1) co-location, direct market access or proximity hosting;
- (2) daily portfolio turnover of at least 50%;
- (3) cancellation ratio exceeding 20%;
- (4) a majority of positions unwound in the same day; and/or
- (5) over 50% of orders/transactions on venues offering discounts or rebates.

¹⁰ See, e.g., CFTC v. Moncada, 12-CV-8791 (S.D.N.Y. Dec. 4, 2012) (“Moncada’s large-lot orders were manually canceled on average within approximately 2.06 seconds of entry, and as quickly as 0.226 seconds”).

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to-market messaging ratios, and participant-to-market trade volume ratios are insufficient to distinguish between market maker activity in an illiquid market and automated HFT activity.

In sum, Gelber urges the CFTC to utilize a strong and flexible definition of ATS that aligns with existing exchange definitions of that term. There are no regulatory benefits to be gained from applying different standards as between firms that operate ATSS and firms that deploy “HFT” strategies, however that term might be defined.

II. Current Market Protections and Whether Such Standards Should Be “Federalized”

This section of the letter contains Gelber’s responses to questions in the Concept Release regarding risk controls and other market protections and whether the CFTC should “federalize” such standards. For ease of reference, we have included each relevant question (*in italics*), as numbered in the Concept Release, followed by Gelber’s response.

Pre-Trade Risk Controls

7. Are there distinct pre-trade risk controls, including measures not listed below, or measures in addition to those already adopted by the Commission, that should apply specifically in the case of DMA?

Pre-trade risk controls are the most essential controls necessary to combat potential market disruptive events. It is critical that pre-trade risk controls are an instrumental part of the ATS and that they are built into any gateway application through which ATS orders flow. The trading application risk controls guard against an individual program malfunctioning, while gateway risk controls guard more broadly against placing orders which violate specific firm and exchange risk parameters.

Gelber firmly believes that inclusion of pre-trade risk controls at the application and firm gateway level is critical to avoiding disruptive market events. The CFTC and the exchanges have already enacted rules and regulations that require firms to have risk controls preventing orders from disrupting the markets. Therefore, Gelber does not believe additional rules are necessary.

Message and Execution Throttles

8. If ... maximum message rates and execution throttles were used as a mechanism to prevent individual entities or accounts from trading at speeds that are misaligned with their risk management capabilities, how should this message rate be determined?

Risk management capabilities should be stringent enough to ensure that maximum messaging rates and execution fall within a firm’s risk guidelines.

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9. Message and execution throttles may be applied by trading firms (FCMs and proprietary trading firms), clearing firms, and by exchanges. The Commission requests public comment regarding the appropriate location for message and execution throttles.

a. If throttles should be implemented at the trading firm level, should they be applied to all ATSS, only ATSS employing HFT strategies, or both?

Messaging throttles should be implemented at the trading application level, the Exchange gateway and at the Exchange at the account identifier (tag) level and the product level. The throttles should be used to identify excessive messaging and stop the applications from flooding the market with erroneous messages.

b. What role should clearing firms play in the operation or calibration of throttles on orders submitted by the trading firms whose trades they guarantee?

In many cases, FCMs receive fills from the exchanges and have no control over the amount of messaging coming from a customer controlled-and-run applications. Therefore, FCMs need to have the ability to coordinate throttle rates through the account identifier at the exchange.

10. Should the message and execution throttles be based on market conditions, risk parameters, type of entity, or other factors?

Messaging and execution throttling at the application should be based on the capital allocated to a specific application and at the firm or gateway by account at some defined level higher than the application throttling rate. Product messaging guidelines should be the responsibility of the exchanges.

11. What thresholds should be used for each type of market participant in order to determine when a message or execution throttle should be used? Should these thresholds be set by the exchange or the market participant?

Please see Gelber's response to Question 10 above. In Gelber's view, both the exchange and the market participant should set these thresholds.

12. Are message and execution thresholds typically set by contract, or by algorithm? What are the advantages and disadvantages to each method?

Messaging thresholds are typically set by contract at the exchange level. Gelber believes that continuing to have the rates set by contract at the exchange level is the most efficient method of setting messaging thresholds. Exchanges are in the best position to determine what the impact of a particular level of messaging might have on the market data for a particular product. Exchanges also have strong incentives to ensure messaging levels are economically efficient, since the cost of a high volume of messaging without corresponding trades is directly borne by the exchange.

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13. Who should be charged with setting message rates for products and when they are activated?

Both exchanges and market participants need to utilize messaging rate thresholds as a risk control. Messaging rates set by the exchanges ensure that market performance is not impacted by excessive messaging by a market participant. Exchanges can use messaging rates in a product to identify potential problems in a market and act to slow down or disable the violating market participant. Messaging rates set by market participants are a critical part of any market participant's risk management controls: 1) to ensure that the market participant complies with the rates set by the exchange; and 2) to alert the market participant to potential problems with an automated order entry system.

14. Would message and execution throttles provide additional protection in mitigating credit risk to DCOs?

Gelber believes that appropriately designed message and execution throttles would provide additional protection in mitigating credit risk to DCOs.

Volatility Awareness Alerts

15. The Commission is aware that alarms can be disruptive or counterproductive if "false alarms" outnumber accurate ones. How can volatility alarms be calibrated in order to minimize the risk that false alarms could interrupt trading or cause human monitors to ignore them over time?

The Exchanges already use effective price controls to manage volatility. Additional volatility alerts at a federal level would be inherently subjective and thus inefficient.

Self-Trade Controls

16. What specific practices or tools have been effective in blocking self-trades, and what are the costs associated with wide-spread adoption of such practices or tools?

In Gelber's view, the self-match prevention functionality developed by the CME Group Exchanges for Globex users ("SMP") and the Self Trade Prevention Functionality ("STPF") developed by ICE can be utilized in a manner that is highly effective in eliminating self-trades. In Gelber's experience, use of self-match prevention tools developed by the exchanges does not impose additional costs on market participants, provided that market participants are given appropriate leeway to apply such tools in a manner that is appropriate in light of their particular business structure and trading strategies.

17. Please indicate how widely you believe exchange-sponsored self-trading controls are being used in the market.

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While Gelber cannot speak for other market participants, it has implemented the self-trade prevention tools available from ICE and the CME Group Exchanges. In addition, use of ICE's self-match prevention tool is mandatory for certain market participants.

18. Should self-trade controls cancel the resting order(s)? Or, instead, should they reject the taking order that would have resulted in a self-trade? If applicable, please explain why one mechanism is more effective than the other.

This should not be viewed as a "one size fits all" issue. Rather, market participants should have the capability of choosing whether they want the resting order, the aggressing order or both cancelled in a potential self-trade scenario.

19. Should exchanges be required to implement self-trading controls in their matching engines? What benefits or challenges would result from such a requirement?

Most exchanges have already voluntarily implemented self-trading controls, and we understand that other exchanges are in the process of doing so. Accordingly, any requirement for exchanges to adopt such controls would appear unnecessary.

20. Please explain whether regulatory standards regarding the use of self-trading control technology would provide additional protection to markets and market participants.

21. If you believe that self-trading controls are beneficial, please describe the level of granularity at which such controls should operate (e.g., should the controls limit self-trading at the executing firm level? At the individual trader level?) What levels of granularity are practical or achievable?

22. If you believe that self-trading controls are beneficial, please explain whether exchanges should require such controls for market participants and identify the categories of participants that should be subject to such controls. For example, should exchanges require self-trading controls for all participants, some types of participants, participants trading in certain contracts, or participants in market maker and/or incentive programs? What benefits or challenges would result from imposing such controls on each category of participant?

Gelber urges the CFTC to avoid operating from a "one size fits all" mindset with respect to self-match prevention controls. Any attempt to "federalize" standards with respect to such controls does not appear necessary or beneficial, and would risk locking in standards or technology that may quickly become outmoded. Exchanges have voluntarily developed self-match prevention tools for market participants and are in the best position to work with market participants to further develop and enhance such tools, as necessary, based on experience.

Gelber agrees with the position adopted by the CME Group Exchanges, pursuant to which use of SMP "is optional and each firm has the flexibility to tailor its application of SMP functionality

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and its use of SMP IDs in ways that are appropriate for its particular business model and trading strategies.”¹¹ At the same time, the CME Group Exchanges have made clear that wash trades are prohibited and that “market participants should carefully review their operations ... and, where appropriate, take steps necessary to minimize the potential for such trades either through the use of SMP functionality or by alternative means.”¹² Market participants are in the best position to determine what kind of self-match prevention functionality is best for their particular firm, based on such things as number of traders or trading groups and trading strategies.

In general, Gelber believes that use of self-match prevention tools to prevent an individual trader from trading with himself is appropriate, and would not object if a particular exchange chose to mandate use of such tools at the “trader ID” level. However, Gelber agrees with the views espoused in the CME Group Exchanges’ Advisory Notice on wash trades (which was approved by the CFTC under Regulation 40.5), which recognizes that

... many firms have proprietary trading operations in which multiple traders making fully independent trading decisions enter orders for a commonly owned account (the firm’s proprietary account) that may unintentionally and coincidentally match with each other on the electronic platform. Provided that the respective orders of each independent trader are entered in good faith for the purpose of executing bona fide transactions, are entered without prearrangement, and are entered without the knowledge of the other trader’s order, then such trades shall not be considered to violate the prohibition on wash trades.¹³

Price Collars

23. The Commission is aware that some exchanges already have price collars in place for at least a portion of the contracts traded in their markets. Please comment on whether exchanges should utilize price collars on all contracts they list.

24. Would price collars provide additional protection in mitigating credit risk to DCOs?

Price collars on contracts can be used to prevent orders outside of acceptable price ranges from entering the market or being executed at extreme levels. It should be the responsibility of the exchanges to establish collars. The use of collars benefits and protects DCOs and market participants from unusually volatile markets.

¹¹ CME Group Exchanges Market Regulation Advisory Notice RA1308-5, “Wash Trades Prohibited” (Nov. 19, 2013), at 6.

¹² *Id.*

¹³ *Id.* at 5.

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Maximum Order Sizes

26. Do exchanges allow clearing members to use the exchange's technology to set maximum order sizes for specific customers or accounts?

27. Would additional standardization in the capabilities of this technology or more uniform application of this technology to all customers and contracts improve the effectiveness of such controls?

28. To what extent are clearing firms and trading firms conducting pre-trade maximum order size screens? Please explain whether firms are conducting such screens by utilizing: (1) their own technology; (2) the exchange's technology; or (3) a combination of both.

29. Would regulatory standards regarding the use of such technology provide additional protection to the markets?

Gelber includes maximum order sizes in all of its trading software. The maximum order size is set by Gelber's risk department for each trader and product. Gelber's maximum order sizes typically are significantly smaller than conceivable exchange maximums. However, maximum order sizes at the exchanges on a product basis could potentially be a useful risk control for other market participants. Gelber urges the CFTC to the work with the exchanges on these issues.

Trading Pauses

30. Trading pauses, as currently implemented, can be triggered for multiple reasons. Are certain triggers more or less effective in mitigating the effects of market disruptions?

Trading pauses triggered because a market reaches a certain level or limit are a useful tool to slow the movement of a market, provide market participants time to reassess their strategies, and allow an orderly market to be re-established. This is true whether the limit move is caused by a legitimate market event or a market disruption caused by a malfunctioning ATS or the mishandling of an order. Also, since many markets are interrelated, taking a pause can be useful in mitigating the possible spread of risks inherent in major market movement.

31. Are there additional triggers for which pauses should be implemented? If so, what are they?

Gelber does not recommend implementation of any additional triggers at this time.

32. What factors should the Commission or exchanges take into account when considering how to specify pauses or what thresholds should be used?

33. How should the re-opening of a market after a trading pause be effected?

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As was demonstrated by the CME's Stop Logic Functionality that triggered a five-second trading halt in E-Mini S&P 500 futures during the "Flash Crash" on May 6, 2010,¹⁴ the exchanges are in the best position to determine the appropriate thresholds for pauses based on the movement of the prices and volume in a particular product. Pauses should not be standardized at the federal level. The exchanges should develop mathematical models for each contract under their jurisdiction, and enact pauses specific to each contract.

Credit Risk Limits

34. What positions should be included in credit risk limit calculations in order to ensure that they are useful as a tool for limiting the activity of a malfunctioning ATS? Is it adequate for such a screen to include only those positions entered into by a particular ATS or should it include all the firm's positions?

35. Should pre-trade credit screens require a full recalculation of margin based on the effect of the order?

36. In light of your answers to the previous two questions, where in the lifecycle of an order should the credit limits be applied and what entity should be responsible for conducting such checks.

Credit limit calculations do not necessarily need to be accomplished by a margin-based system. The same level of control can be established by establishing maximum position sizes in an application. Credit usage can be controlled when an independent risk department sets position limits. Every order is checked against an order limit that is set on a user/context in a risk server and the position is pre-validated to check whether the position that would result if the order were filled would violate the position limits set by a risk department.

37. If credit checks are conducted post-trade, what should be done when a trade causes a firm to exceed a limit?

If maximum position sizes were controlled as described above, post-trade credit checks would be redundant and unnecessary.

38. Please describe any technological limitations that the Commission should be aware of with respect to applying credit limits.

¹⁴ As CME observed, "there is no visible support for the notion that algorithmic trading models deployed in the context of stock index futures traded on CME Group exchanges caused the market fluctuations" on May 6, 2010. CME Group, "What Happened on May 6th?" (May 10, 2010), at 3, available at <http://cmegroup.mediaroom.com/index.php?s=114&item=159>.

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Gelber is not aware of any such technological limitations.

39. The Commission is particularly interested to receive public comment on the "hub" model and its applicability to different types of pre-trade risk controls. What are the strengths and weaknesses of this approach relative to other pre-trade or post-trade approaches to checking trades against credit limits? How would the latency between the "hub" and the exchanges be managed to provide accurate limits for high frequency ATS?

For purposes of trading in the OTC derivative markets (including trading on multiple SEFs), a well-designed centralized credit "hub" would be an efficient mechanism to provide pre-trade credit controls to the swaps marketplace, particularly with regard to transactions cleared by prime brokers. Gelber does not believe, however, that a "hub" model would be beneficial or viable for the futures markets, in which DCOs, DCMs and FCMs have, at considerable cost, already developed a host of pre- and post-trade controls that are appropriate for the various futures markets in which they conduct business. Checking every futures order against a centralized credit hub would inject additional latency into the system and, if the hub model were used only in the U.S., would disadvantage U.S. futures markets from a global perspective. In addition, implementing a hub model in the futures markets would be costly and complex, and would introduce considerable risk associated with technological failures at the centralized hub.

40. If you believe that post-trade credit checks would be an effective safeguard against malfunctioning ATSS, what is the maximum amount of latency that should be allowed for conducting such checks? What technological or information flow challenges would have to be addressed in order to implement post-trade checks with that degree of latency?

The speed at which many ATSS trade means that post-trade credit checks and position checks would be ineffective as a safeguard to a malfunctioning ATS. It would be more efficient for the exchanges to allow firms to set order and position levels per account for exchange-side validation.

Order, Trade and Position Drop Copy

42. What order and trade reports are currently offered by DCMs and DCOs? What aspects of those reports are most valuable or necessary for implementing risk safeguards? Please also indicate whether the report is included as part of the exchange or clearing service, or whether an extra fee must be paid.

Most exchanges have straight-through, real-time trade reporting, and the post-trade data can be used in risk systems. Generally, exchange gateways and third-party front-ends have the capability of immediate delivery of trade data to a risk system for post-trade risk analysis.

43. If each order and trade report described above were to be standardized, please provide a detailed list of the appropriate content of the report, and how long after order receipt, order

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execution, or clearing the report should be delivered from the trading platform to the clearing member or other market participant.

Standardized information currently issued by the exchanges is for the purpose of clearing trades. Although the data could perhaps be standardized for use in a post-trade risk system, the delivery of the information would be slower than current methods of extracting trade data.

Trade Cancellation or Adjustment Policies

44. Is a measure that would obligate exchanges to make error trade decisions (i.e., decisions to cancel a trade or to adjust its price) within a specified amount of time after an error trade is reported feasible? If so, what amount of time would be sufficient for exchanges, but would be sufficiently limited to help reduce risk for counterparties to error trades?

Although establishing a time period that would obligate exchanges to make error trade decisions within a specified amount of time is difficult, it is both feasible and a necessary protection for market participants on the other side of an errant trade. In Gelber's view, the identification and resolution of an error trade should be automated and it should take an exchange no more than three minutes to adjust the price of the erroneous order.

45. Should exchanges develop detailed, pre-determined criteria regarding when they can adjust or cancel a trade, or should exchanges be able to exercise discretion regarding when they can adjust or cancel a trade? What circumstances make pre-determined criteria more effective or necessary than the ability to exercise discretion, and vice versa?

As a general rule, exchanges should develop detailed, predetermined criteria regarding when they can adjust a trade. Gelber recognizes, however, that exchanges may need to exercise their discretion to adjust or cancel trades when presented with extreme circumstances that may require them, for example, to exercise their emergency powers.

46. Do error trade policies that favor price adjustment over trade cancellation effectively mitigate risk for market participants that are counterparties to error trades? Are there certain situations where canceling trades would mitigate counterparty risk more effectively? If so, what are they and how could such situations be identified reliably by the exchange in a short period of time?

47. Should error trade policies be consistent across exchanges, either in whole or in part? If so, how would harmonization of error trade policies mitigate risks for market participants, or contribute to more orderly trading?

Gelber is a strong advocate for consistent error trade policies across exchanges and believes that price adjustments are a far superior method over trade cancellation to mitigate risk for market participants. Because markets are interrelated, an errant trade can affect other markets in addition

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to the market where the error occurred. Trading participants on the other side of an errant trade often spread the risk of taking the other side of an errant trade into other markets by hedging. That offsetting hedge transaction becomes exposed to outright risk if the trade in question is cancelled by an exchange pursuant to its error trade policy. In order to avoid such inequitable and problematic market dynamics arising from cancelled trades, all errant trades should be price adjusted pursuant to exchange rules.

Controls Related to Order Placement

48. The Commission's discussion of kill switches assumes that certain benefits accrue to their use across exchanges, trading and clearing firms, and DCOs. Please comment on whether such redundant use of kill switches is necessary for effective risk control.

As a general rule, the use of "kill switches" can be an effective tool to shut an order execution application down before it can do irreparable harm to a firm and a market. However, a kill switch (or other such mechanisms) may create more problems than it solves if it is applied at a firm-wide level and prevents a firm from entering liquidating or other risk-reducing orders. A requirement that all ATSs have kill switches should be limited to a requirement for the installation of kill switches that shut down a single problematic ATS. If a kill switch is triggered, the firm should still be in a position to mitigate risk through manual order entry. Therefore, a kill switch should be required at the ATS level, but should not be applied by an exchange on a firm or market participant level.

49. What processes, policies, and procedures should exchanges use to govern their use of kill switches? Are there any different or additional processes, policies and procedures that should govern the use of kill switches that would specifically apply in the case of DMA?

Exchanges should require all ATSs to have the capability of stopping a program from entering, canceling or modifying orders if the ATS is, or is reasonably perceived to be, malfunctioning.

51. What objective criteria regarding kill switch triggers, if any, should entities incorporate into their policies and procedures?

All applications should contain monitoring tools which identify when an ATS is not functioning properly. The tools should set off an alarm notifying the operator of the problem so that the operator can kill the program. In extreme cases, the application should be required to immediately shut down or be killed because the activity is potentially damaging to the market. Rules to this affect should be memorialized in a firm's supervisory procedures manual.

52. What benefits or problems could result from standardizing processes, policies, and procedures related to kill switches across exchanges and/or clearing firms?

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Other than a broad requirement that all ATSS have an automated kill switch, it would be inadvisable and a practical impossibility to standardize across exchanges and clearing firms the processes, policies and procedures related to kill switches. Reasons for needing to “kill” an ATS are varied, and if a problem is detected, a firm must have the capability to enter orders into the market to offset the risk of its open positions.

53. Please explain how kill switches should be designed to prevent them from canceling or preventing the submission of orders that are actually risk reducing or that offset positions that have been entered by a malfunctioning ATS.

If an application is malfunctioning, it should be shut down or killed. Once an ATS is killed and the operator notified, a human must interact with the markets to offset any risk. As noted above, it is important not to attempt to enact kill switches at a firm-wide level, which might prevent the entry of risk-reducing orders.

Repeated Automated Execution Throttle

As a general comment, Gelber believes that automated execution throttles on ATSS should be required by the exchanges to keep ATSS from disrupting the markets from repeated executions. A throttling mechanism should be fully configurable by the trading firm. Once an ATS has been shut down for excessive or erroneous executions, it should be a requirement that the ATS not be re-activated without human intervention, after it has been confirmed that the cause of the excessive or erroneous executions has been remedied.

Policies and Procedures for the Design, Testing and Supervision of ATSS

56. Please describe the necessary elements of an effective ATS testing regime, in connection with both the initial deployment and the modification of an ATS.

To create an effective ATS testing regime, specific testing requirements should be defined early in the software development process. Unit tests, integration test and system test guidelines should be explicitly specified, and the creation of these tests should be an integral part of the ATS design. An effective ATS testing regime will have a clear delineation between those responsible for the design of the ATS, and those responsible for certifying that the ATS has been appropriately tested. Those with responsibility for testing the ATS must be empowered to delay the release of any software.

57. With respect to testing of modifications, how should the Commission and market participants distinguish between major modifications and minor modifications? What are the objective criteria that can be used to make such distinctions? Should any testing regime applicable to ATS modifications distinguish between major and minor modifications, and if so, how?

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Software modifications, whether major or minor, should not be released into production without having passed a standard suite of predefined unit and, where applicable, integration tests. In addition, no software modification, whether major or minor, should be released without an independent review of the modifications being performed by someone other than the developer responsible for the proposed change.

58. What challenges or benefits may result from exchanges implementing standardized procedures regarding the development, change management, and testing of exchange systems? Please describe, if any, the types of standardized procedures that would be most effective.

Standardization of procedures regarding the development, testing and change management of exchange systems would make it easier to verify that established protocols were being adhered to as exchange systems evolve. For trading firms that interact with a large number of disparate exchange testing requirements, standardizing the testing and change management procedures at the exchanges would likely make the firm certification process more consistent and more efficient. At the same time, standardizing inherently complex procedures across a large number of exchanges would be a difficult and time-consuming process. It is more important that clear and comprehensive development, testing and change management procedures exist at every exchange, than that those procedures be standardized across exchanges.

Crisis Management Procedures

59. Should basic crisis management procedures be standardized across market participants? If so, what elements should be addressed in an industry-wide standard?

Although crisis management procedures should be required of market participants, standardized procedures are unrealistic and inadvisable given the different sizes and roles of exchanges, FCMs, DCOs, proprietary trading firms and other market participants. Each should be required to memorialize their crisis management procedures, and to demonstrate that they fulfill applicable requirements for responsiveness and notification.

60. Are there specific, core requirements that should be included in any crisis management procedures? Similarly, are there specific types of crisis events that should be addressed in any crisis management procedures? If so, please identify such requirements and/or crisis events and the level of granularity or specificity that the procedures should have with respect to each.

The critical element that should be included in crisis management procedures is who should be notified and under what circumstances should they be notified. Notification is clearly necessary when the action would result in disrupting a specific market or markets. In general, crises management procedures describing how to deal with a rogue trader, problems with an ATS, problems with a customer and/or a significant market event should be specifically outlined in a firm's written supervisory procedures. Different market events may require different guidelines.

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Self-Certifications and Notifications

61. How often should a market participant certify that their pre-trade risk controls, post-trade reports and other measures, and system safeguards meet the necessary standards?

A market participant should certify that each of its ATSS employs pre-trade risk controls, post-trade reports and system safeguards. Such certification should be done at least twice a year and every time a material change to a program has been implemented.

62. Which representative of the market participant should be required to attest that the certification standards have been met? Should it be the market participant's chief executive officer, chief compliance officer, or similar high-ranking corporate official, or some other individual?

The ATS should be certified by the chief technology officer or their equivalent and the certification attested to by another "C-level" executive officer.

63. Which entity(ies) should receive certifications from market participants? For example, should it be the market participant's clearing firm, its designated self-regulatory organization (if applicable), one or more trading platforms, a registered futures association, the Commission, or other entity?

64. Should DCMs, SEFs or clearing member firms be required to audit market participant certifications? What would be covered in an audit and how often should these audits occur? Should the same entity that receives the certification be required to perform the audit?

In Gelber's view, exchanges should require firms operating ATSS to maintain certifications as part of their books and records, and to produce such certifications to the firm's clearing firm and/or the exchange, upon request. Each exchange should be permitted to utilize its discretion to determine how often it will request and review such certifications, in furtherance of its obligations under the DCM Core Principles.

Risk Event Notification Requirements

65. Do commenters believe that risk event notifications would help to better understand and ultimately reduce sources of risk in automated trading environments? What information should be contained in a risk event notification to maximize its value?

66. What types of risk events should trigger reporting requirements, and what entities should receive risk event notifications from market participants operating ATSS?

67. Which entities should receive risk event notifications?

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Whether risk event notifications would help to better understand and ultimately reduce sources of risk in automated environments is unclear. However, it is important that risk events that would have a material impact or disrupting effect on a particular market or markets are reported immediately to the exchanges directly impacted by the market event. The exchanges can then contact the CFTC, as necessary and appropriate.

ATS or Algorithm Identification

69. What are the existing practices within trading firms for internally identifying ATSs or algorithms and for tracking their performance, including profit and loss? What elements of existing practices could be leveraged in any ATS or algorithm identification system proposed by the Commission in the future?

When entering an order onto an electronic trading platform, market participants are required under exchange rules to utilize an operator ID, known as a “Tag 50 ID” at the CME Group Exchanges and a “Tag 116 ID” at ICE. Exchange requirements with respect to Tag IDs for ATSs are robust and heavily monitored and enforced by the exchanges.¹⁵ At Gelber, ATSs are further identified by a designation in the account number. Given the exchanges’ existing Tag IDs for ATSs, the CFTC should not require any additional identifications of an algorithm or the underlying algorithms in an ATS, as a multiplicity of such IDs would make the identification system overly complicated and unmanageable.

70. The Commission understands that an ATS may consist of numerous algorithms, each of which contributes to a trading decision. If an algorithm-based identification system is proposed, which of the potentially multiple algorithms that constitute an ATS should carry the ID? In addition, what degree of change to an algorithm should necessitate the use of a new ID, and how often does this change typically occur? What is the appropriate definition of “algorithm” for purposes of an algorithm identification system?

The ATS should be identified. A requirement seeking to differentiate between discrete algorithmic components within the ATS would be overly complex and unworkable.

71. If the identification system resides at the ATS level, how should such IDs be structured to ensure that they are nonetheless sufficiently granular to identify components that may be leading or have led to unstable market conditions?

72. What message traffic between an ATS and a trading platform should include the ATS or algorithm ID (all messages, orders only, etc.)?

¹⁵ See, e.g., CME Group Exchanges Market Regulation Advisory Notice RA0908-5, “Identification and Registration of Globex Operator IDs (Tag 50 IDs)” (Sept. 10, 2009).

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73. What relationship should this ATS ID have to the legal entity identifier (LEI)?

The exchanges have adequately addressed these issues in their use and development of Tag IDs for ATSS, and are in the best position to expand requirements as needed. Gelber urges the CFTC to coordinate with the exchanges on these issues in an effort to avoid imposing redundant and needlessly burdensome requirements on market participants.

Data Reasonability Checks

74. Please describe existing practices in the industry concerning how and the extent to which ATSS use (1) market data; and (2) news and information providers, including social media, to inform trading decisions.

75. The Commission requests comment regarding any risk controls, including reasonability checks, currently being used by market participants operating ATSS to review market data and news and information providers, including social media. Please describe the risk control, including the purpose of the control, the extent of its use among derivatives market participants, and any other aspects of the risk control that you believe would be helpful for the Commission to understand.

ATSS need accurate and timely data in order to perform properly. Government agencies must do their best to ensure that the dissemination of economic reports is consistent and fair. Exchange price data needs to be accurate and timely.

Market Quality Incentives

96. Should exchanges impose a minimum time period for which orders must remain on the order book before they can be withdrawn? If so, should this minimum resting time requirement apply to orders of all sizes or be restricted to orders smaller than a specific threshold? If there should be a specific threshold, how should that threshold be determined?

Gelber does not believe that orders should be subject to a minimum exposure period. Since the introduction of ATSS into the futures markets, the markets have become more efficient as the minimum unit of movement or “tick” size narrowed. Requiring market makers to have orders remain in the book for a minimum time before being withdrawn or changed will cause the bid/ask spread to widen. Liquidity providers have sophisticated ATSS which depend upon correlations between various markets to determine the current prices to bid and offer. If liquidity providers are not allowed to change their quotes after the market price should have changed, they potentially become subject to greater market risk and are likely to adjust the spread between the bid and the offer to compensate for the greater risk, resulting in less efficient markets.

100. What costs and benefits result from providing market participants with real-time access to information about the order book that extends beyond aggregate size available at a limit price?

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Is there a legitimate economic benefit that results from market participants (both human participants, and ATSS) accessing such information? Is it possible for market participants to use such information to manipulate the order book?

Real-time access to information about the order book can only benefit market participants and allow markets to run more efficiently. Usually, the more information provided to a market, the more efficiently it performs. In Gelber's view, CFTC and exchange rules prohibiting manipulative and disruptive trading practices can be appropriately utilized to address any efforts by market participants to abuse order book information.

101. The Commission seeks to understand whether any of the recommendations above are inapplicable or irrelevant to markets subject to the CEA. If so, please indicate which recommendation(s) and what makes it inapplicable or irrelevant to those markets.

In Gelber's experience, markets act most efficiently when fills are on a first come, first served basis. All other types of order and "specialized" fill algorithms welcome market abuse, increase risks and encourage market inefficiencies.

General Questions Regarding All Risk Controls

106. For each of the specified controls described above [see sections III.C-F], please indicate whether you are already using the control on customer and/or proprietary orders. If applicable, please also indicate how widely you believe the control is currently being used in the market, and how consistent the application of the control is among firms.

Gelber employs controls similar to those discussed in the Concept Release. While Gelber is generally not in favor of the CFTC micromanaging the use of trading applications, it believes that all firms operating ATSS should adopt the types of controls discussed in sections III.C-F of the Concept Release. Existing CFTC and exchange surveillance and enforcement authority, including but not limited to rules prohibiting market manipulation and disruptive trading practices, can be effectively employed to encourage market participants to utilize risk controls to avoid such things as potentially serious implications of a malfunctioning ATS.

107. If possible, please indicate specific costs associated with implementing each of the risk controls described above [see sections III.C-F]. Please include detailed estimates, distinguishing between the cost of developing the functionality, the cost of implementation, and the cost of ongoing operations.

108. Please describe the specific benefits associated with each of the risk controls. Where possible, please indicate the market participant category(ies) to which the benefit would accrue.

As an overarching principle, the need to embody risk controls in ATSS to protect the market participant, carrying and clearing firms, the exchanges, DCOs and the marketplace outweighs

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reasonable costs arising from implementation and ongoing operations. That being said, Gelber appreciates efforts by the exchanges to develop, implement and operate certain risk controls for use by market participants, which can assist in providing significant cost savings to the marketplace as a whole.

In Questions 109 through 118, the CFTC seeks comments relating to details of implementing and overseeing the various risk controls discussed in the Concept Release, including whether the CFTC should standardize risk controls or “specify more granular or specific requirements with respect to any of the controls to improve their effectiveness or provide greater clarity to industry participants.” In general, existing rules are appropriate to control the risks inherent in any ATS and are appropriately flexible to reflect both the diversity of market participants and technological advances. More granular regulations would result in making the markets less efficient, and may become outmoded as the markets change and evolve over time.

119. Should the Commission consider any pre-trade risk controls, post-trade reports, or system safeguards appropriate exclusively to market makers or to ATSs used by market makers? If so, please describe such controls or safeguards.

Exchanges should establish appropriate pre-trade risk controls, post-trade reports and system safeguards requirements for those firms with which they enter into market-maker agreements. If a market maker is required to make bid/ask spreads within a certain differential throughout a large percentage of the trading day, they should be allowed to operate under guidelines tailored by the exchanges to reflect such requirements. For example, a market maker required to the quote two-sided markets throughout the day should not be subject to messaging-to-fill ratios.

120. Should the Commission or Congress revisit its approach to issuing civil monetary penalties for violations of the Act, particularly as they relate to automated trading environments? Currently, the maximum civil monetary penalty the Commission may issue is capped at \$140,000 “per violation.” Is such a civil monetary penalty sufficient to deter acts that constitute violations of the Act, given that an individual violation could impose costs to the market and the public well in excess of \$140,000?

Current civil monetary penalties available to the CFTC are more than adequate to deter regulatory violations, particularly in combination with the CFTC’s ability to seek disgorgement of profits and restitution and to ban market participants from trading. Significantly, there is no “cap” on the aggregate amount of monetary sanctions the CFTC can impose in an enforcement action. We note that CFTC civil monetary penalties of \$1 million dollars or more are no longer uncommon, and that the CFTC typically does not provide calculations to support the size of its civil monetary penalties. Furthermore, it is not uncommon for the CFTC to impose monetary

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sanctions in cases where one or more regulators have also imposed monetary fines on a market participant.¹⁶

121. Please describe the documentation (or categories of documents) that would demonstrate that a market participant operating an ATS has implemented each risk control addressed in this Concept Release, including, for example, computer code, system testing results, certification processes and results, and calculations.

Exchanges should require market participants using ATSs to provide documents, upon request, that contain a qualitative description of the ATS and certify that each ATS employs pre-trade risk controls, post-trade reports and system safeguards. Gelber does not believe that market participants should be required to provide computer code to regulators as a routine matter.

122. Would a fee (collected by, for example, the DCM or SEF) on numbers of messages exceeding a certain limit be more appropriate than a hard limit on the number or rate of messages?

123. Should such a penalty be based on a specified number or rate of messages or on the ratio of messages to orders filled over a specified time period?

Fees on numbers of messages, and at a ratio to fills exceeding certain limits, as established by each exchange and by product, are appropriate. Market makers should be exempt from messaging order-to-fill ratio requirements.

III. Registration of Firms Operating ATSs

The Concept Release posits the notion that firms operating ATSs fit within the CFTC registration category of “floor trader”, a term the CEA defines to include any person “who, in or surrounding any pit, ring, post, or other place provided by a contract market for the meeting of persons similarly engaged, purchases, or sells solely for such person’s own account” any futures contracts or swaps.¹⁷ The Concept Release suggests, without explanation, that the inclusion of the phrase “or other place” in this definition signifies that anyone who trades solely for their own account can be characterized as a floor trader. That is not the case.¹⁸

¹⁶ See, e.g., In the Matter of Panther Energy Trading, LLC, CFTC Docket No. 13-26 (July 22, 2013).

¹⁷ CEA §1a(23).

¹⁸ While not mentioned in the Concept Release, the definition of “swap dealer” in Section 1.3(ggg) of the CEA provides an exclusion for certain swaps entered into by persons who are registered as floor traders. The fact that certain firms may choose to *voluntarily* register as floor

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As the term itself implies, a floor trader is a person who may access and trade on the floor of an exchange in which they are a member. This is supported by the CFTC's Glossary, which defines "floor trader" as "[a] person with exchange trading privileges who executes his own trades by being personally present in the pit or ring for futures trading. See Local."¹⁹ Exchanges without trading floors typically do not offer floor trader status to market participants, as they would if that term were synonymous with proprietary trader. Exchanges with trading floors, such as CME, have rules stating that "[i]ndividuals not accessing the trading floor are not required to obtain floor broker or floor trader registration."²⁰ They also have rules that place additional obligations on floor traders, such as: (a) being available on the trading floor to resolve outrades in contracts in which they executed trades on the previous day, prior to the opening of the relevant market;²¹ and (b) attending courses in floor trading.²² As the content of these rules suggests, requiring proprietary trading firms without floor trading privileges to register as "floor traders" would be illogical, and may not survive judicial review.²³

Moreover, it is doubtful that perceived benefits from requiring firms operating ATSS to register with the CFTC would outweigh costs associated with creating and maintaining a new category of registrant. Exchanges already impose significant regulatory requirements on firms operating ATSS. In combination with CFTC regulations governing trade practice issues (including but not limited to the CFTC's new "disruptive trading practices" authority) and DCO and FCM risk management,²⁴ exchange requirements adequately address concerns relating to regulatory oversight, pre-trade controls and risk management without needlessly increasing costs to market participants and regulators.

Furthermore, it is common for firms operating ATSS to be exchange members, primarily to obtain reduced execution and clearing fees. Exchange membership triggers certain obligations under existing CFTC regulations. Recordkeeping requirements under Regulations 1.31 and 1.35

traders to utilize this exclusion should not be viewed as an open invitation to misapply the "floor trader" definition.

¹⁹ Available at http://www.cftc.gov/consumerprotection/educationcenter/cftcglossary/glossary_f.

²⁰ CME Group Exchanges Rule 105.C (Application for Floor Broker's or Floor Trader's License).

²¹ CME Group Exchanges Rule 535 (Responsibility of Floor Brokers and Floor Traders).

²² ICE Futures US Rule 2.18 (Floor Trading Privileges).

²³ See Goldstein v. Securities and Exchange Commission, 451 F.3d 873 (2d Cir. 2006) (vacating the SEC's hedge fund registration rule, which relied upon an interpretation of the term "client" that the court found to be "counterintuitive" and "outside the bounds of reasonableness").

²⁴ FCMs, for example, are required under Regulation 1.73 to ensure that all orders are automatically screened for pre-trade risk management.

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apply to members of contract markets. Regulation 1.40 requires members of contract markets to furnish certain documents to the CFTC upon request.²⁵ The CFTC has utilized these regulations in enforcement actions against firms engaged in proprietary trading that were exchange members but not CFTC registrants.²⁶ Exchange rules also place additional regulatory obligations on members, including a requirement to diligently supervise their employees.²⁷ Exchanges have utilized such rules in bringing disciplinary actions against member firms for, among other things, failing to conduct sufficient testing of ATSS prior to deployment.²⁸

As recent developments have demonstrated, the CFTC and the exchanges have sufficient jurisdiction to exercise regulatory oversight over firms operating ATSS, regardless of member or registrant status. The CFTC's Part 38 regulations mandate that each DCM require all market participants to consent to the DCM's jurisdiction.²⁹ In complying with this requirement, exchanges have adopted rules that obligate all market participants to agree to be bound by and comply with exchange rules, including but not limited to rules requiring cooperation and participation in investigatory and disciplinary processes.³⁰ Exchanges have utilized this broad jurisdiction over market participants to bring numerous disciplinary actions against both member and non-member firms, whether or not the firms are registered with the CFTC, and the CFTC has brought its own charges in those cases where it deems such action to be warranted. Absent evidence of tangible benefits accruing to the marketplace from requiring firms operating ATSS to register with the CFTC, such registration should not be required.

* * *

²⁵ It should also be noted that, pursuant to DCM Core Principles and Part 38 Regulations, exchanges maintain a complete audit trail of orders and trades, which are traceable to particular ATSS, as applicable. As the exchanges' regulator, the CFTC may review this information as it deems necessary in furtherance of its regulatory objectives.

²⁶ See, e.g., In the Matter of Dynegy Marketing & Trade, CFTC Docket No. 03-03 (Dec. 18, 2002).

²⁷ See, e.g., CME Group Exchanges Rule 501 (Employees of Members); CME Group Market Regulation Advisory Notice RA-1203-5, "Member Supervisory Responsibilities for Employees" (Feb. 9, 2012); ICE Futures U.S. Rule 2.33 (Duty to Supervise). Some firms operating ATSS are clearing members and, thus, are subject to additional rules with respect to, among other things, capital requirements and risk management. See, e.g., CME Group Exchanges Rules 970 (Financial Requirements) and 982 (Risk Management).

²⁸ See, e.g., In the Matter of Chopper Trading, LLC, CBOT 12-8969-BC (Nov. 27, 2013); In the Matter of Kohl Trading LLC, CME 12-8783-BC (Nov. 27, 2013).

²⁹ CFTC Regulation 38.151(a).

³⁰ See, e.g., CME Group Exchanges Rule 418 (Consent to Jurisdiction).

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On behalf of Gelber, we thank you again for the opportunity to submit these comments in response to the Concept Release. If the CFTC has any questions regarding this letter, please contact the undersigned at (312) 902-5594 or lisa.dunsky@kattenlaw.com.

Sincerely,

A handwritten signature in black ink that reads "Lisa Dunsky". The signature is written in a cursive, flowing style.

Lisa A. Dunsky