



Alternative Investment Management Association

Christopher Kirkpatrick
Secretary of the Commission
COMMODITY FUTURES TRADING COMMISSION (CFTC)
Three Lafayette Centre
1155 21st Street, NW
Washington DC
DC 20581
USA

Submitted Online: <http://comments.cftc.gov>

16 March 2016

Dear Mr Kirkpatrick,

AIMA Response to CFTC Regulation Automated Trading

The Alternative Investment Management Association (AIMA)¹ is grateful for the opportunity to respond to the Commodity Futures Trading Commission (**the Commission**) proposed rulemaking 'Regulation Automated Trading' (**Regulation AT**).²

AIMA's diverse hedge fund manager members include quantitative managers as well as fundamental value investors and are active participants in futures markets globally. Our members generate orders and execute transactions on designated contract markets (**DCMs**) and their global equivalents through a broad range of mechanisms with a varying degree of automation - ranging from fully algorithmic investment decision and subsequent execution processes making use of direct market access (**DMA**) connections, to manual investment decision making and traditional manual execution *via* executing brokerage. Our members, nonetheless, all have the common desire for efficient and stable markets with a high degree of liquidity and robustness during periods of economic stress.

The increasing technological development and automation of trading on DCMs has brought with it numerous benefits, including greater liquidity,³ lower transaction costs, increased transaction speeds, enhanced transparency and broader market access, thus competition. We believe that it is important to ensure that the benefits of new technology are enjoyed, whilst mitigating any potential risks. In this regard, we believe that well-tailored and proportionate rules for minimum testing, risk controls and other safeguards for algorithmic trading (**AT**) are an important foundation upon which modern, technologically advanced markets should be built. To maximise the efficiency of Regulation AT, AIMA agrees with the Commission's approach that these minimum rules should be flexible and specific to each entity within the AT transaction chain.

Industry has itself already developed and widely implemented various risk controls for AT - including those within the FIA Guide to the Development and Operation of Automated Trading Systems (**the FIA Guide**).⁴ AIMA broadly supports the codification of these standards using a

¹ Founded in 1990, the Alternative Investment Management Association (AIMA) is the global representative of the hedge fund industry. Our membership is corporate and comprises over 1,500 firms (with over 9,000 individual contacts) in more than 50 countries. Members include hedge fund managers, fund of hedge funds managers, prime brokers, legal and accounting firms, investors, fund administrators and independent fund directors. AIMA's manager members collectively manage more than \$1.5 trillion in assets. See www.aima.org.

² Regulation Automated Trading amending 17 CFR Parts 1, 38, 40 and 170, available online here: <http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/federalregister112415.pdf>

³ See, e.g., *CME Group, Growth of CME Globex Platform: A Retrospective*, available at: <http://cmegroup.mediaroom.com/index.php?s=114&item=119>. The CME Globex's "open access" policy led to enhanced liquidity, reduced costs and large-scale advances in volume.

⁴ Available here: <https://fia.org/sites/default/files/FIA%20Guide%20to%20the%20Development%20and%20Operation%20of%20Automated%20Trading%20Systems.pdf>

The Alternative Investment Management Association Limited
167 Fleet Street, London, EC4A 2EA

Tel: +44 (0)20 7822 8380 Fax: +44 (0)20 7822 8381 E-mail: info@aima.org Internet: <http://www.aima.org>



principles based approach wherever possible within Regulation AT, with the DCMs themselves playing the central role in maintaining risk controls internally and through mandates upon their FCMs.

AIMA's members appreciate the difficulties faced by the Commission in seeking to account for the technicalities of modern DCM trading when seeking to formulate rules that meet the regulatory objectives, whilst avoiding placing unduly burdensome requirements on market participants that could increase barriers to entry and stymie technological innovation and progress. We agree with the Commission's sentiment that well-drafted and efficient regulation could have a positive effect on market confidence, reduce market risk and reduce transaction costs. However, we would note our concerns that inefficient and poorly formulated regulation could have the opposite consequence.⁵

AIMA's detailed response contained within the Annex to this letter seeks to provide the Commission with both insight and assistance on various aspects of proposed Regulation AT and the specific requests for comment within the Proposing Release. Nonetheless, our detailed response also sets out significant industry concerns relating to certain other proposed requirements for Regulation AT - namely the source code repository requirement for AT Persons.

Our response makes the following key points:

- **Summary access to source code repositories is highly problematic** - AIMA supports the obligation for AT Persons to maintain source code repositories. However, we strongly disagree and have significant security concerns about the proposal for firms' source code and related documents to be available for summary inspection by the CFTC and Department of Justice (DoJ) due to the significant security risks posed and the lack of any supervisory benefit from such access;
- **Too broad definition of Algorithmic Trading (AT)** - AIMA is concerned that the definition of AT within Regulation AT is excessively broad and would capture trading activities that are not algorithmic trading as is broadly understood by industry and is understood by other regulators, in particular by seeking to capture systems used simply to route orders to particular venues;
- **Inappropriate definition of Algorithmic Trading Compliance Issue (ATCI)** - AIMA recommends amending the proposed definition of ATCI to remove reference to the breach of an AT Person's own internal standards in order to prevent counterproductive incentives for firms and promoting a race to the bottom for firms' internal standards;
- **Definition of Algorithmic Trading Disruption (ATD) to be amended** - AIMA recommends that the definition of ATD be amended to require a material practical disruption to have occurred. We also suggest that purely internal operational issues within an AT Person are not caught as ATDs without broader consequences for the DCM and/or other participants;
- **Substituted compliance for firms in compliance with Article 17 MiFID II** - AIMA recommends that the Commission ensure that the substance of Regulation AT is consistent with the provisions of Article 17 of MiFID II and its related technical standards, and make substituted compliance available with Regulation AT for AT Persons subject to and in compliance with the latter MiFID II obligations. We believe strongly that avoiding duplicative and conflicting rules is important to promote increased cross-border futures trading activities, helping to increase competition, increase liquidity and reduce transaction costs;
- **Distinction needed between investment decision and execution algorithms** - AIMA considers that it is especially important for the appropriateness and proportionality of the Regulation AT obligations that a clear distinction is made between execution and

⁵ Referencing Commission Question 126 of the Proposing Release. AIMA would suggest, for example, that insufficient tailoring of regulatory compliance obligations could increase transaction costs directly through operational complexity, as well as indirectly through a reduction in numbers of market participants and liquidity, thus broadening spreads.



AIMA Response to CFTC Proposed Rulemaking - Regulation AT

investment decision algorithms, with only those algorithms with a direct connection to the market being the relevant targets of Regulation AT;

- **Proprietary traders utilising Direct Electronic Access (DEA)** - AIMA is supportive of a requirement for all persons undertaking AT with direct access to a DCM to be registered with the Commission;
- **Support further DCM development of effective self-trade controls** - AIMA supports the introduction of self-trade controls and the promotion of investment in self-trade control technology by DCMs. Nonetheless, we advocate flexibility in the application of controls to enable AT Persons to undertake *bona fide* trading without overly burdensome restrictions;
- **Support greater transparency of DCM matching engines** - AIMA is strongly supportive of maximising transparency for participants of DCMs into the functioning and rules of DCM matching engines. Information is fundamental to the ability for buy-side participants to make efficient decisions as to venue selection and trade execution.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Jiri Król". The signature is fluid and cursive, with a large loop at the end.

Jiri Król
Deputy CEO, Global Head of Government Affairs
Alternative Investment Management Association (AIMA)



ANNEX - AIMA Detailed Comments

a) DEFINITION OF ALGORITHMIC TRADING

The definition of AT is a vital foundation upon which an appropriate regulatory regime for such trading should be built. However, AIMA believes strongly that the proposed definition of AT within Regulation AT would be excessively broad and would capture systems and activities that: (i) are demonstrably not considered to be AT by the market or regulators more broadly; and (ii) are not of the kind that pose any material risk to market stability. AIMA disagrees that such a broad range of activities should be captured within the scope of Regulation AT, which is a regulatory initiative with the objective of promoting the stability of US futures markets when participants use algorithmic trading systems (ATSs) to submit and amend orders.

It is AIMA's opinion that AT involves situations in which one or more algorithms within an ATS controls the key parameters of orders initiated, amended and/or cancelled on a market, with limited or no human intervention. The important aspect here is the ATS's connection with the market and its ability to submit and tailor the parameters of orders actually submitted to the market with limited or no human intervention. In direct response to Question 7 of the Proposing Release, AIMA, therefore, suggests that the use of a pure 'investment decision' algorithm should not constitute AT unless it is also accompanied by automated execution with limited or no human intervention. It is our members' strong belief that investment decision algorithms that simply process market and other data to reach trading decisions do not pose risks to the orderly functioning of markets unless they have a direct connection to the market, enabling the transmission of the latter algorithms' trading decisions to the market with limited or no human intervention. To this end, pure investment decision algorithms without automated execution function in a similar way to trade indicator systems, highlighting trading opportunities to human traders. The latter trade indicator systems are proposed by the Proposing Release to be excluded from the scope of Regulation AT, which AIMA supports.

'...otherwise makes determinations with respect to an order'

In terms of the specific definition of AT proposed within Regulation AT, AIMA recommends that the 'catch-all' phrase within paragraph 1 of proposed §1.3(zzzz) that would include any algorithm or system that '...otherwise makes determinations with respect to an order...' be removed, so that the definition of AT covers only algorithms or systems that automatically determine the 'individual parameters' of orders. We consider that the breadth of the wording 'including but not limited to', as proposed within the Proposing Release, would render meaningless the prior wording within the first clause of the definition of AT.

If an ATS does not make determinations in relation to a specific list of parameters of a particular order, AIMA does not believe that it should fall within the scope of AT. To this end, we believe that the particular venue to which an order is routed should not be considered to be a 'parameter' of the order. AIMA, therefore, disagrees with the Commission's proposal to capture within the definition of AT any automated order routers (AORs) that function merely to route orders to particular venues without amending their particular parameters.

Furthermore, in direct response to Question 6 within the Proposing Release, AIMA suggests that the CFTC should maintain its current intended approach not to capture within the definition of AT any non-clearing FCMs or other entities that are pure conduit entities that do not make any determinations of the parameters with respect to orders submitted to a DCM. Nonetheless, we do believe that such entities should be regulated for the purposes of their conduit activities, where relevant, with requirements similar to those contained within proposed §1.82 for Clearing FCMs.

'...every parameter or attribute is manually entered...'

AIMA disagrees with the Regulation AT proposal to only exclude orders '...whose every parameter or attribute is manually entered into a front-end system by a natural person, with no further discretion by any computer system or algorithm...'. When combined with the Commission's proposed non-exhaustive



wording discussed above that would include any circumstance where computer systems ‘otherwise making determinations with respect to an order’, this extremely limited exclusion requiring full manual order entry would result in the definition of AT having a disproportionately broad reach to activities that are in no way AT as currently understood by the market and the broader regulatory community. It could in fact extend to some forms of manual order entry.

In direct response to Question 7 of the Proposing Release, AIMA disagrees that the Regulation AT definition of AT ought to be extended to purely manually entered orders as well. We consider that extending AT to manual trading would be conceptually unhelpful for regulatory initiatives going forward. Regulation AT and the rules promulgated therein are rules for AT - a practice that has sufficient distinction from manual trading as to warrant separate tailored rules. It would undermine the conceptual scope of Regulation AT not to clearly distinguish AT from manual trading. AIMA notes current industry best practices for fat finger limits and other specific controls to be utilised for manual traders and, therefore, suggest that the extension of Regulation AT to manual trading would be unnecessary as well as conceptually inappropriate.

Compatibility with MiFID II definition of ‘Algorithmic Trading’

Further to the above, AIMA would strongly recommend that the Commission seek to ensure the consistency and compatibility of its definition of AT with the definition of ‘Algorithmic Trading’ under Article 4(1)(39) of MiFID II.⁶

AIMA believes that global consistency should be the goal of financial market reforms, for AT and for all other aspects of market regulation. The recent positive agreement reached between the Commission and the European Commission on a ‘common approach’ to the regulation of transatlantic CCPs⁷ is a good example inter-regulator cooperation in the clearing space that AIMA strongly supports being applied to algorithmic trading controls. Ensuring consistency of definitions and substantive rules would help to minimise operational burdens on market participants trading across numerous different jurisdictions globally, both reducing costs and providing greater access to markets, thus facilitating greater liquidity.

In the context of global investment fund managers, the cross-jurisdictional consistency of rules would: (i) reduce operational costs through the avoidance of regulatory duplication and/or conflicts, the efficiency savings from which could be enjoyed by end investors in the form of higher returns; and, (ii) broaden the number of jurisdictions in which fund managers’ are able to trade in an economically viable manner, providing superior diversification and flexibility to meet investors’ return objectives.

We note that, in line with AIMA’s position, the MiFID II definition excludes ‘any system that is only used for the purpose of routing orders to one or more trading venues or for the processing of orders involving no determination of any trading parameters or for the confirmation of orders or the post trade processing of executed transactions.’ To help facilitate a globally consistent set of rules for AT, AIMA would suggest the Commission adopt wording that moves closer to the MiFID II definition.

Further to our discussion on the definition of AT, above, AIMA would propose the following amendments:

§1.3(zzzz) Algorithmic Trading. This term means trading in any commodity interest (as defined in Regulation 1.3(yy) on or subject to the rules of a designated contract market, where:

(1) one or more computer algorithms or systems **automatically** determines whether to initiate, modify or cancel an order, **or automatically determines any of the following parameters of orders or otherwise makes determinations with respect to an order, including but not limited to:**

- the product to be traded;
- ~~- the venue where the order will be placed;~~
- the type of order to be placed;
- the timing of the order;

⁶ Directive 2014/65/EU on markets in financial instruments, available online: <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A32014L0065>

⁷ Press release available online: http://europa.eu/rapid/press-release_IP-16-281_en.htm



- whether to place the order;
- the sequencing of the order in relation to other orders;
- the price of the order;
- the quantity of the order;
- the partition of the order into smaller components for submission; or
- the number of orders to be placed; or
- ~~how to manage the order after submission;~~

and

(2) such order, modification or order cancellation is automatically electronically submitted for processing on or subject to the rules of a DCM with limited or no human intervention. provided, however, that Algorithmic Trading does not include an order, modification, or order cancellation whose every parameter or attribute is manually entered into a front-end system by a natural person, with no further discretion by any computer system or algorithm, prior to its electronic submission for processing on or subject to the rules of a DCM.

This definition shall exclude any system that is only used for the purpose of routing orders to one or more trading venues or for the processing of orders involving no determination of any trading parameters or for the confirmation of orders or the post-trade processing of executed transactions.

b) DEFINITION OF AT PERSON

§1.3(xxxx) of proposed Regulation AT would define an AT Person as any person registered or required to be registered as a FCM, floor broker, swap dealer, major swap participant, Commodity Pool Operator (CPO), Commodity Trading Advisor (CTA) or introducing broker that is engaged in AT on or subject to the rules of a DCM, or otherwise is a floor trader that is caught by the expanded definition under Regulation AT when trading on its own account, using DEA and is not otherwise registered with the CFTC.

Fund manager v fund

Directly responding to Question 15 of the Commission's request for comment, AIMA considers that in a fund management scenario, it is the fund manager that actually places the trade that should be deemed to be undertaking AT, thus is the AT Person, rather than the underlying fund. Thus, for commodity pools that are operated by a CPO and/or managed by a CTA, it is either the CPO or CTA that 'engages in Algorithmic Trading' pursuant to the definition of AT Person and not the underlying commodity pool on whose behalf the manager is exercising discretion.

Geographical scope of Regulation AT - substituted compliance for MiFID II firms

AIMA notes the potentially broad geographical scope of Regulation AT, such that a significant number of AT Persons caught under Regulation AT will be established outside of the US. Many of these AT Persons will be established in and/or subject to the requirements of Article 17 of EU Directive 2014/65/EU on markets in financial instruments (MiFID II).⁸

The MiFID II rules to be introduced on AT are both comprehensive in scope and highly detailed in nature. AIMA, therefore, would suggest that substituted compliance be made available to as great a degree as possible, such that compliance with MiFID II by an AT Person may be deemed as fulfillment of the requirements for AT Persons proposed to be introduced under Regulation AT. For example, firms in compliance with MiFID II would, by definition, have extensive pre-trade and other risk controls in place, maintain robust development and testing protocols for their ATs, as well as maintain real-time monitoring systems for their AT for ATS functioning and market abuse purposes.

To this end, AIMA proposes substituted compliance be made available with the obligations of Regulation AT for all Non-US established AT Persons that are subject to, and in compliance with, Article 17 of MiFID II

⁸ Available online here: <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32014L0065&from=BG>



and its associated technical standards. We would also suggest that MiFID investment firms captured by the definition of an AT Person should not be forced to become a member of a Registered Futures Association (RFA).

We note the significant operational costs that will be associated with compliance with the MiFID II requirements once they enter into effect in 2018, and would suggest that imposing duplicative and perhaps conflicting obligations for the purpose of Regulation AT would be undesirable and unnecessary, bearing in mind that the firm will likely already have met the required standards for Regulation AT through its MiFID II compliant systems and controls. AIMA also notes that such firms would likely be subject to the oversight of their Regulation AT compliant Clearing FCM and DCM, themselves both subject to their own requirements under Regulation AT to protect the integrity of the market. In all circumstances, we would suggest that introducing additional specific regulation on MiFIDII compliant firms as AT Persons and obligating them to become members of an RFA would be disproportionate and could disincentivise cross-border trading activities on US DCMs.

Ensure proportionate rules for the heterogeneous business activities of different AT Persons

In response to Question 40 within the Proposing Release and the principle articulated explicitly by Chairman Massad in his statement on Regulation AT,⁹ AIMA is highly supportive of the principle that risk controls are to be maintained at three levels - the exchange, the clearing member and the trading firm.

The definition of AT Person captures a broad variety of registered entities that undertake a broad variety of different activities related to AT at various of the three levels described above. AIMA is supportive of all persons involved within an AT transaction chain being within scope of Regulation AT. However, in direct response to Question 48, it is our strong belief that AT Persons must be subject to proportionate and targeted rules most appropriate to their particular business structure and business activities; the requirements within §1.80 and §1.81 should indeed vary depending upon the AT Person. Also, we contend that the principal obligations to protect the stability of DCM markets should fall upon the DCMs themselves and the FCMs through which AT Persons access the DCM.

AIMA suggests that the wording of the definition of an AT Person be amended as follows:

§1.3(xxxx) AT Person. This term means any person registered or required to be registered as a-

- (1) Futures commission merchant, floor broker, swap dealer, major swap participant, commodity pool operator, commodity trading advisor, or introducing broker that engages in Algorithmic Trading on or subject to the rules of a designated contract market; or
- (2) Floor trader as defined in paragraph (x)(3) of this section.

Any AT Person not established in the U.S. that is subject to and in compliance with the obligations under Article 17 of European Union Directive 2015/65/EU on markets in financial instruments and its related regulatory and implementing technical standards shall be deemed compliant with the substantive obligations contained within §§1.80-1.83 of this Title in relation to its Algorithmic Trading on designated contract markets.

AT Persons for which substituted compliance is available will also not be required to register with a registered futures association under § 170.18.

c) DEFINITION OF ATCI

Regulation AT would introduce a definition of an ATCI that would sit alongside ATD under the overarching definition of an Algorithmic Trading Event (ATE).

⁹ Statement of Chairman Timothy Massad Regarding Proposed Rule on Regulation Automated Trading, 24 November 2015. Available here: <http://www.cftc.gov/PressRoom/SpeechesTestimony/massadstatement112415>



AIMA recognises the purpose of the proposed definition of ATCI within Regulation AT to cover within the scope of an ATE any circumstances whereby an AT Person acts in breach of relevant legislative, regulatory or market based rules.

However, we would strongly disagree with the current proposal that would include within the scope of an ATCI any breach by an AT Person of its own internal requirements. AIMA is concerned that such a requirement would be counterproductive and introduce fundamental conflicts of interest between AT Persons and the objectives of Regulation AT.

In addition to questions of legality surrounding any possible administrative sanctions being levied upon an AT Person that is compliant with all of its legislative, regulatory and market based obligations, but has been held to have overseen an ATCI (thus an ATE) due solely to it breaching its own internally calibrated standards, the proposal would introduce a counterproductive *de facto* incentive for all AT Persons to follow a 'race to the bottom' approach for their internal rules, whereby they keep standards as low as possible whilst ensuring compliance with external obligations, so as to avoid the likelihood of breaching its own internal rules resulting in an ATCI, thus an ATE.

AIMA would urge the Commission to ensure that Regulation AT is formulated to encourage a positive culture amongst AT Persons of developing and maintaining robust internal standards and implementing industry best practices when engaging in AT. The Proposing Release already goes a long way towards this end, establishing minimum standards to be built upon by individual AT Persons and RFAs as appropriate to the particular nature and scale of the AT activities undertaken. However, AIMA is concerned the proposed definition of ATCI to include internal requirements would undermine this objective and *de facto* result in AT Persons loosening their own internal requirements in order to avoid incurring a regulatory sanction for failing to meet their Regulation AT obligations.

We would propose the amendment of the definition of ATCI, as follows:

§1.3(tttt) Algorithmic Trading Compliance Issue. This term means an event at an AT Person that has caused any Algorithmic Trading of such entity to operate in a manner that does not comply with the CEA or the rules and regulations thereunder, the rules of any designated contract market to which such AT Person submits orders through Algorithmic Trading, the rules of any registered futures association of which such AT Person is a member, ~~the AT Person's own internal requirements,~~ or the requirements of the AT Person's clearing member, in each case as applicable.'

d) DEFINITION OF ATD

Material disruption

§1.3(uuuu) would define an ATD as any event originating with an AT person that 'disrupts, or materially degrades' the AT of an AT Person, the operation of the DCM or the trading of other participants on the DCM. It would appear, therefore, that it requires a more serious degradation of one of the factors listed from (1)-(3) to constitute an ATD, thus ATE, than it would for a disruption of one of the factors. AIMA suggests that there is no practical reason for this distinction. We believe that the degree of disruption that is sufficient to constitute an ATD, thus an ATE, should be the same as for the degree of a degradation.

Actual practical consequences - not merely breach of rules

AIMA also recommends that the Commission's final rules clarify that an ATD explicitly covers only those events originating with an AT Person that actually have a disruptive practical impact on trading and operational activities of the DCM and other participants. We believe that events that arise through breach of rules alone should be held to be ATCIs only. Our concern as to potential confusion between ATD and ATCI arises from the wording of Section 747 of the Dodd-Frank Act, amending Section 4c(a) of the Commodity Exchange Act (CEA) with a new subparagraph (5), which uses the term 'disruptive practices' to describe practices in breach of the rules of a registered entity, such as 'spoofing'. These 'disruptive



practices' under the CEA (and implemented in DCM rulebooks such as Rule 575 of the CME rulebook)¹⁰ do not require practical disruptive consequences for trading in the manner that an ATD would do under proposed Regulation AT. We envisage that such 'disruptive practices', despite the name, will be ATCI's under Regulation AT. AIMA would greatly value explicit clarity within the Commission's Final Report that an ATD does not include 'disruptive practices' under Section 4c(a) subparagraph 5 of the CEA and requires actual material disruptive consequences, not merely the breach of rules.

Merely internal disruptions to an AT Person

AIMA notes that subparagraph (1) of the proposed definition of an ATD includes events that merely disrupt or degrade the AT of the AT Person with which the event originates; not requiring any impact on other participants or the DCM itself. We disagree with this element of the definition of ATD and suggest that it would be disproportionate for merely internal operational issues at an AT Person to constitute an ATD without broader disruptive consequence for the DCM or other participants. We suggest that the policy objective of Regulation AT is the prevention of disruption of DCM markets and the ability for market participants to trade optimally. We recommend that the definition of ATD should be fundamentally consistent with this policy objective - thus not including purely internal issues to an individual AT Person participant without material disruption or degradation to the DCM or other participants.

In particular, we are concerned that subparagraph (1) of the proposed definition of ATD could introduce complexity in the context of Clearing FCM obligations under proposed §1.82 of Regulation AT to have in place systems and controls reasonably designed to prevent or mitigate ATDs. If ATDs include purely internal issues to AT Persons, it could be especially burdensome for Clearing FCMs to be required to prevent them arising at their AT Person clients. In particular, purely internal issues to an AT Person may not involve any order flows that passing through the FCM or DCM's systems and controls designed to prevent disruptions. An FCM cannot control or influence the actions of its AT Person client on a real time basis until messages actually hit its and/or the DCM's systems. It could, therefore, be potentially extremely invasive and restrictive for AT Person clients for Clearing FCMs to seek to prevent purely internal operational disruptions at the AT Person *ex ante*.

AIMA strongly supports the role of FCMs and any other market access providers to ensure that their AT clients have in place their own robust risk controls and procedures to prevent disruptions which could threaten the market. An indirect consequence of robust due diligence of AT Person clients and their operational controls by Clearing FCMs would be to reduce the likelihood of internal operational issues at the AT Person. However, we consider that a direct granular obligation to prevent purely internal disruptions at an AT Person resulting from the definition of ATD would go beyond what is necessary and appropriate to the objective of Regulation AT.

We, therefore, propose the following amendments to the definition of an ATD:

§1.3(uuuu) Algorithmic Trading Disruption. This term means an event originating with an AT Person that **materially** disrupts, or materially degrades—

- (1) ~~The Algorithmic Trading of such AT Person,~~
- (2) The operation of the designated contract market on which such AT Person is trading, or
- (3) The ability of other market participants to trade on the designated contract market on which such AT Person is trading.

e) SOURCE CODE REPOSITORIES

§1.81(1)(vi) of Regulation AT would require all AT Persons to maintain a source code repository to manage their source code access, persistence, copies of all code used in the production environment, and changes to such code. The repository is to be available for inspection by the CFTC and Department of Justice on a summary basis in accordance with §1.31.

¹⁰ <http://www.cmegroup.com/tools-information/lookups/advisories/market-regulation/files/RA1405-5.pdf>



AIMA supports the maintenance by each AT Person of a proportionate change management audit trail for material changes to AT Persons' production algorithms. To this end, we note that the FIA Guide makes clear that firms should 'maintain a source code repository to manage source code access, preservation and changes'.¹¹ Such an obligation is also due to be introduced under Article 5 of MiFID II RTS 6 which specifies that investment firms must maintain records of material changes to software, including: (a) when a change is made; (b) the nature of the change; (c) who made the change; and (d) who approved the change.

However, AIMA strongly disagrees with the Regulation AT proposal for AT Persons to be required to make copies of all source code used in a production environment for summary inspection by CFTC or Department of Justice (DoJ) officials in the absence of a subpoena. No equivalent obligation is due to be introduced under MiFID II and is not an obligation in any other jurisdiction that permits AT.

We consider this aspect of the Regulation AT source code repository proposal to be entirely disproportionate and potentially dangerous to the confidentiality of what is the extremely commercially sensitive intellectual property of market participants representing their principal source of competitive advantage, the leakage of such data would destroy the AT Person's source of added value and ultimately disincentivise the AT Person from making the significant investment into the development of high-quality source code that is currently undertaken. Source code information is not currently available without a subpoena and AIMA would strongly recommend that this continue to be the case under Regulation AT.

Security of source code and confidential descriptions

Market participants exert significant effort and go to great lengths to protect both their source code and commercially sensitive descriptions thereof - such as internal 'White Papers' developed by internal research teams and other commercially sensitive descriptions of source code and its functioning. Policies and procedures maintained by firms include requiring employees to sign non-competition agreements with the firm, as well as severely restricting employees' access to code internally.

If the DOJ or the Commission were to obtain either hard or soft copies of source code or commercially sensitive descriptions thereof on a summary basis, AIMA's AT Person members would be extremely concerned about these safeguards being undermined and the security and confidentiality of AT Persons' proprietary intellectual property being put at significant risk.

AIMA notes that recent examples demonstrate the fallibility of U.S. government agencies' security systems. It has been shown in the case of the US Office of Personnel Management that data breaches can and have occurred even in relation to extremely sensitive personal information relating to the backgrounds of 21.5 million current and former federal employees, military personnel, contractors and others.

AIMA would also suggest that the potential financial and/or disruptive benefits for criminals, hackers or government sponsored groups of attacking a government system which maintained the detailed source code data summarily obtained by the CFTC or DoJ would actually serve to *encourage* attacks which would otherwise not occur. Should such sensitive information be kept at the AT Person level, so kept spread behind hundreds of discrete physical and cybersecurity measures, the cost/benefit payoff for any potential hacker becomes much reduced.

Overall, AIMA members would be highly concerned about the ability for government agencies to guarantee the safety and confidentiality of personal data from cyber-attacks or other systems breaches. We would, therefore, strongly resist any proposal for summary access to source code information without the Commission of DOJ first obtaining a relevant subpoena.

¹¹ FIA Guide *Op.Cit.* at 24



Consequences for third-party and 'off-the-shelf' algorithms

AIMA also notes that it is currently impossible for an AT Person utilising third-party algorithms and software to provide summary access to the source code of that third party software without then being in breach of confidentiality obligations to the third-party provider. We would also stress that this would not change even if such summary access rights were to be contractually mandatory under Regulation AT - with providers likely simply to cease trading rather than risking their fundamental trade secrets.

The source code of third-party algorithm providers, as for AT Persons developing proprietary code, represents the fundamental source of commercial value to the third party provider. Algorithm providers, for example, maintain a significant degree of confidentiality protection even from their clients, with the underlying source code never actually being disclosed. Information to clients is limited strictly to only the information needed to understand the high-level functioning and use the system.

In the context of third-party execution algorithms, AIMA notes that it is also not as simple as being able to disclose a single or set of algorithms responsible for best execution. To understand how an individual algorithm works requires disclosure of the entire platform of the third-party algorithm provider. This represents the career's work of many such providers and their fundamental trade secrets, such that they would simply cease providing third-party software services to AT Persons rather than disclose it to either clients or the Commission in absence of a subpoena.

To require access and disclosure of third-party software source code - in particular for best execution - would, therefore, result in a reduction in the number of providers willing to offer their services to AT Persons trading on US DCMs, a reduction in competition and a reduction in conditions of best execution on US DCMs at the expense of smaller market participants. AIMA, on behalf of buy-side participants, stresses the importance of avoiding this consequence.

Utility of such information

As AIMA has pointed out to the EU legislative authorities who initially proposed the reporting of source code to national competent authorities under MiFID II, hard source code - or even descriptions thereof - provides very little supervisory or investigative utility, and would simply risk the commercially sensitive IP of investment firms. This proposal was quickly dropped as part of the MiFID II development process as the EU legislative bodies and national competent authorities recognised this fact. AIMA would strongly urge the Commission to recognise this also.

Summary access to source code data by the Commission or the DoJ would not provide any supervisory and investigative benefits beyond those offered by the current regime enabling access only with a subpoena. It would, however, introduce disproportionate risks of IP leaks and other data risks. It must be stressed that without higher-degree level qualifications in advanced mathematics and related subjects, extensive experience of different coding languages, as well as an in-depth understanding of the coding style of a particular developer responsible for a specific set of algorithms, source code is likely to be meaningless and would not hope to assist in identifying potential market abuse or contribution to market disorder. In fact, AIMA suggests that is not theoretically possible to be able to simply look at source code in isolation and to tell whether it will be problematic from the perspective of market stability due to the non-linear nature of the interaction between different algorithms in a trading environment.

Further to this, for the DoJ in particular, AIMA would suggest that the Regulation AT source code repository proposal would provide no additional utility beyond the current subpoena system as we do not envisage any circumstance whereby the DoJ would require source code outside the specific circumstances of criminal proceedings, for which a subpoena would surely be obtainable.

Recordkeeping based on Regulation 1.31

AIMA is also concerned that source code repository proposal is proposed to be kept available for inspection pursuant to Commission Regulation 1.31. AIMA considers that Regulation 1.31 on electronic recordkeeping and third-party technical consultant requirements is technically outdated and costly. We petitioned the



CFTC alongside the Managed Futures Association (MFA) and Investment Advisers Association (IAA) in July 2014 stating this belief.¹²

f) **PRE-TRADE AND OTHER RISK CONTROLS FOR AT PERSONS**

As proposed by Regulation AT, §1.80 of the CEA will require that AT Persons implement risk controls and other measures reasonably designed to prevent an ATE, including - but not limited to - pre-trade risk controls, order cancellation systems, system connectivity tools and self-trade controls.

AIMA recognises and has consistently advocated for the benefits of proportionate and appropriately calibrated risk controls in markets that permit AT in order to prevent the magnification of trading errors and prevent market disorder. It is in all of our members' interests to be able to trade on stable, consistent and efficient markets. We believe that it is beneficial to ensure that pre-trade and other risk controls are applied in a coordinated manner by each participant in the AT order submission process, with the principal role being played by the DCMs and their FCMs.

We would also support the Commission looking to ensure that the substance of final Regulation AT is consistent with the rules to be introduced in the EU under MiFID II, thus facilitating substituted compliance and enabling a greater volume of cross-border futures trading activity.

AIMA has also sought to ensure that controls are applied, as appropriate, to those algorithms that are actually responsible for the submission of orders to the market i.e., execution algorithms, rather than those algorithms that merely compute market data to reach particular investment decisions i.e., decision algorithms. AIMA does not believe that pure investment decision algorithms should be subject to pre-trade and other risk controls as covered under §1.80(a)-(f) without automated execution.

i. **Pre-trade controls**

§1.80(a) of the CEA will require that AT Persons implement pre-trade risk controls including at least (i) maximum AT Order Message frequency limits and maximum execution frequency limits (otherwise referred to as throttles); (ii) 'order price parameters' (price collars) and maximum order size (fat-finger) limits.

AIMA agrees with the FIA Guide that localised pre-trade risk controls should be the primary tools used to prevent inadvertent market activity stemming from trading errors, systems errors and unauthorised access.

We deal with each tool in more detail below, although we stress the importance that the latency impact of pre-trade controls be minimised. To this end we are grateful that the Commission has not requested the implementation of mandatory pre-trade credit checks within the Proposing Release.

AT Order Message frequency throttles

AIMA agrees that order message frequency throttles are important to prevent a defect in an AT Person's ATS from causing the inadvertent submission of an extremely high number of orders within a short space of time, potentially causing an ATD by potentially overwhelming the capacity of the DCM's systems, slowing them down or otherwise impeding normal market activities.

Such excessive order message frequencies could be caused, for example, by the ATS mistakenly identifying fallacious trading opportunities or otherwise malfunctioning so as to submit excessive numbers of order messages.

¹² AIMA submitted a Petition to the CFTC alongside the Managed Funds Association (MFA) and Investment Adviser Association (IIA) on 21 July 2014. AIMA-IAA-MFA Petition for Rulemaking to Amend CFTC Regulations 1.31, 4.7(b) and (c), 4.23 and 4.33, available online: http://www.aima.org/filemanager/root/site_assets/regulatory_and_tax/final_petition_for_rulemaking_to_amend_cftc_regulation_-_joint_letter_mfa_iaa_aima.pdf



Execution throttles

AIMA supports the mandatory introduction of repeat execution throttles. Execution throttles serve a similar purpose to AT Order Message throttles. They prevent an ATS from malfunctioning such that an ATD is caused, but this time through the repeated submission of erroneous AT Order Messages that have already been executed.

Such erroneous execution could cause an ATD by overwhelming current liquidity and creating false directional trading pressures leading to mini price crashes. Such can occur, for example, due to an ATS mistakenly concluding that certain trades were not filled, thus re-submitting the AT Order Message to the market.

An equivalent obligation for repeated automated execution throttles is current contained under Final RTS 6 under MiFID II.¹³

Fat-finger limits

AIMA also supports the mandatory application of appropriately calibrated fat-finger limits by each AT Person upon each new order or modifications of existing orders on a DCM's order book. AIMA agrees with the FIA Guide that ATS controls should prevent orders from being placed in cases where no fat finger limits have been calibrated for a particular instrument. Obligations for maximum order values and volumes to prevent orders with 'uncommonly large' values and size from entering the order book are currently found in Final Draft RTS 6 under MiFID II.¹⁴

Fat-finger limits typically protect against an error in the order of magnitude of the quantity traded, for example stemming from the use of an incorrect factor within an automated system, thus protecting the natural price discovery process that could be distorted by an unintentionally large order.

Price collars

AIMA also supports the mandatory use of internal price collars calibrated according to the particular strategy and trading activities of each AT Person. This is a simple way to help prevent an ATS from contributing to market disorder. A rule for price collars that automatically block or cancel orders that do not meet set price parameters can be found in Final Draft RTS 6 under MiFID II.¹⁵

ii. Order cancellation systems

§1.80(b) would require AT Persons to have systems that are able to: (i) immediately disengage Algorithmic Trading; (ii) cancel selected or up to all resting orders when market conditions require it; and (iii) prevent submission of new AT Order Messages - (**Kill Switches**).

AIMA's members recognise the importance of kill functionality for all market participants as an emergency 'last resort' option should an ATE occur, such that their trading needs to be immediately halted. We, therefore, support the CFTC's approach within the Proposing Release which calls for AT Persons consider, among other things, the FIA Guide's recommendations on kill switches. We also support the degree of flexibility that is proposed under Regulation AT to implement the kill switches most appropriate for each AT Person's ATS and trading activities.

We would, nonetheless, stress the significant operational disruption that can be caused by using kill-switches. This is particularly so for kill switches managed by the DCM itself, which would require significant manual resources for participants to look back at cancelled orders and to attempt to discover which have been filled or otherwise. For DCMs, in particular, a managed shut-down is preferable in the majority of circumstances.

¹³ Article 15(2) of Draft RTS 6

¹⁴ Article 15(1) of Draft RTS 6

¹⁵ *Ibid*



§1.80(b) would also require AT Persons to notify the DCM of how the AT Person wishes the DCM to deal with its resting orders in the event of a systems disconnect. AIMA supports the option of AT Persons to advise their DCMs on how to deal with resting orders upon their systems' disconnection, including the option to use a Cancel-on-Disconnect (COD) service.

Final Draft RTS 6 under MiFID II currently contains an obligation for investment firms to be able to cancel unexecuted orders submitted to individual trading venues originated by individual traders, desks or, where applicable, client; as well as all outstanding orders of the firm.¹⁶

iii. System connectivity

§1.80(c) would specify that AT Persons with DEA are to implement systems to indicate on an ongoing basis whether they have proper connectivity with the DCM's trading platforms and market data systems.

AIMA supports the maintenance of such systems 'heartbeats' by all AT participants with a direct connection to a DCM.

iv. Notification of AT

AIMA supports this requirement.

v. Self-trade prevention tools

See specific AIMA response, below.

vi. Periodic Review for Sufficiency and Effectiveness

AIMA believes that the periodic review of ATS controls to ensure their sufficiency, and the swift resolution of any issues identified, is an important process to keep ATS systems and controls up-to-date and to avoid ATEs. AIMA, therefore, supports the inclusion within Regulation AT of an obligation to undertake such reviews for pre-trade and other risk controls under §1.80(f) of proposed Regulation AT. We are particularly supportive of the level of flexibility contained within this provision to undertake reviews as appropriate rather than on an arbitrary periodicity.

We also support periodic reviews of other measures, including development and testing procedures and monitoring processes.

g) CLEARING FCM OBLIGATIONS UNDER §1.82

AIMA believes that Regulation AT obligations should be applied in a flexible and proportionate manner to all AT Persons and Clearing FCMs according to their structure and business activities.

In this regard, AIMA believes that any entity that provides market access to an AT Person, such as an FCM providing DEA, ought to be subject to specific and appropriately tailored obligations such as those to be provided under §1.82 rather than obligations for AT Persons that are trading firms.

We would suggest that there is no reason to limit the provisions of §1.82 to Clearing FCMs. As the Commission notes in the Proposing Release, IOSCO recommends¹⁷ and the EU under MiFID II requires intermediaries that provide DEA to have appropriate operational and technical capabilities to manage risks.¹⁸ AIMA would recommend that §1.82 apply not only to Clearing FCMs, but to any AT Person providing market access services in the AT transaction chain.

We recommend the expansion of relevant client due diligence and other controls obligations to any entity that provides market access. We believe such would be desirable and consistent with both MiFID II and market practice.

¹⁶ Article 12 Final Draft RTS 6

¹⁷ IOSCO 2015 Consultation Report, supra note 106 at 22-23

¹⁸ Proposing Release at 78862



h) DEVELOPMENT AND TESTING BY AT PERSONS

§1.81(a) would require AT Persons to implement written policies and procedures for the development and testing of its ATs, including: (i) a development environment that is adequately isolated from the production environment; (ii) testing all code and systems internally and at the relevant DCM(s) prior to implementation, including to identify circumstances that may contribute to future ATEs; (iii) regular back-testing; (iv) regular stress tests to verify their ATs ability to operate as intended under a variety of market conditions; (v) procedures to document strategy and design of proprietary ATs software and any changes implemented in a production environment; and (vi) maintaining a source code repository.

AIMA members and other buy-side participants have a strong interest in ensuring markets are robust, resilient and stable by ensuring that all algorithms present have been extensively tested against a number of factors. As we have stated on numerous occasions previously in response to other regulatory consultations, AIMA members are supportive of ensuring that all algorithms used a production environment to submit orders to live markets undergo rigorous development and testing procedures in a tailored and proportionate manner to the nature, scale and complexity of each participant's business and production algorithms. The malfunctioning of execution algorithms with a direct connection to markets is the principal concern to our members, as it is these that can cause market disorder constituting an ATD.

As part of this approach, we consider that the central role ought to be played by Clearing FCMs, other DEA providers and the DCMs themselves to provide adequate test functionality to help ensure that all algorithms used in live markets are sufficiently tested for stability and propensity for abusive behaviour.

Investment decision v execution algorithms

As with other systems and controls, AIMA would stress the importance of distinguishing between pure investment decision algorithms and execution algorithms for the purposes of development and testing obligations. Investment decision algorithms do not have direct connections with markets, and rely on execution algorithms in order to convert their investment ideas into orders to be submitted to the live market. The relevant algorithms that could cause disorder and should undergo minimum testing obligations are, therefore, those execution algorithms that submit orders directly onto the market.

In the EU, the European Securities and Markets Authority (ESMA) has explicitly recognised the distinction in its Final Draft RTS and recommended the exclusion of pure investment decision algorithms from the scope of the MiFID II testing obligations. AIMA would support the Commission doing the same under §1.81(a) of Regulation AT.

Adequate isolation

AIMA supports the proportionate isolation of production and development systems, although we would not support an obligation for full-hardware separation such that duplicate hardware would have to be maintained for development and for testing.

We would suggest that, as long as a system is not used contemporaneously for testing and production, then the same hardware should be able to be used. This, for example, could involve production hardware being used for out-of-hours testing.

Testing all new code and systems and changes thereto

AIMA supports the re-testing of systems and code that have undergone material changes. We are concerned, however, that the current wording of proposed §1.81(a)(ii) would require the re-testing of 'any changes' to source code and systems - however small or trivial the amendment may be. This, for example, could require retesting after every amendment to trading parameters by traders on an intraday basis. AIMA would suggest that this would be extremely burdensome to the point that it would prevent normal trading activities.



AIMA would suggest the introduction of the word ‘material’ to the obligation under §1.81(a) to ensure that the testing obligation applies only to new code and systems, and ‘material’ changes thereto, as follows:

§1.81(a)

[...]

(ii) Testing of all Algorithmic Trading code and related systems and any **material** changes to such code and systems prior to their implementation, including testing to identify circumstances that may contribute to future Algorithmic Trading Events. Such testing must be conducted both internally within the AT Person and on each designated contract market on which Algorithmic Trading will occur.

Regular back testing

AIMA notes the utility of traditional market replay back-testing as a minimum standard of testing for execution algorithms and ATs used in a production environment. However, we would suggest that replay back-testing is not necessarily the optimal solution for testing across the board, as it can struggle to uncover certain stability issues resulting from an algorithm’s interaction with the market and other algorithms. Further to the principles based approach of Regulation AT, AIMA believes that testing standards ought to be flexible and proportionate to the nature, scale and complexity of a particular AT Person’s business - with the principal responsibilities falling upon DCMs themselves and respective Clearing FCMs to facilitate testing by AT Persons.

Separate to profitability and conformance testing, testing the potential of an algorithm to create and/or contribute to market disorder is an important element to ensuring the stability of an algorithm that is placed in the live market environment. Stability testing can be undertaken to a degree using dummy symbols in a live environment, as well as via responsive non-live testing environments provided by DCMs that closely resemble live markets in respect of microstructure and dynamics, and which allow stress testing. When using realistic non-live testing, a result (either pass or fail) could be certified by a responsible person within an AT Person and provided to each FCM providing market access to the relevant algorithm and the DCM on which the algorithms is intended to be placed into a production environment.

AIMA considers that it should be a responsibility of the DCM and each FCM providing market access to provide a range of economically viable non-live testing solutions for market participants. To the aforementioned end, AIMA would suggest that the Commission, DCMs and service providers collaborate and invest in the relevant technology in order to develop a range of economically viable non-live testing solutions for market participants.

Stress testing

AIMA supports the obligation for AT Persons to perform regular stress testing of their ATs. However, we would urge the final wording of Regulation AT make explicit reference to the fact that turning off during particularly stressed market conditions is an appropriate response.

AIMA would suggest against any obligation that would require ATs to be able or otherwise required to remain on during periods of market stress. This would itself create a disproportionately complex coding requirement which, even if possible, could introduce the risk unintended reactions of ATs to even normal market events, thus cause or exacerbate ATDs.

AIMA would suggest the introduction of the following wording:

§1.81(a)

Regular stress tests of Algorithmic Trading systems to verify their ability to operate in the manner intended under a variety of market conditions.

The ability to operate in the manner intended includes automatically turning-off upon the threat or occurring of stressed market conditions.



i) **CONTINUOUS REAL TIME MONITORING**

§1.81(b) would require all AT Persons to implement written policies and procedures reasonably designed to ensure that its ATSs are subject to continuous real-time monitoring by knowledgeable and qualified staff.

AIMA supports the introduction of a formalised obligation on AT Persons to ensure continuous real-time monitoring by knowledgeable and qualified staff, ensuring sufficient oversight and accountability with regard to the AT Person's AT. We would be concerned, however, if any obligation was placed on every AT Person to have a multiple layers of real-time monitoring beyond the specific trader responsible for the operation of the ATS. The additional staff costs of hiring teams of additional real-time monitoring staff would be prohibitive and disproportionate when compared to the supervisory benefit that would be obtained.

It is current best practice within many firms that algorithms or ATSs are designed and manufactured by a model builder who is a different person to the trader responsible for the operation of the algorithm or ATS in a production environment. Individual traders here function as the layer of real-time supervision, rather than as a 'trader' in the manual sense using discretion in the placing of trades. AIMA would suggest, in fact, that for many systematic fund managers the term 'trader' is perhaps not the most appropriate term to describe the function. The actual role of 'traders' is often to supervise the implementation of a particular ATS or algorithm in a production environment - thus it is in fact closer to that of a 'supervisor'. The trader will, in many cases, have no influence in the functioning of the algorithm beyond turning it on and off and flagging any issues back to the firm's risk manager and model builder(s) *ex post* who will be responsible for making relevant changes to its parameters and completing a new validation process. It is not true to say that in every situation the trader responsible for an ATS is 'trading' in the manual sense of the term, making changes to its parameters continuously on an intraday basis.

A variety of models, of course, exist and AIMA is highly supportive of the principle of flexibility to enable AT Persons with different business models to meet this obligation in a proportionate way best tailored to their AT activities. We note, however, that it would not be consistent with this principle for AT Persons to be required to maintain duplicate layers of real-time monitoring.

AIMA would be especially grateful for clarification in the Commission's Final Rules that the obligation within §1.81(b) is *not* intended to require all AT Persons to maintain an additional layer of real-time risk management supervision of individual traders whose primary function is real-time supervision.

j) **AT PERSON COMPLIANCE REPORTS TO DCMs AND RECORDKEEPING**

§1.83(a) would require each AT Person to annually prepare a report to be submitted by 30 June to each DCM on which the AT Person engages in AT. The Report will include a description of pre-trade risk controls required under Regulation AT. The AT Person will also submit copies of written policies and procedures developed to comply with §1.81(a) and (c) on testing and general compliance of the AT Persons ATSs. Records must also be maintained and provided to each DCM on request under §1.83(c). It would then be up to the DCM to review these reports.

Difficulty of DCM reporting and review

AIMA supports the role of DCMs as Self-Regulatory Organisations (SROs) to enforce theirs and their participants' compliance with the requirements of Regulation AT. However, we would note the size of the task of DCMs formally reviewing the compliance reports of each and every AT Person and FCM - especially if the number of AT Persons caught by Regulation AT is higher than currently envisaged by the Commission. This could be extremely resource intensive. We would suggest that the most efficient focus of resources would be for DCMs to make sure theirs and their FCMs' systems and controls are effective to prevent ATDs.



Confidentiality of information

Additionally, AIMA has certain concerns about the degree of potentially sensitive information to be recorded and sent to DCMs as part of the abovementioned annual compliance reports to be generated under §1.83(a). AIMA suggests that any obligation to report commercially sensitive information to a DCM should be accompanied by explicit wording within Regulation AT that confidentiality must be maintained by the DCM and that to the extent that the Commission obtains such records as part of a review of DCM activities, the Commission will treat these as non-public records for FOIA purposes (see CFTC Regulation 145.5(d)(2)).

Staggering of report dates

In direct response to Question 59 of the Proposing Release, AIMA would also suggest staggering the dates upon which different categories of AT Persons must report. The Proposing Release currently envisages that 420 AT Persons will exist under Regulation AT. AIMA is concerned that bottlenecking of compliance reports could well occur if all 420 attempt to submit their reports on 30 June each year. DCM review of these reports would accordingly be delayed and/or be reduced in quality. There are numerous possible options for the timing of compliance reports, such as the as of the month end of anniversary of a firm's registration. The latter would also be preferable from many AT Persons' perspectives as this would coincide with other annual requirements such as the self-examination checklist.

Recordkeeping

In direct response to Question. 63 of the Proposing Release on where to put the recordkeeping requirements of Regulation AT, AIMA would suggest that recordkeeping obligations for AT Persons should be located alongside the other recordkeeping requirements for CPOs and CTAs in Part 4 of the Commission's regulations. AIMA would note that, if the Commission also wants to have the Regulation AT rules grouped together, then Part 4 should at least contain something that cross-references to the relevant location of the Regulation AT recordkeeping requirements, if applicable, in Regulation 1.83. We consider that this could make it easier for those unfamiliar with Commission regulations to navigate their obligations, thus ease compliance burdens.

We suggest the following wording for §1.83(C):

§1.83(C)

[...]

At all times, each designated contract market must ensure the confidentiality of the information obtained.

k) SELF-TRADE CONTROLS

§40.23(a) would require a DCM to implement rules reasonably designed to prevent self-trading by market participants not covered by a legitimate reasons exemption. In order to comply, a DCM would have to either decide itself which accounts should be prohibited from trading with one another, or require market participants to identify which accounts should be prohibited from trading with each other. §1.80(e) would require AT Persons to calibrate or take such other action as is necessary to apply the DCM's self-trade tool if required for its implementation.

AIMA is highly supportive of DCMs developing and introducing robust self-trade controls to efficiently prevent inadvertent self-matching of orders in the market. The consequences of inadvertent and undesirable self-trading is especially time consuming and involves lengthy discussions with the DCM as to why it happened. Our members see as a positive any requirement that would oblige DCMs make the requisite investment in the development of effective and efficient self-trade prevention tools, so as to enable buy-side firms to avoid the currently burdensome processes that result from inadvertent and undesired self-trades.



Current Self-trade controls are useful, but are not perfect - especially when being applied to cross-broker trading activities. We would be supportive of a regulatory incentive to ensure the development of the requisite technology to overcome these issues.

Bona fide self-trading and flexibility of controls

AIMA also agrees strongly that it is important to enable 'bona fide and desirable self-trade matches'. We suggest that there are many circumstances in which blocking an inadvertent self-trade would result in more significant disruption and distortion to the market than would occur should the trade be permitted. For example, as described within the FIA Guide, a large resting order should not have to be cancelled in order for an AT Person to be able to submit a new aggressing order to the DCM which could partially fill the large resting order.

To this end, we would recommend that the final Regulation AT provide specific flexibility on how to deal with self-trades once detected. Rather than the default response being the immediate cancellation of the relevant trades, we suggest that self-trade tools should be able to function in the most appropriate way in the circumstances - either cancelling the new or resting order, cancelling both orders or, instead, adjusting order sizes.

Permitted self-trades

To facilitate *bona fide* self-trading, we are supportive of the Regulation AT 'permitted self-trades' exemption when there is: (i) a common owner and independent decision maker; or (ii) a common decision maker and independent owner. We would, nonetheless, suggest further flexibility be provided to incorporate *bona fide* transactions executed by the same decision maker on behalf of the same beneficial owner, but which are in furtherance of different investment strategies within the scope of 'permitted self-trades'.

Bearing in mind the proposal that self-trade tools be applied universally to AT Persons, we also have comments on how self-trade control exemptions are intended to function. We suggest against requiring AT Persons to obtain positive DCM approval for a 'permitted self-trade' exemption on a case-by-case basis. Instead we would recommend that each AT Person be able to unilaterally apply the exemption, subject to DCM monitoring. If the DCM deem an AT Person's self-trading under the 'permitted self-trades' exemption to be excessive, AIMA believes that the DCM should investigate and require objective justification from the AT Person. If objective justification is not forthcoming or is otherwise insufficient, AIMA would support the possibility to prevent the AT Person from utilising the relevant permitted self-trade exemption or

AIMA would propose the wording of §40.23 be amended as follows:

§40.23

[...]

(b) Notwithstanding the foregoing, a designated contract market may, in its discretion, implement rules that permit self-trading described in paragraphs (b)(1), (b)(2) or (b)(3) of this section to occur, in each case subject to the requirements of paragraph (c) of this section:

(1) A self-trade resulting from the matching of orders for accounts with common beneficial ownership where such orders are initiated by independent decision makers. A designated contract market may through its rules further define for its market participants "independent decision makers."

(2) A self-trade resulting from the matching of orders for accounts under common control where such orders comply with the designated contract market's cross-trade, minimum exposure requirements or similar rules, and are for accounts that are not under common beneficial ownership.

(3) A self-trade resulting from the matching of orders for accounts under common control and common beneficial ownership, where such orders comply with the designated contract market's cross-trade, minimum exposure requirements or similar rules, and are for accounts that are implementing multiple, mutually exclusive investment strategies.



(c) A designated contract market may permit self-trading described in paragraph (b) of this section only if the designated contract market:

(1) Requires market participants to provide a periodic written explanation containing objective justification for their disapplication of the self-trade prevention tool ~~request approval from the designated contract market that self-trade prevention tools not be applied with respect to specific accounts under common beneficial ownership or control,~~ on the basis that they meet the criteria of paragraph (b) of this section. The designated contract market must require that such approval request written explanation be provided to it by a compliance officer or senior officer of the market participant; and

(2) If self-trading of individual market participants is deemed to be persistently excessive by the designated contract market, ~~requires market participants to amend their trading activities and/or restricts the market participant's usage of the self-trade prevention tool exemption under this paragraph. - withdraw or amend an approval request if any change occurs that would cause the information provided in such approval request to be no longer accurate or complete.~~

[...]

l) TRANSPARENCY OF MATCHING ENGINES

AIMA strongly supports the Regulation AT proposals for greater transparency into DCM matching engines. Our investment manager members, as users of DCM systems, desire as much information on the characteristics of the matching engine as is physically possible to assist them in understanding and obtaining optimum execution of their trades.

Separately to Regulation AT, AIMA would also recommend that the Commission extend its transparency proposals to capture SEFs too as the benefits of greater transparency are not exclusive to DCM trading. This would also help to ensure equal conditions of competition between SEFs and DCMs.

m) DISCLOSURE OF MARKET MAKING AND TRADE INCENTIVE PROGRAMS

AIMA supports the greater public disclosure and restrictions upon market making and trade incentive programs. True incentives for participants to provide usable liquidity to the market are desirable.

However, certain of our members are concerned and sceptical about the real benefits provided by the scale and type of market making incentive programmes currently offered by DCMs. This is particularly the case when one considers the provision of liquidity during extreme market conditions, for which incentives may not prove successful. We would recommend further investigation into the costs and benefits of such incentive programmes, perhaps with restrictions should they be deemed not to be providing a net benefit to broader market participants in terms of greater liquidity.

n) REGISTRATION OF PROPRIETARY TRADERS USING DEA

AIMA supports the requirement for all participants with a direct connection to a market to be required to register with the relevant regulatory authority. Therefore, we support the extension of the registration requirement for floor traders under Regulation AT to capture previously unregistered proprietary traders that undertake AT through DEA.