[XTX]

March 16, 2016

Via Electronic Submission

Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: CFTC's Notice of Proposed Rulemaking on Regulation Automated Trading, RIN 3038–AD52

Dear Secretary Kirkpatrick:

XTX Markets Limited ("XTX") appreciates the opportunity to submit the following comments to the Commodity Futures Trading Commission (the "CFTC" or "Commission") in response to the proposed rulemaking entitled Regulation Automated Trading ("Regulation AT" or the "Proposed Rule") issued by Staff on November 24, 2015.[1]

XTX is a UK proprietary trading firm that is a market maker in numerous asset classes across multiple jurisdictions, primarily trading spot foreign exchange, commodity derivatives, futures, and equities. XTX trades on more than 25 exchanges across the world, including designated contract markets (each, a "DCM").

I. Summary of Comments

We support the Proposed Rule and believe it will enhance the stability and integrity of the markets.

The focus of this response is questions 99-107 (IV(R) DCM Market Maker and Trading Incentive Programs §§ 40.25–40.28), contained in the Proposed Rule.

XTX benefits from a number of market maker and trading incentive programs offered by the exchanges on which it trades. This comment letter is focused primarily on transparency around market maker programs contained in proposed §§ 40.25–40.28 (DCM Market Maker and Trading Incentive Programs). We strongly support increased transparency in relation to market maker programs and encourage the CFTC to use this opportunity to strengthen the principles of impartiality already required under CFTC Reg. § 38.151.

In particular, we advocate the adoption of regulation that supports the following key principles:

- Pricing, including the availability and amount of any rebates, should be transparent;
- Corporate structure (*i.e.* classification of an entity – fund/proprietary trading entity/etc.) should not influence eligibility for market making or trading incentive programs;
- Eligibility for market making programs should include meaningful requirements: spreads, sizes and percentage of day coverage;

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[1] Regulation Automated Trading, Proposed Rule, 80 Fed. Reg. 78,824 (Dec. 17, 2015).

- Net rebates (rebates that exceed trading fees) from purely volume-based programs (*i.e.* where both the maker and taker qualify for the rebate) should be prohibited. They result in perverse incentives that encourage self-matching and/or pre-arranged trading if rebates are paid to both sides of transaction;

- "Outsized" net rebates (rebates that exceed trading fees of both sides of the trade) should be prohibited. They result in perverse incentives that encourage self-matching and/or pre-arranged trading, even if rebates are only paid to one side of trade; and

- Market maker or trading incentive programs should be subject to careful monitoring by the CFTC and DCMs and those that are vulnerable to abuse should be prohibited. Detecting abuse is complicated so the CFTC and DCMs should carefully determine how abusive behavior is identified.

II. Certain Types of Market Maker and Trading Incentive Programs are Structured in Such a Manner that Makes them Susceptible to Abuse and Should be Prohibited

99. To what extent do market participants currently trade in ways designed primarily to collect market maker or trading incentive program benefits, rather than for risk management purposes?

100. To what extent do that market maker and trading incentive programs currently provide benefits for self-trades? To what extent do market participants collect such benefits for self-trades?

Discussion

It is helpful to distinguish between different types of market maker or trading incentive programs to understand when and where market participants may trade in a manner which is intended purely to collect the incentive. When this type of trading occurs, there is no discernable benefit to the market and, despite appearances, no increased liquidity.

First, note the following terminology:

- *Rebate*: a reduction to the DCM's normal trading fees.[2] For example, where the normal trading fee payable by the market participant of 10 is reduced to 5.

- *Net rebate*: a reduction to the DCM's normal trading fees such that a market participant receives payment for executing the trade. For example, where the normal trading fee of 10 is reduced to -2 so 2 is paid to the market participant (we refer to the 2 paid to the market participant as the net rebate).

- *"Maker"*: a market participant that continuously places bids and offers.

- *"Taker"*: a market participant that accepts market prices.

- *Self-trading*: a market participant trading with itself.

- *Pre-arranged trading*: market participants trading pursuant to a formal or informal agreement.

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[2] For these purposes, "reductions to normal trading fees" could include any payments, incentives, discounts, considerations, inducements or other benefits.

It is important to note that DCMs may offer different fee structures and rebates to market makers and market takers. However, currently, in relation to futures markets, the majority of DCMs' market marker and trading incentive programs do not distinguish between makers and takers (*i.e.* they apply to all trading by a market participant).

The following table sets out some examples where market participants may trade for the purpose of collecting benefits from market maker or trading incentive programs. We also specify where we think these types of rebates should be permitted as the risk of abuse is minimal.

	Rebate for all trading volume	**Rebate for "makers" only**
Rebate	Unlikely to trade purely for rebate Should be permitted due to minimal risk of abuse	Unlikely to trade purely for rebate Should be permitted due to minimal risk of abuse
	Example: Normal trading fee of 10 is reduced to 5. Result: Cost of trading is 5 for each side. Total fee for the trade is 10. Neither party receives a payment for the trade, so there is minimal risk of abuse by way of self-trading or pre-arranged trading.	Example: Normal trading fee of 10 is reduced to 5 for makers. Result: Cost of trading is 5 for the maker and 10 for the taker. Total fee for the trade is 15. Neither party receives a payment for the trade, so there is minimal risk of abuse by way of self-trading or pre-arranged trading.
Net rebate which is less than normal trading fees payable by a market participant	Possible to trade purely for rebate Should not be permitted due to high risk of abuse	Unlikely to trade purely for rebate May be permitted due to low risk of abuse
	Example: Normal trading fee of 10 is reduced to -2. Result: Each side receives 2 and no fee is paid to the DCM. (*i.e.,* the DCM will pay out more than it receives). There is a risk that a market participant could engage in self-trading or pre-arranged trading to capitalize on the net rebate received by each side to the trade. Total profit for the self-trade or pre-arranged trade = 4 (2+2)).	Example: Normal trading fee of 10 is reduced to -2 for makers. Result: The maker receives 2 and the taker's fee is 10. Total fee for the trade is 8 (10-2). It is unlikely that market participants can engage in self-trading or pre-arranged trading to benefit from the net rebate. The net rebate (-2) is smaller than the total amount of fees payable (10) for the trade. Therefore, even though the maker will receive a net rebate of 2, it would still have to pay 10 as the taker (therefore making self-trading or pre-arranged trading unprofitable).
Net rebate which exceeds normal trading fees payable by a market participant	Possible to trade purely for rebate Should not be permitted due to high risk of abuse	Possible to trade purely for rebate Should not be permitted due to high risk of abuse
	Example: Normal trading fee of 10 is reduced to -12.	Example: Normal trading fee of 10 is reduced to -12 for makers.

	Rebate for all trading volume	Rebate for "makers" only
	Result: (1) In the case of self-trading or pre-arranged trading where both market participants are members of the program, the same analysis as row 2, column 1 applies: - Each side of the trade receives 12 and no fee is paid to the DCM. - Total profit for the self-trade or pre-arranged trade = 24 (12+12). (2) In the case of pre-arranged trading where one market participant is a member of the program ("X") and one is not ("Y"), there is still a possibility for abusive behavior: - X receives 12 and Y pays 10. - Total profit for the pre-arranged trade = 2.	Result: The maker receives 12 and the taker's fee is 10. Total fee for the trade is -2 (10-12). As the net rebate is bigger than the total trading fees payable by both sides of the trade, there is a high risk that a market participant could engage in self-trading or pre-arranged trading to capitalize on the net rebate received by the maker. Total profit from the self-trade or pre-arranged trade = 2 (12-10).

It is difficult to quantify the extent to which this type of market maker and trading incentive programs currently "benefits" market participants that self-trade or whether market participants engage in such practices to reap these benefits. While there is minimal transparency in the details of market maker and trading incentive programs, assessing the number of programs that could be abused in this manner is impossible.

Proposal

In our view, the CFTC should prohibit the existence of market maker and trading incentive programs that could be used in an abusive manner. As set out in the table above, this would include programs where:

- The net rebate is bigger than normal trading fees (regardless of whether this applies to makers and takers or just makers); and
- The net rebate is smaller than normal trading fees and such net rebates are available to both makers and takers.

III. "Impartial Access" Requires Greater Transparency and Application of Objective Standards in Market Maker and Trading Incentive Programs

Proposed Rule § 40.25 requires DCMs to make certain disclosures related to its market maker and trading incentive programs, including, in the case that the DCM does not provide impartial access, how such disparate treatment is in compliance with the impartial access requirement. Impartial access requires a DCM to provide similarly situated members with impartial access to its markets and services, including "comparable fee structures" for members receiving equal access to, or services from, the DCM.[3] Such impartial access is cornerstone to the creation of competitive, fair markets. As such, we strongly

[3] CFTC Reg. § 38.151 Access requirements.

support the increased transparency of market maker and trading incentive programs. DCMs should be prohibited from providing market participants access to market maker or trading incentive programs, while not disclosing the existence and details (including pricing) to other market participants.

101. The Commission requests comment regarding whether the information proposed to be collected in § 40.25 would be sufficient for it to determine whether a DCM's market-maker or trading incentive program complies with the impartial access requirements of § 38.151(b). If additional or different information would be helpful, please identify such information.

We address this question by dividing it into two sub-questions:

a. What is meant by the "impartial access requirements of § 38.151(b)"?

Rule § 38.151(b) requires that a DCM provides its members and persons with trading privileges with "impartial access to its markets and services, including (1) access criteria that are impartial, transparent, and applied in a non-discriminatory manner; and (2) comparable fee structures for members [and] persons with trading privileges . . . receiving equal access to, or services from, the designated contract market."[4] The preamble to the final DCM Core Principles included the following key points related to § 38.151(b):

- DCMs may set *non-discriminatory* fee classes (*i.e.* DCMs are permitted to establish categories of market participants, but may not discriminate within a particular category); and

- DCMs may offer different fees to different categories of entities provided there is a legitimate business justification for the distinction. In particular, by way of example, the CFTC confirmed that market making is one type of service that could merit a fee discount.[5]

One of the key considerations, therefore, is how DCMs can categorize market participants. A distinction should be made between DCMs being permitted to categorize market participants for legitimate reasons (and providing different fees for different classes) and arbitrarily providing different fee structures to different market participants who are similarly situated. The latter is clearly contrary to the wording and spirit of § 38.151(b). The former requires further clarification, including what constitutes a "legitimate business justification." There is no definitive guidance on this, but the CFTC has said (in the Swap Execution Facility ("SEF") context) that limiting access to certain types of eligible contract participants is inconsistent with the impartial access requirement.[6] A SEF is required to "establish and impartially enforce rules governing any decision to allow, deny, suspend, or permanently bar eligible contract participants' access to the SEF."[7] A similar approach should be adopted in the context of interpreting § 38.151(b): a DCM should not be able to discriminate between market participants on an arbitrary basis. For example, it should be irrelevant whether a DCM classifies an entity as a fund, proprietary trading entity, corporation, etc. The only factors that are relevant are whether a market participant can demonstrate that it is able to meet certain spread, size, and volume requirements (*e.g.*, [x] spread over [x]% of the day at a certain size). If there is not further guidance, DCMs could take the view that § 38.151(b) permits them to create arbitrary, and extremely limited, sub-categories of market participants, each of which would receive preferable rates or incentives. Although there is a widely held belief that this

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4 *Id.*

5 Core Principles and Other Requirements for Designated Contract Markets, 77 Fed. Reg. 36,612, 36,625 (Jun. 19, 2012).

6 CFTC Staff Letter, Division of Clearing and Risk, Division of Market Oversight and Division of Swap Dealer and Intermediary Oversight Guidance on Application of Certain Commission Regulations to Swap Execution Facilities (Nov. 14, 2013).

7 Core Principles and Other Requirements for Swap Execution Facilities, 78 Fed. Reg. 33,476, 33,509 (Jun. 4, 2012).

is the case today, given that we do not currently have transparency into market maker and trading incentive programs, we cannot know exactly how prevalent such arbitrary distinctions are.

b. Is the information provided in accordance with proposed rule § 40.25 sufficient to assess whether the DCM's market maker or trading incentive program complies with the impartial access requirements?

Sub-clauses (4) and (5) of proposed rule § 40.25 require the DCM to make public a description of any eligibility criteria in relation to a market maker or trading incentive program and, if such program is not open to all market participants, an explanation of why the program is limited to certain market participants. This provides valuable transparency that is necessary for regulators and market participants to understand how to obtain access to market maker and trading incentive programs. The disclosure of parameters relating to the program and an explanation by the DCM as to how the DCM considers it has complied with § 38.151(b) will help market participants make business decisions to ensure that they are able to satisfy the criteria and also provide market participants with grounds to challenge a DCM determination as to its eligibility for the program. We think the information required by proposed rule § 40.25 would be sufficient to determine whether a DCM's market maker or trading incentive program complies with the impartial access requirements of § 38.151(b).

In addition, based on our comments in response to questions 99 and 100, we think the CFTC should include an additional disclosure obligation, which requires DCMs to disclose the type of trading incentive program being offered. This should be supplemental to the disclosure already required under Proposed Rule § 40.25(a)(7). The DCM should be required to categorize whether the program would constitute: a rebate program; a net rebate program in which the rebate is less than total fees paid to the DCM; or, and unless this is prohibited as we recommend, a net rebate program in which the rebate exceeds total fees paid to the DCM. This categorization would provide regulators and market participants with a helpful indicator as to whether the particular program has been structured in a manner that is more or less susceptible to abuse arising from self-trading or pre-arranged trading. As such, appropriate monitoring and controls should be dedicated to such program to ensure that abusive behavior does not occur.

102. The Commission requests comment regarding whether DCMs should be required to maintain on their public websites the information required by proposed §§ 40.25(a) and 40.25(b) for an additional period beyond the end of the market maker or trading incentive program. The Commission may determine to include in any final rules arising from this NPRM a requirement that such information remain publicly available pursuant to proposed § 40.25(b) for an additional period up to six months following the end of a market maker or trading incentive program.

In the interest of enhancing transparency, we view the public availability of information relating to market maker and trading incentive programs as a positive development. We support maintaining information required by proposed §§ 40.25(a) and 40.25(b) on the DCM's public website for an additional period after termination of a market maker or trading incentive program. At a minimum, we request that such information be available to market participants by request to the DCM or CFTC at any time (including any period after the market maker or trading incentive program has ended).

103. The Commission requests comment regarding whether the text of proposed § 40.27(a) identifies with sufficient particularity the types of trades that are not eligible for payments or benefits pursuant to a DCM market-maker or trading incentive program. What amendments, if any, are necessary to clearly identify trades that are not eligible?

Proposed rule § 40.27 is intended to prohibit the receipt of any benefits from market maker or trading incentive programs where there is self-trading. "Self-trading" is defined in proposed rule § 40.23 as trading between accounts that have "common beneficial ownership" or are "under common control." We think that no benefits under a market maker or trading incentive program should be payable for such self-

trading (including, for the avoidance of doubt, any self-trading which is permitted in accordance with proposed rule § 40.23(c)). Therefore, the prohibition on receiving benefits from market maker or trading incentive programs contained in proposed rule §§ 40.27(a)(1) and (2) should be amended to include reference to accounts that are under "common control."

We suggest that the prohibition in § 40.27 be expanded to cover pre-arranged trading as well, with the same exceptions permitted by the CFTC and DCMs.[8] Pre-arranged trading (where there is a formal or informal arrangement between entities to collude on their trading activities) is prohibited in the DCM and SEF Core Principles, and by derivatives exchanges. The Proposed Rule should be amended to make clear that pre-arranged trades are not eligible to receive benefits from market maker or trading incentive programs, except where such pre-arranged trading is expressly permitted.

104. Section 40.27(a) provides that DCMs shall implement policies and procedures that are reasonably designed to prevent the payment of market-maker or trading incentive program benefits for trades between accounts under common ownership. Are there any other types of trades or circumstances under which the Commission should also prohibit or limit DCM market-maker or trading incentive program benefits?

See comments under question 103.

105. The Commission is proposing in § 40.27(a) certain requirements regarding DCM payments associated with market maker and trading incentive programs. Please address whether the proposed rules will diminish DCMs' ability to compete or build liquidity by using market maker or trading incentive programs. Does any DCM consider it appropriate to provide market maker or trading incentive program benefits for trades between accounts known to be under common beneficial ownership?

See comments under question 103.

In our view, neither market maker nor trading incentive programs should provide benefits for self-trading or pre-arranged trading. Permitting such payments could incentivize manipulative behavior and market abuse.

106. In any final rules arising from this NPRM, should the Commission also prohibit DCMs from providing trading incentive program benefits where such benefits on a per-trade basis are greater than the fees charged per trade by such DCMs and its affiliated DCO (if applicable)? The Commission also specifically requests comment on the extent, if any, to which one or more DCMs engage in this practice.

Yes.

See comments under question 100.

As indicated under question 100, we believe that the CFTC should prohibit market maker and trading incentive programs in the following circumstances:

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[8] 77 Fed. Reg. at 36,625-6 (clarifying that pre-arranged trading as otherwise permitted under Part 38 would, likewise, be permitted under § 38.152—Abusive Trading Practices Prohibited (*e.g.*, block trades, permissible cross-trades, and exchange for related position transactions, in certain circumstances)).

- Where the net rebate is bigger than normal trading fees (regardless of whether this applies to makers and takers or just makers); and

- Where the net rebate is smaller than normal trading fees and such net rebates are available to both makers and takers (and based on trading volumes).

We have provided detail on why these types of market maker and trading incentive programs should be prohibited in our answer to question 100. Such programs create perverse incentives for market participants and encourage self-trading and/or pre-arranged trading in order to capitalize on the benefit payable by the DCM.

107. Proposed § 40.25(b) imposes certain transparency requirements with respect to both market maker and trading incentive programs. The Commission requests public comment regarding:

a. The most appropriate place or manner for a DCM to disclose the information required by proposed § 40.25 (b);

b. The benefits or any harm that may result from such transparency, including any anti-competitive effect or pro-competitive effect among DCMs or market participants;

c. Whether transparency as proposed in § 40.25(b) is equally appropriate for both market maker programs and trading incentive programs, or are the proposed requirements more or less appropriate for one type of program over the other?

d. Whether any of the enumerated items required to be posted on a DCM's public website pursuant to proposed § 40.25(b) could reasonably be considered confidential information that should not be available to the public, and if so, what process should be available for a DCM to request from the Commission an exemption from the requirements of proposed § 40.25(b) for that specific enumerated item?

We fully endorse the complete disclosure of information as contemplated in proposed rule § 40.25(b). We also encourage the CFTC to provide guidance with regard to the appropriate format for disclosures to ensure consistency across DCMs (*e.g.,* by providing a standard table or chart which the DCM can then complete in respect of each program). The disclosures should be made in such a manner that is easy for market participants and non-market participants to access. We advocate for disclosure of the information to be made both in CFTC filings and on a publicly available website of the relevant DCM. Additionally, termination of a market maker or trading incentive program prior to the termination date previously disclosed should be publicly disclosed, not just disclosed to the CFTC as contemplated in § 40.25(c).

Complete disclosure would enhance transparency, encourage open and impartial access and would have a pro-competitive effect. We do not see any good reason to keep any of the information referred to in proposed § 40.25(b) confidential.

IV. The Jurisdictional Scope of Regulation AT Should be Limited to Avoid Duplicative or Conflicting Requirements

In addition to our views relating to questions 99-107 (IV(R) DCM Market Maker and Trading Incentive Programs §§ 40.25–40.28) contained in the Proposed Rule, we wish to highlight our concerns relating to the jurisdictional scope of Regulation AT. As currently drafted, Regulation AT will bring within scope both US and non-US entities engaged in algorithmic trading through the definition of "AT Person." In our view, "AT Person" should not include entities that are subject to comparable rules of a third country jurisdiction.

For example, and as discussed in the Proposed Rule, the European Commission is currently implementing MiFID II which subjects entities engaged in algorithmic trading and/or high frequency trading to similar requirements to those of Regulation AT.[9] Other jurisdictions may also implement similar rules. This would mean that entities trading in numerous jurisdictions will need to comply with multiple sets of rules which, at best, are duplicative and, at worst, conflict. This would not only create further unnecessary costs, but, more importantly, could impact the jurisdictions in which entities are able to trade, thereby negatively impacting liquidity in markets.

V. Conclusion

We ask that the Commission greatly increases transparency in relation to market maker and trading incentive programs through Regulation AT. The proposal contemplates market maker and trading incentive programs on a going forward basis. However, the enhanced transparency requirements of Regulation AT must also apply to programs currently in place. Failure to do so will encourage continued use of the market maker and trading incentive programs in place, which have negatively impacted the market. We also ask that the CFTC carefully scrutinize new programs for compliance with impartial access. So long as partiality is permitted, market maker programs will continue to advantage select market participants while disadvantaging the rest.

We welcome the opportunity to discuss the contents of this letter and XTX's views regarding the Proposed Rule with the CFTC in person.

Respectfully submitted,

/s/ XTX Markets Limited

XTX MARKETS LIMITED

[9] 80 Fed. Reg. at 78,832-33.