



SUTHERLAND



March 16, 2016

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street NW
Washington, DC 20581

VIA ELECTRONIC SUBMISSION

Re: Regulation Automated Trading, Notice of Proposed Rulemaking, RIN 3038-AD52

Dear Secretary Kirkpatrick:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (the “**Working Group**”) and the Commodity Markets Council (“**CMC**”) (collectively, the “**Commercial Alliance**”), Sutherland Asbill & Brennan LLP hereby submits this comment letter in response to the Commodity Futures Trading Commission’s (the “**CFTC**” or “**Commission**”) Notice of Proposed Rulemaking, *Regulation Automated Trading*,¹ which proposes risk controls, transparency measures, and other safeguards to improve the Commission’s regulatory oversight of automated trading on designated contract markets (“**DCMs**”).

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group considers and responds to requests for comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

CMC is a trade association that brings together exchanges and their industry counterparts. Its members include commercial end-users that utilize the futures and swaps markets for agriculture, energy, metal, and soft commodities. Its industry member firms also include regular users and members of swap execution facilities (each, a “**SEF**”) as well as DCMs, such as the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Minneapolis Grain Exchange, NASDAQ Futures, and the New York Mercantile Exchange. Along with these

¹ See *Regulation Automated Trading*, Notice of Proposed Rulemaking, 80 Fed. Reg. 78,824 (Dec. 17, 2015) (“**Regulation AT**”).

market participants, CMC members also include regulated derivatives exchanges. The businesses of all CMC members depend upon the efficient and competitive functioning of the risk management products traded on DCMs, SEFs, and over-the-counter (“**OTC**”) markets.

The Commercial Alliance believes automated trading should be subject to appropriate pre- and post-trade risk and other controls. In this regard, the Commercial Alliance appreciates the Commission’s efforts under Regulation AT to (i) promote market integrity and transparency and (ii) mitigate exposure to systemic risk as the derivatives markets continue to evolve, transitioning from a manual, open-outcry trading pit paradigm to automated trading systems. As proposed, however, the Commercial Alliance believes Regulation AT will have a broad impact on commodity markets and could subject a large segment of commercial energy and agricultural firms to Regulation AT contrary to the Commission’s stated intent to limit the scope and applicability of this proposed rulemaking to approximately an additional 100 new registrants.

Specifically, as discussed below in Section II.A, commercial firms (i) utilizing basic order management functionality, including, but not limited to, excel spreadsheets, auto-spreaders, iceberg/reserved quantity orders, and order cancels order functionality (“**Order Management Functionality**”), and (ii) accessing DCMs through software, servers, or systems (collectively, “**Routing Infrastructure**”) owned by independent software vendors (“**ISVs**”)² or DCMs³ could be deemed to fall within the definitions of “Algorithmic Trading” (“**AT**”) and “Direct Electronic Access” (“**DEA**”). As a consequence, if Regulation AT is adopted as proposed, such commercial firms will be required to register as “Floor Traders” and be subject to regulation as “AT Persons,” even though the manner in which they access DCMs and trade does not pose the systemic risk concerns that Regulation AT seeks to protect against.

In short, the proposed registration framework set forth in Regulation AT requires: (i) registrants using AT to implement the requirements applicable to AT Persons, such as risk controls, and (ii) non-registrants trading for their own account with AT through direct access to a DCM to register as Floor Traders and implement the requirements applicable to AT Persons. The Commercial Alliance believes this registration framework is unnecessary to achieve the Commission’s goals. Accordingly, as further described below, the Commercial Alliance recommends that the Commission eliminate the registration framework and instead require any person with DEA on a DCM using AT, as these two terms are defined herein by the Commercial Alliance, to implement appropriate risk controls and certain other measures applicable to AT Persons.

Given the complexity and technical nature of the comments requested by the Commission in this rulemaking as well as the unintended consequences of Regulation AT on commercial end-users, the Commercial Alliance recommends that the Commission (i) establish another

² Examples of ISV-owned routing infrastructure include, but are not limited to, those provided by Trading Technologies International, Inc. (“**TT**”) and Bloomberg Tradebook Futures ISV platform (“**Bloomberg**”). There are several commercial reasons in derivative markets supporting the migration away from the use of routing systems and infrastructure owned by third-party clearing members, including futures commission merchants (“**FCMs**”), to ISV-owned, non-dedicated multi-broker systems, including the reduction of concentration risk in one FCM.

³ Examples of DCM-owned routing infrastructure include, but are not limited to, WebICE and CME Direct.

Technology Advisory Committee (“TAC”) meeting to discuss the proposals under, and the comments to, Regulation AT, including whether the use of a threshold test is a more appropriate mechanism for establishing to whom the Regulation AT requirements apply,⁴ (ii) reopen the comment period for Regulation AT to allow market participants to further comment on the discussions and proposals addressed at the new TAC meeting, and (iii) issue a new proposed rulemaking, including a full cost-benefit analysis,⁵ that is more appropriately tailored and addresses the concerns of the Commercial Alliance and other commercial market participants.

The Commercial Alliance appreciates the opportunity to submit these comments and looks forward to working with the Commission to develop a framework for regulating automated trading. The Commercial Alliance submits that, if Regulation AT is adopted as proposed, many commercial firms will (i) stop using the Order Management Functionality and revert to using a single FCM for routing orders to a DCM, which would have the effect of reducing liquidity in DCM markets and re-inject significant risk into energy and agricultural commodity markets, and (ii) be discouraged from developing product enhancements or adopting new technologies allowing them to hedge more effectively.

II. COMMENTS OF THE COMMERCIAL ALLIANCE.

The primary business activity of the Working Group and many CMC members involves the physical delivery of one or more energy or agriculture commodities to others. Members of the Commercial Alliance actively participate in commodity futures markets as commercial hedgers. In this capacity, they use commodity derivatives to protect against exposure to price volatility and risks associated with their respective obligations to produce, process, purchase, merchandize, and deliver physical energy and agricultural commodities to others.

Commercial firms utilize Order Management Functionality in a basic manner to manage the routing of orders to DCMs. The Order Management Functionality utilized by Commercial Alliance members is distinguishable from proprietary, automated order generation systems that automatically generate and send orders to a DCM using software configurable only through the manipulation of source code where parameters regarding time, price, quantity, and how the model can be employed, are not subject to the system owner’s discretion (“**Automated Order Generation Systems**”). Further, commercial firms access DCMs using Order Management Functionality through the Routing Infrastructure of a DCM, ISV, or FCM, which, at all times, are subject to multiple layers of pre- and post-trade risk and other controls throughout each segment of the transaction chain (*i.e.*, over the lifecycle of a trade). In this respect, the Commercial Alliance notes that Regulation AT does not identify any disruptive events or other systemic risks in energy or agriculture derivatives markets attributable to the activities of commercial firms.

⁴ See Regulation AT at 78,847 (requesting comment on whether trading volume, order, or message levels or thresholds should be considered in establishing to whom Regulation AT applies).

⁵ As presented throughout these comments, the Commercial Alliance submits that Regulation AT applies to a much broader set of market participants than Regulation AT seeks to regulate. As a result, these market participants will be subject to substantial compliance burdens not only under Regulation AT but also under other CFTC rules if these market participants are forced to register as Floor Traders.

A. PROPOSED DEFINITIONS.

1. Proposed “Direct Electronic Access” Definition.

Proposed CFTC Regulation 1.3(yyyy), in relevant part, defines DEA as “an arrangement where a person electronically transmits an order to a DCM, without the order first being *routed through a separate person who is a member of a derivatives clearing organization* to which the DCM submits transactions for clearing.”⁶ In this context, “routed” means the process by which an order physically moves from a customer to a DCM.⁷

A definition of DEA that excludes only Routing Infrastructure owned or controlled by a “separate person who is a member of a DCO” suggests that only orders routed to a DCM through Routing Infrastructure owned by a “separate person who is a member of a DCO” are subject to adequate controls to prevent systemic risk and other disruptive events that can result from automated trading. This is not the case. Further, the DEA definition fails to recognize the variety of options utilized by market participants to route orders to DCMs. For example, in addition to routing orders through third-party FCMs, Commercial Alliance members route futures orders using the Routing Infrastructure:

- Owned and operated by DCMs, such as CME Direct and WebICE; and
- Owned and operated by, or leased from ISVs, such as TT and Bloomberg.⁸

These ISV and DCM Routing Infrastructure are subject to a pervasive, tiered set of risk and operational controls imposed by DCMs, clearing firms, including FCMs, and market participants throughout the transaction chain from order entry to order matching in the DCM’s central limit order book. Each tier of controls is briefly addressed below.⁹

Designated Contract Markets. DCMs require any entity routing orders to their markets to implement and comply with a robust set of pre- and post-trade risk and operational controls designed to protect market integrity. For example, CME Group provides to clearing firms the functionality needed to administer such controls, including, but not limited to, (i) maximum order size limits, (ii) stop logic functionality, (iii) pre-trade risk management interface with clearing firms’ proprietary risk systems, (iv) kill switch functionality, (v) browser-based order management tools that provide real-time access to order information and “kill button” for

⁶ See Regulation AT at 78,844.

⁷ See *id.*

⁸ The Commercial Alliance understands that futures orders also are routed to DCMs using the Routing Infrastructure developed and owned directly by market participants, such as bespoke proprietary systems deployed by market participants using their own API. However, Commercial Alliance members do not route orders to a DCM in this manner.

⁹ ISVs also provide a robust suite of operational controls to orders routed to a DCM using their Routing Infrastructure. However, the Commercial Alliance does not address herein the specific controls applied by the ISVs to orders routed to DCMs through the ISV Routing Infrastructure.

individual orders, groups of orders, and working orders, and (vi) cancel on disconnect functionality.¹⁰ In addition, DCMs provide market participants with the ability to implement and administer certain pre-trade risk controls, such as self-trade prevention, cancel on disconnect functionality, and browser-based order management tools that can withdraw orders and terminate a user's trading platform access.¹¹

Such controls protect the integrity of DCM markets by providing the functionality to block orders before they are entered in a DCM's matching engine or cancel resting or working orders. Such controls are equally, if not more, robust and broadly applicable than controls that registered FCMs are required to implement under CFTC Regulation 1.73. Additionally, DCMs can provide controls tailored to the unique characteristics of a particular market, product, or market participant.

Clearing Firms. Clearing firms impose various pre-trade risk and other controls on their customers, whether the customer is utilizing the clearing firm's proprietary Routing Infrastructure, or ISV or DCM Routing Infrastructure. These controls include, but are not limited to, (i) order size limits, (ii) maximum intra-day position limits, (iii) price limits, (iv) order monitoring using DCM order mitigation tools, and (v) credit limits. Clearing firms registered with the Commission also must comply with CFTC Regulation 1.73. All clearing firms are required by DCMs to have written risk management policies and procedures, which are regularly audited by DCMs. Finally, clearing firms with customers that utilize DCM or ISV Routing Infrastructure are granted access to these systems by the DCM or ISV, as applicable, to implement and administer their own proprietary and DCM-mandated pre-trade risk and other controls for their customers (and any operational controls mandated for ISV systems).¹²

Market Participants. Market participants adopt and enforce internal risk management controls, which can be implemented on a pre- and post-trade basis. Additionally, they are economically incentivized to mitigate exposure to potential credit and operational risks through bottom line profit and loss performance metrics. Market participants also coordinate directly with their clearing firms on the establishment of appropriate risk limits for their traders, as well as with DCMs, whether they are engaged in purely manual trading or using automated trading functionality.

¹⁰ See CME Group, Comments on Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, RIN 3038-AD52 (Dec. 11, 2013) ("**CME 2013 Concept Release Comments**"); see also CME Group, Introduction to Risk Management Tools, available at <http://www.cmegroup.com/globex/trading-cme-group-products/risk-management-tools.html#cmeRiskManagement1>. Other DCMs also provide similar controls. See, e.g., How the ICE Market Works, ICE Derivatives Markets, September 2015, available at <https://www.theice.com/publicdocs/circulars/15044.pdf>; see also NASDAQ Futures, Inc. (NFX), TradeGuard PTRM Reference Guide, Version 1.02, 2015-6-29, available at http://business.nasdaq.com/Docs/NFX%20PTRM%20Reference%20Guide_tcm5044-18292.pdf.

¹¹ Examples of browser-based order management tools, include, among others, FirmSoft (CME Group), ACE (Intercontinental Exchange), and Q-port (NASDAQ).

¹² ISVs have developed a robust suite of controls. Although they may not be mandated for use by trading firms, the Commercial Alliance notes they are available and often required by clearing firms on behalf of their customers.

In light of the foregoing, any DEA definition adopted by the Commission in a final rule in this proceeding should be limited in scope. Specifically, the DEA definition should focus on the use of bespoke, proprietary Application Programming Interface (“API”) and Routing Infrastructure developed by market participants to directly connect to a DCM using their own front-end Automated Order Generation Systems that lack pre-trade risk and other controls administered by a separate person who is an FCM or clearing member of a derivatives clearing organization (“DCO”). This narrowly tailored definition of DEA seeks to balance the policy objectives of Regulation AT while limiting the application of Regulation AT to market participants whose algorithmic trading presents identifiable systemic risks to market integrity.

Accordingly, the Commercial Alliance recommends that the Commission adopt the following language for the DEA definition, which is nearly identical to the proposal the Commercial Alliance understands the Futures Industry Association (“FIA”) will put forth in its comment letter:

Direct Electronic Access. This term means an arrangement where a person uses its own, proprietary Application Programming Interface (“API”) to electronically transmit an order to a designated contract market’s API without the order first being routed through an order routing system that includes risk and operational controls under the administrative control of a separate person who is a futures commission merchant or clearing member of a derivatives clearing organization.¹³

2. Proposed “Algorithmic Trading” Definition.

If adopted as proposed, the AT definition will adversely impact a large segment of commercial firms. The term “Algorithmic Trading” is defined in proposed CFTC Regulation 1.3(zzzz) as:

(zzzz) *Algorithmic Trading.* This terms means trading in any commodity interest as defined in paragraph (yy) of this section on or subject to the rules of a designated contract market, where:

- (1) One or more computer algorithms or systems determines whether to initiate, modify, or cancel an order, 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

¹³ Orders routed through routing systems under the administrative control of an FCM or clearing member of a DCO are subject to pre-trade risk and operational controls applied by DCMs, FCMs, and clearing members of a DCO, including, but not limited to, (i) maximum order size limits, (ii) stop logic functionality, (iii) DCM pre-trade risk management interface with clearing firms’ proprietary risk systems, (iv) kill switch functionality, (v) order management tools with a “kill button,” (vi) cancel on disconnect functionality, (vii) maximum intra-day position limits, (viii) price limits, (ix) order monitoring using DCM order mitigation tools, and (x) credit limits. See CME 2013 Concept Release Comments; see also CME Group, Introduction to Risk Management Tools, available at <http://www.cmegroup.com/globex/trading-cme-group-products/risk-management-tools.html#cmeRiskManagement1>.

placed; the type of order to be placed; the timing of the order; 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; the number of orders to be placed; or how to manage the order after submission; and

(2) Such order, modification or order cancellation is electronically submitted for processing on or subject to the rules of a designated control market; 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 designated control market.¹⁴

Although the Commercial Alliance supports market efficiency and transparency, and the Commission's efforts to prevent the types of market activity that occurred (i) in the market for U.S. Treasury securities and futures on October 15, 2014, (ii) in the equities markets in August 2012, and (iii) during the Flash Crash of 2010,¹⁵ the proposed definition of AT could be interpreted to include the basic Order Management Functionality, which is used by the Commercial Alliance members and most other commercial firms. Commercial firms utilize Order Management Functionality in a basic manner to implement trading decisions and parameters by which the specific order type is executed, which are determined by a natural person. A non-exclusive list of Order Management Functionality used by commercial firms includes:

- Auto-Spreaders. Auto-spreaders are used by commercial firms to create and trade synthetic calendar, inter-product, and inter-exchange spreads. Auto-spreaders often are used by commercial firms during the order entry process when hedging to mitigate exposure to market volatility. Information regarding the desired spread is manually entered by traders, and the auto-spreader functionality then will execute the legs of the spread in the outright market to match the desired spread price.
- Iceberg or Reserved Quantity Orders. This functionality permits a market participant to bring significant hidden liquidity to the market through the execution of a series of smaller orders. When one disclosed smaller order is filled, the next smaller order is

¹⁴ See CFTC Proposed Regulation 1.3(zzzz); see also Regulation AT at 78,839-40.

¹⁵ See *id.* at 78,827 (citing the unusually high level of volatility and very rapid round-trip in prices on October 15, 2014, in the market for U.S. Treasury securities, futures, and other closely related financial markets, which was caused by automated trading); see also Statement of Commissioner Bowen before the Technology Advisory Committee Meeting (Feb. 23, 2016), available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/bowenstatement022316> (“February 23rd TAC Meeting”) (stating that Regulation AT is intended to address aspects of AT that pose systemic risks).

displayed to the market. This process continues until all of the volume is fully brought to the market, and all orders are filled.

- Sliced Orders (Scale in Orders). This functionality divides large quantity orders into smaller disclosed orders. Child order portions are sent to the market at fixed time intervals. It is similar to an Iceberg Order, but the smaller disclosed orders are executed based on a set time rather than the previous order portion being filled.
- Timed Orders (with Offset Capability). This functionality involves orders used to manage a trading day. For example, timed orders generally are executed if a trader wants to submit an order as soon as the market opens or exit a position before the market closes. Timed Orders allow traders to schedule an order's start date and time or end date and time and may be included with most order types.
- Trailing Limit Orders. This functionality involves the submission of an order priced at a fixed distance from the market that re-prices relative to the market. For example, a buy Trailing Limit sets the price at a fixed amount below the market price. The order moves higher if the market moves above the highest recent price. The order will not adjust if the market moves lower.
- Sweep Orders. This functionality permits a trader to sweep the total quantity of orders available at a certain price (up to a defined maximum quantity).
- Synthetic MIT or Stop Orders. This functionality involves an order that is triggered when the market has reached or penetrated a specified price in the market. For certain markets, these are standard order types. However, for other markets, they may be synthetically created.
- Order Cancels Order. This functionality permits traders to automatically cancel one order based on another order (*e.g.*, if one order gets filled the second order will be automatically canceled).¹⁶

The Commercial Alliance believes that Automated Order Generation Systems can be easily distinguished from the Order Management Functionality used by the Commercial Alliance members and other commercial firms wherein a natural person retains the discretion to trade and establish the parameters by which the order will be executed. Order Management Functionality cannot execute any trades outside of the specific order parameters that were entered by the natural person deciding whether to trade. In contrast, Automated Order Generation Systems effectively function as independent traders through their ability to automatically generate and execute independent trading decisions and send orders to DCMs without any human intervention.

In this light, the Commercial Alliance requests that the Commission categorically exclude from the AT definition basic Order Management Functionality or provide a safe harbor that

¹⁶ See WebICE User Guide available at https://www.theice.com/publicdocs/WebICE_Userguide-lo-res.pdf.

provides market participants with certainty that such Order Management Functionality would not fall within the proposed AT definition.¹⁷

B. PROPOSED REGISTRATION REGIME.

As noted above in Section I, the Commercial Alliance generally believes that a registration regime is not required to provide for appropriate regulatory oversight of automated trading, even if the Commission amends the AT and DEA definitions as recommended herein. The Commercial Alliance supports comments submitted in response to the Commission's 2013 Concept Release, stating that a registration framework for regulating automated trading in commodity markets would not provide any significant regulatory benefit, and current industry practices provide the required regulatory tools that registration would address.¹⁸ Registration typically is designed to provide the Commission with certain market participant identification information or to require market participants to comply with requirements to which they are not already subject. As noted in the CME 2013 Concept Release Comments, DCMs already have addressed these important registration goals by requiring firms to use unique identifications, which are included in each order message sent to DCMs and maintained in the DCM's audit trail, whether the order is manually generated or generated from an automated system.¹⁹

The Commercial Alliance believes the information currently collected by the DCMs in their audit trail—to which the Commission has access on a daily basis—should satisfy the Commission's goals underlying its proposed registration paradigm. Pursuant to DCM Core Principle 2, all market participants with access to a DCM's markets must consent to the DCM's jurisdiction.²⁰ As such, there is an appropriate degree of regulatory oversight to address, as necessary, a market participant's automated trading activity.

Accordingly, the Commercial Alliance recommends that the Commission retain its existing definition of Floor Trader and not adopt the expanded definition of Floor Trader as proposed under Regulation AT. Rather, the Commission should adopt the following definition of AT Person:

¹⁷ The Commercial Alliance understands that, as part of their submission of comments addressing Regulation AT, certain DCMs will propose that the Commission categorically exempt from the proposed definition of AT the types of basic DCM-provided order management functionality discussed in this Section II.A.2. The Commercial Alliance supports such a proposal. The DCMs already are registered with the Commission and have well-established risk and operational controls that govern the use of DCM-provided order management functionality, and any inappropriate use of such order functionality by a market participant is subject to real-time market surveillance and enforcement by the DCMs and the Commission. *See* Commodity Exchange Act Section 5, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010; H.R. 4173, Pub. L. No. 111-203, 124 Stat. 1376 (July 21, 2010) ("**Dodd-Frank Act**"); Part 38 of the CFTC's Regulations.

¹⁸ *See* CME 2013 Concept Release Comments at 32; FIA, Comments on Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, RIN 3038-AD52, at 43 (Dec. 11, 2013) ("**FIA 2013 Concept Release Comments**").

¹⁹ *See* CME 2013 Concept Release Comments at 32-34; FIA 2013 Concept Release Comments at 43-45.

²⁰ *See* Subpart C – Compliance with Rules, CFTC Regulations 38.1-38.12; 17 C.F.R. §§ 38.1-38.12 (2015).

(xxxx) AT Person. This term means any person—

(1) Who purchases or sells solely for such person’s own account—

- (i) Any commodity for future delivery, security futures product, or swap; or**
- (ii) Any commodity option authorized under section 4c of the Act; and**

(2) Who uses Direct Electronic Access²¹ as defined in paragraph (yyyy) of this section, in whole or in part, to access a DCM for Algorithmic Trading.²²

The Commercial Alliance believes that this proposed AT Person definition is consistent with, and furthers, the policy objectives of Regulation AT. Specifically, it focuses the scope and applicability of Regulation AT on the activities that create identifiable systemic market risks while treating existing registrants and non-registrants equally. Finally, it avoids the need to impose a registration regime that would impose unnecessary costs on DCMs and market participants.

1. **Obligations Applicable to AT Persons under Regulation AT.**

As noted above in Section I, the Commercial Alliance supports the Commission’s goal of mitigating exposure to systemic risk as DCM markets continue to transition to a paradigm that primarily utilizes automated trading and matching systems. However, if commercial firms are required to register as Floor Traders as a result of broad AT and DEA definitions, they will be subject to a host of compliance obligations applicable to AT Persons, including (i) the implementation of certain pre-trade risk and other controls *that already exist across the transaction chain*, (ii) standards for the development, monitoring, and compliance of AT systems, and (iii) new reporting and recordkeeping requirements.

The Commercial Alliance submits that the proposed compliance obligations for AT Persons as applied to commercial firms will provide limited benefit to the integrity of the DCM markets for energy and agricultural commodities given (i) systemic risk concerns, which are the focus of Regulation AT, generally do not arise from the trading activity typically engaged in by commercial participants in these markets, and (ii) a tiered, robust set of risk and operational controls exist throughout each segment of the transaction chain for market participants transacting through FCM, ISV, or DCM Routing Infrastructure.

Accordingly, as recommended below in Section II.C, the Commission should allow DCMs the flexibility under their Core Principles set forth in Part 38 of the CFTC’s Regulations in establishing and implementing the appropriate controls applicable to automated trading used in their markets. Should the CFTC decline this recommendation, the Commercial Alliance

²¹ The reference to “Direct Electronic Access” in this AT Person definition would reflect the Commercial Alliance’s recommended DEA definition.

²² The reference to “Algorithmic Trading” in this AT Person definition would reflect the Commercial Alliance’s recommendation that the AT definition include only Automated Order Generation Systems.

provides below in Section II.B.1.i-iv specific comments addressing certain obligations imposed upon AT Persons under Regulation AT.

i. Pre-Trade Risk Controls.

Under Regulation AT, an AT Person would be required to implement pre-trade risk controls and other measures reasonably designed to prevent an “Algorithmic Trading Event.”²³ FCMs, ISVs, and DCMs currently provide and apply risk and other controls to their Routing Infrastructure and orders utilizing their Routing Infrastructure. Thus, a market participant using such Routing Infrastructure should not be required to build a duplicative set of pre-trade risk and other controls that cannot even be applied to such third-party’s Routing Infrastructure.

ii. Standards for the Development, Monitoring, and Compliance of Algorithmic Trading Systems.

Under Regulation AT, each AT Person would be required to implement written policies and procedures for the development, testing, monitoring, and compliance of its Algorithmic Trading systems.²⁴ Commercial Alliance members primarily utilize basic Order Management Functionality, which typically is “off-the-shelf” and provided by a DCM or ISV. Because Commercial Alliance members do not own the software of the Order Management Functionality, if Commercial Alliance members are regulated as AT Persons, they should not be required to adopt written policies and procedures governing the development, testing, and monitoring of such. Rather, only the owners of the Order Management Functionality (*e.g.*, the DCMs or ISVs) should be required to adopt such written policies and procedures.

iii. Compliance Reports.

Under Regulation AT, an AT Person would be required to certify and submit annual compliance reports to a DCM, providing information on the AT Person’s controls for (i) maximum AT Order Message frequency, (ii) maximum execution frequency, (iii) order price parameters, and (iv) maximum order sizes. Along with these annual compliance reports, Regulation AT would require an AT Person to submit copies of its written policies and procedures developed to comply with Regulation AT.

Panelists at the February 23rd TAC Meeting stated that DCMs have existing rules and policies that permit them to seek information from a market participant regarding its use of automated trading systems and the pre-trade risk and other controls implemented by that market participant.²⁵ Further, DCMs currently provide conformance testing of functionality to users of their markets to ensure that trading systems connecting to the trading host will not adversely impact the DCMs’ markets. DCMs also generally require that all electronic programs and systems connecting to the DCM’s API, regardless of trading strategy, be certified by the DCM

²³ See Proposed CFTC Regulation 1.80.

²⁴ See Proposed CFTC Regulation 1.81.

²⁵ See February 23rd TAC Meeting, Panel I: CFTC Proposed Rule: Regulation Automated Trading, available at <https://www.youtube.com/watch?v=qTu-FIPctw&feature=youtu.be>.

on order entry or market data interfaces before being deployed. Additionally, DCMs require clearing members to adopt written risk management policies and procedures and routinely conduct reviews of such clearing members.

In light of the foregoing, the Commercial Alliance believes that certifying and submitting to DCMs annual compliance reports will be unnecessarily duplicative and burdensome on AT Persons and provide little, if any, benefit to the DCMs or Commission.²⁶ The costs in certifying and submitting annual compliance reports to a DCM will be magnified for commercial firms using Order Management Functionality and accessing DCMs through ISV or DCM Routing Infrastructure, as their trading activity generally does not pose systemic risk to commodity derivatives markets, and their resources are more focused on facilitating their primary physical businesses. If the Commission proceeds with a final rule in this proceeding, it should eliminate the requirement for AT Persons to certify and submit to DCMs annual compliance reports.

iv. Recordkeeping.

Regulation AT requires AT Persons to adopt written policies and procedures that require the AT Person, among other things, to maintain a source code repository in accordance with CFTC Regulation 1.31 to manage source code access and copies of all code used in the production trading environment (each repository must include an audit trail of material changes to source code to allow AT Persons to determine who made the material change, when it was made, and the coding purpose). The Commercial Alliance submits that almost all source code associated with the Order Management Functionality utilized by Commercial Alliance members is the proprietary property of the Order Management Functionality's owner, such as the ISVs or DCMs. As such, AT Persons cannot, and should not be required to, maintain a source code repository for Order Management Functionality provided by a third-party, such as an ISV or DCM.

Additionally, source code is proprietary and confidential intellectual property that represents a person's current and future trading strategies, including the positions the person intends to buy or sell in the future upon specified market events. Given source code must be retained pursuant to CFTC Regulation 1.31, the Commission or Department of Justice ("DOJ") may access such records without a subpoena even though an AT Person's source codes for algorithms are highly sensitive proprietary information. As noted in Appendix 4 to Regulation AT, the federal government generally may not obtain such highly sensitive proprietary information without a subpoena, and the CFTC failed to identify its need for this information.²⁷ Further, the Commercial Alliance is concerned that the Commission will be unable to protect the confidentiality of such source code from cyber attacks or other data breaches. If the confidentiality of an AT Person's source code is compromised, the AT Person's commercial business, as well as the derivatives markets, could be severely harmed. Accordingly, the Commercial Alliance recommends that the Commission require the use of a subpoena to access any information relating to an AT Person's source code.

²⁶ *See id.*

²⁷ *See* Regulation AT at 78,947.

2. Other Unintended Regulatory Consequences Applicable to Commercial Firms Forced to Register as Floor Traders that Arise under Separate CFTC Rules.

Equally important, the consequences of requiring a potentially large segment of commercial firms to register as Floor Traders also will undermine certain relief for which the Commission has provided to commercial end-users as part of its implementation of the Dodd-Frank Act. For example, commercial end-users captured by the proposed expanded definition of Floor Trader would fall within the definition of “financial end-user” and be subject to variation margin requirements and potentially initial margin requirements under the Commission’s recently finalized margin rules for OTC swaps.²⁸ In addition, commercial end-users required to register as Floor Traders would be subject to burdensome recordkeeping obligations, under CFTC Regulation 1.35, if they are “members” of an exchange,²⁹ notwithstanding the fact the Commission has gone to great lengths to provide regulatory relief from Regulation 1.35 to “unregistered members.”³⁰

C. AN ALTERNATIVE PROPOSAL FOR REGULATING AUTOMATED TRADING IN COMMODITY DERIVATIVES MARKETS.

As an alternative to the regulatory regime proposed under Regulation AT, the Commercial Alliance recommends that the Commission permit DCMs under the Core Principles applicable to DCMs in existing Part 38 of the CFTC’s Regulations to establish and administer pre-trade risk and other control requirements applicable to AT used in the DCMs’ markets to ensure the integrity of their markets is not impaired by such use of AT.³¹ Notably, this recommendation was supported by panelists at the February 23rd TAC Meeting.³²

²⁸ See *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, CFTC Final Rule and Interim Final Rule, 81 Fed. Reg. 636 (Jan. 6, 2016). Further, the Commercial Alliance is concerned that falling within the definition of “financial end-user” might also lead to a characterization of “financial entity,” which would impose many other CFTC rules and regulations adopted under the Dodd-Frank Act (e.g., a financial entity is subject to the CFTC’s mandatory clearing determinations and is not eligible for the End-User Exception under Part 39 of the CFTC’s Regulations).

²⁹ See Regulation AT, Appendix 4—Statement of Commissioner J. Christopher Giancarlo, at 78,947.

³⁰ See *Records of Commodity Interest and Related Cash or Forward Transactions*, Final Rule, 80 Fed. Reg. 80,247 (Dec. 24, 2015); *Adaptation of Regulations to Incorporate Swaps – Records of Transactions*, Final Rule, 77 Fed. Reg. 75,523 (Dec. 21, 2012).

³¹ For example, existing CFTC Regulation 38.255 (Risk Controls for Trading), which falls within DCM Core Principle No. 4, and Appendix B to Part 38 are examples of principles-based regulation that provides DCMs with the authority, flexibility, and discretion to protect their markets as they deem appropriate. Consistent with existing CFTC Regulation 38.255, DCMs have developed many of their current risk control systems. The Commercial Alliance supports CME Group comments stating that existing Regulation 38.255 would become virtually unrecognizable as a core principle if the additional prescriptive requirements under Regulation AT were adopted. See CME Group, Comments on Notice of Proposed Rulemaking, Regulation Automated Trading, RIN 3038-AD52 (Mar. 16, 2016).

³² See February 23rd TAC Meeting, Panel I: CFTC Proposed Rule: Regulation Automated Trading, available at <https://www.youtube.com/watch?v=qTu-FIPctw&feature=youtu.be>.

Christopher Kirkpatrick, Secretary

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III. CONCLUSION.

The Commercial Alliance requests that the Commission consider the comments set forth herein as it develops any final rule in this proceeding. The Commercial Alliance expressly reserves the right to supplement these comments as deemed necessary and appropriate.

If you have any questions, please contact the undersigned.

Respectfully submitted,

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