



Via Electronic Submission

March 16, 2016

Christopher J. Kirkpatrick  
Secretary of the Commission  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 201581

Re: Notice of Proposed Rulemaking on Regulation Automated Trading (“Regulation AT”), RIN 3038–AD52

Dear Mr. Kirkpatrick:

OneChicago, LLC (“OneChicago,” “OCX,” or the “Exchange”) appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) request for public comment on Regulation AT. OneChicago agrees with the Commission that the transition in the derivatives (and securities) markets from the manual, open-outcry method of trading to highly automated trading may present unique risks to the safety and integrity of financial markets. OneChicago believes that this transition to a more automated environment has been a net positive for investors and end users. Nonetheless, we are not unmindful of the fact that past technological disruptions in both the securities and derivatives industries have prompted renewed concerns about the safety and security of these trading systems.

As a general matter, OneChicago agrees with many of the Commission’s proposed regulations relating to designated contract market (“DCM”) risk controls. We were pleased to find that the CFTC has taken a mostly principles-based approach to the proposed risk controls requirements, and that the CFTC has permitted DCMs discretion in the design of these controls and the parameters used to set the controls. However, as a guiding principle, OneChicago believes it is important for the Commission to consider the differences between the various DCMs, and how the proposed risk controls should be applied in each market.

OneChicago, for example, is unlike other DCMs in that the primary use of our product is not hedging, risk transfer, price discovery, or speculation, nor do our products attract high-frequency or low-latency trading activity. Rather, our products—single stock futures (“SSFs”)—provide pure economic (*i.e.*, delta-one) substitution for the underlying equity in the same way an equity total return swap (“TRS”) would in the over-the-counter (“OTC”) market. SSFs and equity TRSs are the only delta-one equity derivatives, and as such, lend themselves to equity financing transactions such as securities lending and (equity) repurchase and reverse repurchase

agreements. These financing transactions require the use of delta-one derivatives because a delta of anything other than one would change the participants' risk of loss or opportunity for gain in the underlying security, which would make the transaction a risk transaction rather than a financing transaction. Moreover, just as in the case of OTC trading in equity TRSs, one party to an SSF is generally financing its counterparty's exposure by pre-hedging the risk of the underlying equity and offsetting the risk by selling/buying the SSF to/from the counterparty. The only variable price component is the interest rate at which one party is willing to extend that financing.

These financing decisions are unlike risk transactions in that they are not made in sub-second or low-latency environments. As a result, transactions on OneChicago occur infrequently, but with large notional values per transaction. The various DCMs provide different trading environments that are each tailored to the type of market activity the DCM wants to promote. These differences are critical because a one-size-fits-all approach to required risk controls would be ineffective and inefficient in making our markets safer. Therefore, although OneChicago agrees with the majority of the proposed regulations, the Commission must allow DCMs wide discretion in how to best implement those regulations, and in some cases exempt a DCM from certain regulations that provide no value for that DCM's market participants. With these considerations in mind, OneChicago offers the below comments on select areas of Regulation AT.

### **Risk Controls for Trading – Direct Electronic Access Provided by DCMs**

OneChicago generally supports the Commission's proposed risk controls for market participants accessing the Exchange via direct electronic access, and provides the following comments:

#### *Maximum Execution Frequency Per Unit Time*

DCMs should be provided flexibility with regard to how to impose the maximum execution frequency per unit time risk control. Specifically, DCMs should be permitted to customize this risk control to ensure minimum interference with the matching algorithm architecture, as these risk controls might interact with various DCM trading platforms differently. For example, a maximum execution frequency might raise questions regarding how the risk control interacts with price-time priority matching logic. Consider the following example:

1. Participant A has a 1,000 lot sell limit order in ABC1D resting at \$35.54. Participant A's maximum execution frequency per second is 10 executions.
2. Participant B has a 20 lot sell limit order in ABC1D also resting at \$35.54, but entered its order later than Participant A, and therefore is behind Participant A in priority.
3. 12 participants (C through N) each enter 1 lot buy limit orders in ABC1D at \$35.54 every 250 milliseconds, sending in new 1 lot buy limit orders at the same price each time each participant receives an execution message. Participants C through N each also have a 10 execution per second limit.

4. Individually, Participants C through N will not reach their 10 execution per second limit, because each only receives 4 executions per second.<sup>1</sup>
5. Participant A, however, will trigger the maximum execution frequency limit because its 1,000 lot sell order is being hit more than 10 times per second.

In this example, Participant A has crossed its maximum execution frequency limit due to the actions of other market participants. An exchange confronted with this scenario would have to determine whether to program its match engine logic to either (a) wait for Participant A to come back into compliance (after a cooling off period or reconnect, for example), forcing Participant B and every other participant in the queue behind Participant A to wait, even though there are bids and offers that should be matched, or (b) violate the principle of price-time priority and allow the rest of the participants behind Participant A to begin to have their orders filled (in essence, to “jump ahead” of Participant A in the queue). Similarly, should a market participant who crosses the maximum frequency threshold due to a series of new orders being executed be treated the same as a market participant who crosses the threshold due to one order being executed by multiple counterparties (like Participant A in the example above)?

Although these are just examples that might not apply to all DCMs, they illustrate the fact that each DCM will be confronted with decisions regarding how to best implement the risk controls. OneChicago encourages the Commission to grant DCMs broad flexibility to program their controls in ways that make sense for each unique market.

#### *Order Price Parameters*

Order price parameters (or “price banding”) pose problems for markets with products that trade infrequently. For products that are not deeply liquid, price bands may do more harm than good, because they may prohibit bona fide transactions that do not fall within the pre-determined price band parameters. As such, price bands would require constant readjustment and widening, rendering them mostly useless. OneChicago requests that the Commission provide an exemption to the order price parameters requirement for products that trade below a minimum frequency per specified unit of time.

#### *Maximum Order Size Limits*

Rather than require DCMs to impose maximum order size limits, the Commission should require maximum notional value limits per order. Using notional values provides a more accurate assessment of an order’s potential market impact because of the wide range of prices for products traded on DCMs. For example, SSFs currently listed on OneChicago range in price from approximately \$2.00 to over \$1,000. Numerical order size limits would not truly capture the risk that may be created by an order for each product, and could unintentionally permit orders for certain products that carry an extremely large notional value if executed. Therefore, using notional value rather than numerical quantity for order size limits would allow for a more accurate risk assessment of incoming orders.

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<sup>1</sup> OneChicago notes that market participants on the Exchange don’t generally trade in sub-second latencies. We are raising this issue as an example of one way the maximum execution frequency risk control can interact with a trading platform’s match engine. This example may be more relevant to low latency exchanges, or exchanges or futures commission merchants (“FCMs”) that offer “iceberg” orders.

### *Granularity of Risk Controls*

Proposed § 38.255(b)(1)(ii) requires that pre trade risk controls established by DCMs must enable the clearing member FCM to set the controls at several levels (including AT Person, product, and account number). OneChicago opposes this requirement. DCMs should be afforded the flexibility to determine which level these controls should apply to, and should not be required to apply or even offer the controls at all of these levels. Requiring controls at each of these levels imposes operational hurdles unique to different DCMs. For example, OneChicago lists futures contracts on over 1,500 unique securities, representing 11,680 tradeable instruments. Requiring risk controls for each different product or tradeable instrument would impose substantial burdens on our trading platform, and may in fact increase the possibility of a disruption event. Given this, the risk of implementation would be greater than the potential benefit of requiring risk controls at each of these levels.

Furthermore unlike other DCMs in which listed futures contracts differ widely in their underlying products but trade on the same exchange (*e.g.*, grains and U.S. treasuries), all of OneChicago's products are identical in that they all overlay securities listed on U.S. securities exchanges. That each SSF overlays a different issuer is immaterial for risk control purposes. As far as risk controls are concerned, futures overlaying Netflix, Inc. and Facebook, Inc. are functionally identical, whereas soybean futures and 10-year Treasury note futures are clearly not. Therefore, a product-based granularity requirement might make sense for other DCMs, but would not for OneChicago's SSF products.<sup>2</sup>

### **Disclosure and Transparency in DCM Trade Matching Systems**

OneChicago supports the Commissions proposed requirement that DCMs disclose material attributes regarding their trade matching systems. Recently, a growing number of regulators and market participants have expressed concern regarding the fairness of market structure in both the equities and futures industry. OneChicago shares these concerns, and believes that an exchange's primary purpose is to match buyers and sellers who are naturally dislocated by time and space. In support of that guiding principle, OneChicago's matching platform only accepts limit orders and operates in strict price-time priority. We believe this structure allows our market participants to transact fairly and equitably. We also believe that an exchange's disclosure of its match engine architecture bolsters its credibility and demonstrates to market participants that all users are transacting on a level playing field. Regarding the proposed disclosure requirements in

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<sup>2</sup> OneChicago notes that it has implemented a "Restricted List" option in its OCX.RiskMan software. This functionality permits clearing FCMs to restrict certain users (or groups of users) from entering orders or reporting bilateral trades in futures overlaying securities that may be impermissible for the user to trade (for example, an investment bank might restrict its traders from trading futures overlaying an issuer undergoing a merger or acquisition which the investment bank is the adviser for). While we do not think a restricted list functionality is necessarily applicable for all (or even any other) DCMs, it is certainly relevant to OneChicago's market participants. As you can see, DCMs differ in the type of risk controls that are most suitable for each exchange. As a result, the Commission should permit broad flexibility in allowing DCMs to determine the types of risk controls necessary on each exchange.

§ 38.401, OneChicago recommends that the Commission provide a sample list of items that might be considered material attributes. This would help ensure that DCMs do not underreport any attributes simply due to a differing interpretation of that fairly vague term.

### **Pre-Trade and Other Risk Controls at DCMs**

OneChicago agrees with and supports the Commission's proposal with regard to risk controls that apply to all market participants. OneChicago appreciates the Commission's grant of flexibility to DCMs with regard to how to apply these risk controls, specifically with regard to DCM's choice in determining the level of granularity to which the pre-trade risk controls apply. OneChicago believes that this discretion should be extended to risk controls required by proposed § 38.255(b) as well. Since the risk controls required by proposed § 40.20 apply to all access methods, and not just direct electronic access, OneChicago requests that the Commission permit DCMs reasonable discretion in determining how to apply the risk controls to FCMs providing access to thousands of customers through one "gateway." Specifically, it would be incredibly burdensome for an exchange to require individual controls for each retail customer accessing the DCM through the FCM's systems. In such a case, it should be permissible for a DCM to establish risk controls at the FCM level (for example, a maximum order message frequency for all activity from that FCM), and then allow the FCM to determine how to divide that access among its customers.

### **DCM Test Environments for AT Persons**

As stated in the Commission's proposal, most DCMs currently provide a test environment to allow market participants to test the operation of their trading systems. We agree that these test environments are a useful tool to conduct conformance testing, and ensuring that market participants' systems operate as expected. OneChicago agrees with the requirement that test environments should enable AT Persons to conduct conformance testing of their Algorithmic Trading systems to verify compliance with pre-trade risk controls.

OneChicago strongly disagrees, however, that DCMs' test environments must completely simulate production trading by including historical transaction, order and message data. As described above, transactions on OneChicago occur intermittently throughout the trading session, but each trade typically represents a large notional value. Most market participants access OneChicago via an Exchange-provided front-end GUI. Accordingly, there is no benefit to providing a full production environment when the majority of market participants will not utilize such an environment to test algorithmic trading.

This requirement imposes an unreasonable expense on small DCMs like OneChicago in which algorithmic trading is fairly uncommon. The expense of creating a fully-enabled simulation of the production trading environment can force a DCM out of business or create an unreasonably high barrier to entry. We propose that the Commission establish a de minimis exception for small DCMs based on either (1) number of trades per day, or (2) frequency of trades per day. Alternatively, OneChicago proposes that the CFTC permit DCMs to use production environments for test purposes on weekends (for those exchanges that close on weekends) or to

use disaster recovery environments during non-D/R conditions (for those non-critical financial markets that are not required to satisfy the same-day recovery requirement).

### **DCM Review of Compliance Reports by AT Persons and Clearing FCMs**

OneChicago opposes the requirement established by proposed §40.22(c) that DCMs establish a yearly program for reviewing AT Person and FCM reports related to compliance with Regulation AT. While it is important for DCMs to have the authority to request information relating to Regulation AT from AT Persons and FCMs, markets will not benefit from DCMs reviewing a yearly report prepared by these entities. It is not clear to what level DCMs will be required to review these reports, or on what basis a determination to take action must be made. According to the Commission's release, a DCM's program to review these reports:

. . . must include measures by the DCM reasonably designed to identify and remediate any insufficient mechanisms, policies and procedures described in such reports, including identification and remediation of any inadequate quantitative settings or calibrations of pre-trade risk controls required of AT Persons pursuant to § 1.80(a).

These instructions are vague and do not offer DCMs a sense of to what extent they will be responsible for the way an AT Person sets or calibrates its risk controls. If a DCM reviews an AT Person's yearly report and concludes that the AT Person has adequately calibrated its risk controls, will the DCM be liable if the AT Person later experiences a disruption arising from an incorrect calibration of its risk controls? Furthermore, what would be considered appropriate remediation of any deficiency found in an AT Person or FCM report? Are DCMs to impose monetary fines, or perhaps even suspend access until deficiencies are addressed? Rather than create more administrative or clerical work for DCMs, the Commission should (1) permit DCMs to rely on attestations by FCMs and AT Persons that their risk controls are adequately set and calibrated, and (2) allow DCMs to be responsible for setting maximum limits for AT Persons, under which the AT Person could set its own limits.

For example, DCMs can be required to permit a range of order message frequencies for AT Persons, and then allow the AT Person to set its own maximum within that range. A DCM might determine that a particular AT Person should be capped at a maximum of 6,000 messages per second. The AT Person would then have the ability to actually cap its maximum messages per second threshold at any rate between 1–6000 messages per second. In this way a DCM may inform an AT Person of the maximum setting the DCM would deem appropriate for that AT Person, and the AT Person would then be able to determine where its actual cap should be within the range provided by the DCM.

Furthermore, OneChicago finds that the ad-hoc reviews permitted by proposed § 40.22(e) are sufficient (indeed, preferable) when compared to the yearly reviews required by § 40.22(c). It makes more sense for DCMs to work with FCMs and AT Persons in initially setting risk controls and requesting information on an as-needed basis when issues arise, rather than to require DCMs to collect and analyze dozens or hundreds of reports yearly. The annual report requirement simply creates more administrative or clerical work, with no corresponding benefit.

## Self-Trade Prevention

OneChicago generally supports the Commission's proposed regulations relating to DCM self-trade prevention tools. OneChicago is concerned, however, that proposed regulation § 40.23(d) relating to DCMs publishing self-trade statistics on their websites will require DCMs to analyze, collect, and display statistics that do not offer any value to the DCM's market participants. Specifically, proposed § 40.23(d) requires that for each product and expiration month traded in a particular quarter, the DCM must display the following information on its public web site:

- (i) The percentage of trades in such product including all expiration months that represent self-trading approved by the designated contract market, expressed as a percentage of all trades in such product and expiration month;
- (ii) The percentage of volume of trading in such product including all expiration months that represents self-trading approved by the designated contract market, expressed as a percentage of all volume in such product and expiration month; and
- (iii) The ratio of orders in such product and expiration month whose matching was prevented by self-trade prevention tools, expressed as a ratio of all trades in such product and expiration month.

As described above, OneChicago's markets fundamentally differ from those described in the Commission's proposal in which self-trading in a particular contract may reach as high as 10 percent of all trades in that contract on a given day. Because market participants don't typically trade OneChicago's SSFs via algorithmic trading, it is unlikely for self-trades (other than a handful of permitted self-trades pursuant to proposed § 40.23(b)) to occur on OneChicago's central limit order book. As such, we do not find the items required by proposed § 40.23(d)(i) and (ii) above to be particularly useful to our market participant because out of thousands of listed products, we would typically expect to see a dozen or so with approved self-trades in any specific quarter.

Furthermore, because OneChicago typically has relatively few but large notional value trades per day, and because the Exchange lists so many products for trading, the statistics required by § 40.23(d)(i) and (ii) may be unnecessarily misleading. For example, consider a scenario in which in a particular quarter a market participant executes a permitted self-trade in IBM1D for 35 contracts, and that quarter there are only 7 other trades in that product for 1 contract each. Our required quarterly statistics would indicate that (1) 12.5% (1/8) of all trades in that product are self-trades, and (2) 83% (35/42) of all volume in that product is the result of self-trades. Alternatively, consider a scenario in which in a particular quarter a market participant executes a permitted self-trade in BAC1D for 5 contracts, and that quarter there is only 1 other trade in that product, which happens to be a 4,000 contract spread trade. Our required quarterly statistics would indicate that (1) 50% (1/2) of all trades in that product are self-trades, and (2) 0.125% (5/4005) of all volume in that product is the result of self-trades. Essentially, in any product with less than a certain number of unique trades, the statistics might be misleading and confusing to our market participants.

These statistics would not provide our market participants any value, and they would not inform any market participant's trading decisions in any way. Therefore, the Commission's proposed requirements under § 40.23(d)(i) and (ii) represent a cost with no benefit, as OneChicago would have to expend new resources to either (1) code new software to generate the data and automatically push it to the Exchange's website, or (2) have an employee manually gather the data for any affected products and then post them to the website. In either case, the CFTC has essentially mandated that the Exchange conduct busy work for no gain to its market participants.

Finally, it is not clear to OneChicago what the purpose of the information required by proposed § 40.23(d)(iii) might be. Whether an exchange's self-trade prevention tools prevented 1%, 10%, or 99% of orders in a particular product from self-trading would not be material to a market participant in making its decision to buy or sell that particular product.

In sum, OneChicago supports the use of self-trade prevention tools by DCMs. We believe these tools will in fact help to prevent self-trades. We do not, however, support the Commission's proposed requirement that all DCMs post self-trade statistics on their web sites. It is important for the Commission to recognize the differences in how various futures products trade, and how those differences might render unnecessary the proposed statistics under § 40.23(d). Insofar as the Commission determines that these statistics are relevant to other markets, the Commission should require those DCMs to publish these statistics, but provide an exemption for markets for which such statistics are not relevant or offer no value.

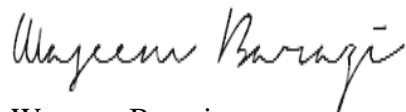
### **DCM Market Maker and Trading Incentive Programs**

OneChicago supports the Commission's proposed regulations relating to DCM market maker and trading incentive programs. The Exchange believes transparency and disclosure are the best mechanisms to safeguard against any abusive practices that may result from such programs.

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OneChicago sincerely appreciates the opportunity to comment on the proposal, and would like to make itself available to provide any further input the Commission may request regarding the proposal. OneChicago looks forward to working with the Commission to address the issues described above. If you have any questions or comments regarding this submission, please feel free to contact me at any time by phone at (312) 883-3441 or through e-mail at [wbarazi@onechicago.com](mailto:wbarazi@onechicago.com).

Respectfully Submitted,



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