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FINAL

March 16, 2016

Christopher Kirkpatrick, Secretary
Commodity Futures Trading Commission
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Re: Comments on Commodity Futures Trading Commission’s Notice of Proposed Rulemaking: Regulation Automated Trading, 80 FedReg78824, RIN 3038-AD52, published on December 17, 2015 (“Regulation AT”)

Dear Mr. Kirkpatrick:

On December 17, 2015, the Commodity Futures Trading Commission (“Commission” or “CFTC”) published the above-captioned Regulation AT as a notice of proposed rulemaking (“NOPR”). As described in this NOPR, Regulation AT “seeks to update Commission rules in response to the evolution from pit trading to electronic trading [and proposes to] adopt a comprehensive approach to reducing risk and increasing transparency in automated trading.”¹ The International Energy Credit Association (“IECA”) respectfully provides these comments in response to the request for public comment set forth in the Commission’s proposed Regulation AT.

Following the passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (“Dodd-Frank Act”) and its amendments to the Commodity Exchange Act (“CEA”), the IECA has filed numerous comments with the Commission seeking to protect the rights and advance the interests of the commercial end-user community that makes up the majority of its membership. Many of the IECA’s members are representatives of small to large physical energy businesses that rely on futures contracts and swaps to mitigate and manage (*i.e.*, hedge) the risks of energy commodity price volatility, which affects their fundamental mission of providing safe, reliable, and reasonably priced energy commodities that US businesses and consumers require for our economy and our livelihood.

¹ 80 Fed.Reg. 78824 at p. 78824.



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By these comments, the IECA wishes to endorse, support and commend to the Commission the comments on the Regulation AT submitted jointly by The Commercial Energy Working Group and the Commodity Markets Council (“Commercial Alliance Comments”), which were submitted to the Commission earlier today on March 16, 2016.

By these comments, the IECA also wishes to emphasize the following additional concerns related to the Commission’s request for comments about whether the Commission should broaden the scope of persons required to register as floor traders in the future, even if those persons do not engage in algorithmic trading.

As noticed to the public by the Commission, the proposed Regulation AT is intended to enhance the regulatory regime for, and address the risks of, automated trading on Designated Contract Markets (“DCMs”).² The NOPR explains that :

Malfunctioning or incorrectly deployed algorithms deploying erroneous messages to trading venues can significantly impact markets and market participants. The speed at which trading occurs can magnify the harm caused by a malfunctioning system, for example, in driving unwarranted price changes. The proposed definitions work in conjunction with proposed regulations requiring certain risk controls and other measures and are intended to describe the types of market disruptions, regulatory violations, or other events that Regulation AT is designed to prevent or mitigate.³

The NOPR then provides several examples of substantial market disruptions that arose from automated trading systems with flawed algorithmic designs or malfunctions, including the Flash Crash of May 2010.⁴

IECA appreciates and shares the Commission’s concerns about these substantial market disruptions resulting from algorithmic trading. We recognize that reasonably-tailored regulatory reforms may be warranted to prevent or mitigate the adverse impacts of such substantial market disruptions resulting from algorithmic trading. IECA is concerned, however, with the NOPR’s suggestion that the Commission might impose new regulatory burdens and costs on commercial energy market participants without any rational nexus whatsoever to algorithmic trading. IECA therefore is responding to this question posed in the NOPR:

25. In the alternative, should the Commission broaden the registration requirements in proposed § 1.3(x)(3)(ii) so that all persons trading on a contract

² 80 Fed. Reg. at pp. 78824, 78838, 78841.

³ 80 Fed. Reg. at p. 78841.

⁴ 80 Fed. Reg. at p. 78837.



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market through DEA are required to register, instead of only those who are engaged in Algorithmic Trading?⁵

IECA respectfully submits that the Commission should not broaden the registration requirements proposed in the NOPR to require all persons who trade on a DCM through Direct Electronic Access (DEA), including all commercial end users which are merely trading for their own account, to register with the CFTC as floor traders.

Simply because commercial energy market participants trade on a DCM through DEA, it does not follow that such commercial energy market participants pose the type of risks identified in the NOPR that led, for example, to the Flash Crash of May 2010 or the other disruptive events resulting from automated trading systems.⁶ If a commercial energy market participant does not use pre-programed computer algorithms to automatically initiate, modify or cancel trades on DCMs (*i.e.*, without human intervention or decision making), then it does not pose a threat that design flaws or malfunctions of those algorithms will harm market integrity.

It also is not necessary to require such commercial market participants to register as floor traders to effectuate the purposes of the CEA to deter or detect price manipulation or other disruptions to market integrity⁷ because the Commission already has the authority to bring enforcement actions against any traders, whether registered or not, which engage in unlawful disruptive trading practices,⁸ manipulative and deceptive devices,⁹ or price manipulation.¹⁰ Moreover, commercial market participants with DEA trading privileges must follow the rules of the DCM, which can be enforced by the DCM,¹¹ and the DCMs can implement controls that are already in place to halt transactions that would disrupt or manipulate their markets.¹²

IECA respectfully submits that it would be arbitrary and capricious and contrary to law and sound public policy if the Commission were to adopt such an overly broad registration requirement. As recognized by the Commission, markets operated by DCMs provide valuable risk mitigation services for numerous physical commodities businesses, including producers and consumers of energy.¹³ If the Commission were to now require

⁵ 80 Fed. Reg. at p. 78847.

⁶ 80 Fed. Reg. at p. 78837.

⁷ 80 Fed. Reg. at p. 78847.

⁸ 7 U.S.C. § 6c (5). *See also* CFTC Interpretive Guidance and Policy Statement, Antidisruptive Practices Authority, 78 Fed. Reg. 31890 (May 28, 2013).

⁹ 7 U.S.C. § 9(1); 17 C.F.R. §180.1.

¹⁰ 7 U.S.C. § 9(3); 17 C.F.R. § 180.2.

¹¹ 7 U.S.C. § 7(d)(13).

¹² 7 U.S.C. § 7(d)(4); 17 C.F.R. § 38.255 .

¹³ 80 Fed. Reg. at p. 78826.

commercial energy market participants, which are simply manually entering trades for their own accounts through the DEA provided by DCMs, to register as floor traders, it would drive those participants away from DCMs, on which transactions are cleared to minimize risks to financial stability, and discourage them from using the valuable risk mitigation tools offered by DCMs. The regulatory burdens and consequences to a commercial energy market participant arising from registration with the CFTC would make continuing to use such DEA to DCMs too great a price to pay.

For example, if a commercial energy market participant is required to register as a floor trader, simply because it manually enters trades for its own account on a DCM using DEA, it would be subject to more onerous recordkeeping burdens that the Commission recently found were not warranted on commercial end users under Regulation 1.35, including requirements to maintain pre-trade communications records.¹⁴ Even more troubling, the commercial energy market participant would be transformed into a “financial end user” under the CFTC’s final rule on margin requirements for uncleared swaps.¹⁵ As a result, the commercial energy market participant would be subject to margin requirements under the Commission’s final rule on margin requirements. In addition, while there are different definitions of a “financial end user”¹⁶ and a “financial entity”¹⁷ under the CEA and CFTC regulations, IECA members are concerned that affixing the “financial” label to such commercial market participants could create confusion with respect to their regulatory compliance requirements, which could result in questions about their eligibility to elect the end user exception to the clearing requirement¹⁸ and questions about which counterparty bears the reporting obligation for swaps.¹⁹ These consequences may be unintended by the Commission, but, at least in the absence of clarification, they are of significant concern to commercial energy market participants.

IECA believes that the imposition of floor trader registration requirements on any commercial energy market participant, who is merely trading for its own account and does not use pre-programed computer algorithms to automatically initiate, modify or cancel trades on DCMs, is unwarranted and the costs of such regulation would outweigh the benefits.

¹⁴ Records of Commodity Interest and Related Cash or Forward Transactions, 80 Fed. Reg. 80247 (Dec. 24, 2015); 17 C.F.R. § 1.35 (a)(2).

¹⁵ Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016); 17 C.F.R. § 23.151 (defining financial end user to include a floor trader in subpart (1) (viii)).

¹⁶ 17 C.F.R. § 23.151.

¹⁷ 7 U.S.C. § 2(h)(7)(A)(i).

¹⁸ 7 U.S.C. § 2(h)(7)(C); 17 C.F.R. § 39.6(a)(1)(i).

¹⁹ 17 CFR § 45.8 (c).

Regarding the possibility of establishing a *de minimis* threshold, as is suggested by one of the questions raised in the NOPR,²⁰ the IECA is not eager to establish yet another *de minimis* threshold that will have to be applied to market participants. Nevertheless, if the Commission continues to propose a broad floor trader registration requirement on all market participants with DEA, then in that event the IECA would support the Commission establishing a *de minimis* threshold whereby commercial market participants, which do not trade a large volume of futures contracts, are excepted or exempted from such registration requirement. Such an exception or exemption is justified because commercial market participants, which do not trade a significant volume of futures contracts, do not have the capability to substantially disrupt the futures markets.

In accordance with fundamental due process principles and the requirement that agencies, such as the CFTC, provide notice and a meaningful opportunity for public comment before adopting new industry-wide rules,²¹ IECA also respectfully submits that a new NOPR would be needed that fleshes out the details of any proposal to require commercial energy market participants to register as floor traders, even if they do not engage in algorithmic trading, before the Commission proceeds any further.²²

The current cost/benefit analysis in the Regulation AT NOPR is insufficient to satisfy the Commission's obligations under Section 15(a) of the CEA, which requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the CEA. Section 15(a) further specifies that the costs and benefits must be evaluated in light of the following five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations.²³

The Commission's current cost/benefit analysis focuses exclusively on the regulatory burdens imposed on AT persons, which by definition is limited to persons engaged in algorithmic trading.²⁴ The Commission has not properly assessed the relative costs and benefits (if any) of broadening the floor trader registration requirement to all other persons with DEA which do not even engage in algorithmic trading. The

²⁰ 80 Fed. Reg. at p. 78859.

²¹ U.S. Const. amend. V; 5 U.S.C. § 553.

²² While the Commission asked for comments on this general concept, it did not propose any regulations that would require registration by traders with DEA that are not engaged in algorithmic trading. Instead, based on comments received in response to the Commission's prior Concept Release, many of which did not support registration, the Commission stated that it "is not proposing broad registration of proprietary traders at this time." 80 Fed. Reg. at 78915.

²³ 7 U.S.C. 19(a).

²⁴ See proposed definitions in § 1.3 (xxxx) and § 1.3 (x)(3)(i)(B)(ii), 80 Fed. Reg. at p. 78937.



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Commission's analyses under the Regulatory Flexibility Act and Paperwork Reduction Act are likewise flawed and insufficient to comply with those laws.

If the Commission were to take this unwarranted step, it would affect vastly more than just the estimated 100 proprietary trading firms engaged in algorithmic trading included in the CFTC's current analyses.²⁵ Indeed the Commission itself recognizes in the NOPR that over 95% of all on-exchange futures trading occurs on DCMs' electronic trade matching platforms²⁶ and, in today's modern age, DEA is commonly used to trade on those platforms. IECA members, which are commercial energy market participants, trade on DCMs using DEA and they are not reflected in the Commission's cost/benefit analysis.

If despite the fact that floor trader registration is unwarranted when a commercial energy market participant does not use pre-programmed computer algorithms to automatically initiate, modify or cancel trades on DCMs, the Commission nonetheless proceeds with its proposal to broaden the floor trader registration requirement, IECA also urges the Commission to give advance notice of the date on which this potential compliance obligation would take effect and to phase in compliance deadlines, consistent with the approach taken by the CFTC in other rulemaking orders significantly affecting commercial market participants.²⁷

Commercial energy market participants will need sufficient time to close their accounts and cease trading through DEA on DCMs and either make alternative arrangements to trade through a middleman broker (at a higher cost to the consumers they serve who will ultimately bear the brokerage fees) or bring themselves into compliance with the floor trader registration requirements, join the National Futures Association, train their employees on the new requirements, and alter their risk mitigation practices, IT and trade capture systems, recordkeeping, reporting and other compliance programs to deal with the potential regulatory fall out that is a domino effect of such registration.

The IECA also supports those who have requested that the Commission hold a public technical conference on its proposed Regulation AT and then allow the public to submit additional comments to the Commission following such a technical conference. Such a technical conference and comment period would allow the Commission to collect additional information about the consequences of its proposal to commercial end-users

²⁵ See, e.g., 80 Fed. Reg. at p.p. 78847, 78886-91, 78914-15, 78925.

²⁶ 80 Fed. Reg. at p. 78826.

²⁷ See, e.g., Swap Transaction Compliance and Implementation Schedule: Clearing Requirement Under Section 2(h) of the CEA, 77 Fed. Reg. 44441, at 44456 (July 30, 2012); 17 C.F.R. § 50.25; Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636, at 703-704 (Jan. 6, 2016); 17 C.F.R. § 23.161.



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who use DEA to DCMs, or who use DEA as a hosted solution through an FCM. In addition, such a technical conference could solicit information enabling the Commission to distinguish between: (i) DEA to trading, which does not use pre-programed computer algorithms to automatically initiate, modify or cancel trades on DCMs, from (ii) algorithmic trading which uses DEA to trading and pre-programed computer algorithms to automatically initiate, modify or cancel trades on DCMs. In this way, the Commission will be able to make a more informed decision as it attempts to protect the markets and market participants from the potentially detrimental impacts of automated trading, without unnecessarily burdening commercial market participants using DEA to DCMs that does not put markets at risk.

Forcing those commercial market participants to abandon the benefits of technology and revert to voice trading, in order to avoid the regulatory burdens of registration, should be seen as a step backward for the Commission not a step forward.

The IECA appreciates the opportunity to provide these comments and would welcome the opportunity to discuss these comments further should you require any further information.

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Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION

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