National Grain and Feed Association

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Chris Kirkpatrick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Notice of Proposed Rulemaking on Regulation Automated Trading (RIN 3038-AD52)

Dear Mr. Kirkpatrick:

The National Grain and Feed Association (NGFA) appreciates the opportunity to submit comments to the Commodity Futures Trading Commission (CFTC) on the Notice of Proposed Rulemaking on Regulation Automated Trading (Regulation AT). We believe a properly structured regulatory regime for automated trading firms and persons – and especially for high-frequency trading entities – is very important to maintain the integrity of futures markets and to help prevent abuses and undesirable outcomes for futures market performance.

The NGFA is comprised of more than 1,000 member firms nationwide operating more than 7,000 facilities that handle and process grains and oilseeds. Futures markets are the primary means of risk management for the industry; for that reason, we are keenly interested in the impacts of automated trading and high-frequency trading on grain and oilseed futures contracts. Above all else, the CFTC rulemaking should strive to preserve the price discovery and efficiency of risk management functions on which our industry has relied so heavily to manage business risk for decades. At the same time, the Commission needs to take extreme care to ensure that the rule does not ensnare commercial hedgers that are utilizing modest levels of technology to efficiently implement their hedging strategies and provide risk management services to U.S. agricultural producers.

Definition of Algorithmic Trading

Generally, the NGFA is supportive of the Commission's goals to reduce risk and increase transparency of the operations of entities involved in algorithmic trading. However, as with many regulatory proceedings, the devil is in the definitions. In this case, it is extremely important that the term "algorithmic trading" be correctly applied. We note in the proposed rule that algorithmic trading is defined as trading in a commodity interest on or subject to the rules of a DCM 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 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 contract market; provided, however, that <u>Algorithmic Trading does not include an order, modification, or order cancellation whose every parameter or attribute is manually entered into a front-end system by a natural person, with no further discretion by any computer system or algorithm, prior to its electronic submission for processing on or subject to the rules of a DCM</u>. (Emphasis added)

The NGFA does not believe it is the intention of the Commission to apply the "Algorithmic Trading" definition in an overly broad manner that would capture technology commonly used by commercial grain hedgers. For example:

- Auto-spreaders are routinely used software applications that allow a commercial grain hedger to enter a spread order – such as a March/May spread. The auto-spreader monitors the market and enters a bid in May when an offer in March matches the criteria initially entered in the software by a natural person. We

believe strongly such a transaction clearly does not meet the definition of algorithmic trading.

- Iceberg orders are another routinely used hedging strategy by commercial grain hedgers. As an example, a hedger enters a 500-contract buy order for December corn. A software application may show only a 10-contract bid until another market participant offers 10 contracts to sell. Then, the software shows another 10-contract bid continuing in like fashion until the 500-contract order is filled. Again, we believe strongly that such a transaction does not constitute algorithmic trading.

- Many grain businesses have developed systems that use programming logic to determine when to execute a hedge for a producer purchase contract. Once the offer is accepted, a futures-price hedge level is established that incorporates the basis price for the farmer's selected delivery point. The programming logic determines, based on changes to the basis differential, when a hedge order is entered and executed on the exchange. This is a system that has been developed to accurately and efficiently manage price offers and risk, and to provide good customer service to farmer customers.

- Some grain companies have developed systems to automatically route orders to a DCM for execution. The parameters around this execution can be controlled by a natural person, and the order originates with a natural person, but the execution can be decided by computers. For example, a firm may desire that all orders below a certain volume threshold be placed directly to the market at the point of execution with the farmer. The farmer sells grain, and the order to sell futures is routed within the firm to a central desk and then automatically routed to the DCM. The goal of this technology is to manage risk in real time. These orders do not fit the conventional view of "algo trading" but could be interpreted as such with proposed regulation. The alternative is to force a natural person to execute the trade to the DCM which is inefficient and increases risk.

In each of the examples above, a natural person enters parameters of the transaction, while computer software performs largely a monitoring or implementation function. However, the current definition could lead to confusion or differing interpretations. The NGFA strongly

submits that the final rule will need to establish a more clear line between technology that merely facilitates activity that has been manually entered by a natural person; and algorithmic trading technology that plays a more active and determinative role in the transaction. Failing to do so will subject virtually every commercial grain hedger (both large and small) to costly and unnecessary registration requirements.

Question 7: "The Commission, recognizing that natural person traders who manually enter orders also have the potential to cause market disruptions, is considering expanding the definition of Algorithmic Trading to encompass orders that are generated using algorithmic methods (e.g., an algorithm generates a buy or sell signal at a particular time), but are then manually entered into a front-end system by a natural person, who determines all aspects of the routing of the orders. Such order entry would not represent Algorithmic Trading under the currently proposed definition. The Commission requests comment on this proposed expansion of the definition of Algorithmic Trading, which the Commission may implement in the final rulemaking for Regulation AT. The Commission requests comment on the costs and benefits of this proposal, in addition to any other comments regarding the effectiveness of this proposal in terms of risk reduction."

NGFA Response: No, the definition of Algorithmic Trading should not be expanded. Per the discussion above concerning commonly used technologies among commercial grain hedgers, the expanded definition would appear to ensnare many commercial, traditional hedgers simply because they are utilizing computer technology – albeit at the direction of natural persons – to facilitate futures trades. Expanding the definition in this manner would dramatically broaden the scope of affected firms, with resulting registration requirements and other regulatory consequences and costs.

Registration Requirements

As noted in the proposal, the use of algorithmic trading systems (ATSs) has proliferated in futures markets in recent years: "Even in agricultural products, a category not typically associated with automation in recent years, ATSs were present in at least 38 percent of futures volume analyzed…in the aggregate, ATSs were present in over 60 percent of all futures volume traded across all products in the nearly two-year period that the Commission examined." According to a statement by Chairman Massad at the Nov. 24 public meeting at which

Regulation AT was approved for publication, roughly thirty-five percent of futures trading is done by traders that use direct electronic access but are not registered with the CFTC.

Question 23: Should firms operating Algorithmic Trading systems in CFTC-regulated markets, but not otherwise registered with the Commission, be required to register with the CFTC?

NGFA Response: The NGFA does not believe creating a new class of registrant is the optimal solution. This path will increase the burden on the already-scarce resources of the CFTC and do little to reduce risk and protect the public interest. In addition, it will unduly increase the regulatory burden on the new registrants as additional regulatory requirements come with registration. The exchanges (DCMs) that provide the direct electronic access that defines this new class of market participant are in the best position to regulate their activity and protect the integrity of the market and public interest.

Question 25: In the alternative, should the Commission broaden the registration requirements in proposed Section 1.3(x)(3)(ii) so that all persons trading on a contract market through DEA are required to register, instead of only those who are engaged in Algorithmic Trading?

NGFA Response: No. Such an approach would needlessly apply the same registration standard to non-algorithmic traders as to algorithmic traders, action that would seem to be beyond the reasonable scope of Regulation AT. This seems to the NGFA an overly broad and unnecessary response that could result in commercial hedgers, who have invested in direct electronic access simply to attempt to respond to the speed of today's marketplace and do not meet the AT Person definition, being swept up in the same regulatory net with unregistered algorithmic traders.

Pre-Trade and Risk Controls for AT Persons

The NGFA generally is supportive of the Commission's approach in establishing new pre-trade risk controls, order cancellation systems and other measures designed to prevent an Algorithmic Trading event. Recognizing the unique characteristics of particular markets and trading strategies, we concur that AT Persons should be provided flexibility in designing and implementing, under exchange and Commission oversight, pre-trade and risk controls reasonably designed to prevent an Algorithmic Trading event. As proposed by the Commission, risk controls implemented by AT Persons should include maximum AT order message and execution frequencies; order price parameters and maximum order size limits; order management controls;

controls to immediately disengage Algorithmic Trading, cancel resting orders, and kill switches, each reasonably designed to prevent an Algorithmic Trading event; notification of Algorithmic Trading; and self-trade prevention tools.

Standards for Development, Testing, Monitoring and Compliance of Algorithmic Trading Systems

The NGFA concurs with the importance of AT Persons establishing policies and procedures for development and testing of Algorithmic Trading systems on each trading platform on which they will be used. The NGFA also concurs that a principles-based approach, rather than prescriptive regulation, is appropriate.

DCM Trade Matching Systems

The NGFA recommends full transparency of the design and operations of DCMs' electronic order matching platforms. Market participants need readily accessible and timely access in plain language to information that impacts their market experience.

Question 70: "…Should the Commission revise the final rule so that it only applies to latencies within a platform and how a self-trade prevention tool determines whether to cancel an order?"

NGFA Response: No. The NGFA supports the proposed rule in that "all known attributes" of an electronic matching platform that materially affect the time, priority, price or quantity of execution of market participant order messages, or the ability to cancel, modify or limit display of, market participant order messages, should be disclosed.

Question 71: "…Would a narrative description of attributes be preferable, including a description of how the attributes might affect market participant orders under different market conditions…"

NGFA Response: Yes, in addition to statistics on latencies and other attributes, a narrative description would be extremely useful for market participants.

Question 76: "The Commission proposes that DCMs provide a description of the relevant material attributes in a single document "disclosed prominently and clearly" on the exchange's

Web site. The Commission also proposes that this document be written in "plain English" to allow market participants, even those not technically proficient, to understand the attributes described. Would these requirements be practical and help market participants locate and understand the information provided?"

NGFA Response: Yes, disclosure and a clear description of relevant attributes would be valuable to market participants.

Self-Trade Prevention

The NGFA supports the Commission's approach of implementing a flexible self-trading prevention regime by exchanges to screen out unintentional self-trading. The burden of monitoring self-trades should not fall on the individual firm.
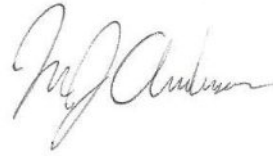
Market Maker and Trading Incentive Programs

The NGFA believes that DCMs should provide transparency around market maker and trading incentive programs. To that end, we are supportive of the Commission's concepts that information regarding such programs should be easily accessible on DCMs' web sites and that such programs should not provide payments or incentives for trading activity between accounts under common ownership.

Concerns About Cost of Implementation

With passage and implementation of Dodd-Frank and other new rules, regulatory costs of DCMs and FCMs have increased significantly. The NGFA approaches Regulation AT and other regulatory proceedings with an eye toward implementation costs and ripple effects through the futures industry. Eventually, many such costs flow down to the end-user. We believe the transparency, reporting and risk controls of Regulation AT are beneficial on balance to commercial grain hedgers and other market participants. However, we urge the Commission to move toward a final rule cognizant of the fact that the costs of this rule will impact transaction costs for a broad range of market participants. Where possible, the NGFA supports applying Regulation AT in a manner that will allow some flexibility to help minimize unnecessary costs to the system.

Sincerely,

MJ Anderson, Chair
Risk Management Committee