

June 24, 2016

VIA ONLINE SUBMISSION

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

**Re: Reopening of Comment Period re Regulation Automated Trading (“Regulation AT”), RIN 3038-AD52**

Dear Mr. Kirkpatrick:

CME Group Inc. (“CME Group”)<sup>1</sup> appreciates this opportunity to provide additional comments on specific elements of the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) proposed rulemaking regarding “Regulation Automated Trading” (“Proposal” or “Regulation AT”).<sup>2</sup> On March 16, 2016, CME Group submitted a comment letter in response to the Proposal (“First Regulation AT Comment Letter”).<sup>3</sup> Since then, CME Group has continued to review the Proposal and to engage with market participants and the Commission, including at the Commission staff roundtable held on June 10, 2016 (“Roundtable”). In this letter, CME Group reiterates some of the issues we raised in our First Regulation AT Comment Letter and elaborates upon topics discussed at the Roundtable.<sup>4</sup>

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<sup>1</sup> CME Group is the parent of four U.S.-based designated contract markets (“DCMs”): Chicago Mercantile Exchange Inc. (“CME”), Board of Trade of the City of Chicago, Inc. (“CBOT”), New York Mercantile Exchange, Inc. (“NYMEX”) and the Commodity Exchange, Inc. (“COMEX”) (collectively, the “CME Group Exchanges” or “Exchanges”). These Exchanges offer a wide range of products available across all major asset classes, including: futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, and agricultural commodities. The CME Group’s Exchanges serve the hedging, risk management and trading needs of our global customer base by facilitating transactions through the CME Globex® electronic trading platform, our open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions. CME Group also operates CME Clearing, a derivatives clearing organization (“DCO”) which provides clearing and settlement services for exchange-traded and over-the-counter derivatives transactions as well as a swap execution facility (“SEF”).

<sup>2</sup> See Regulation Automated Trading, 80 Fed. Reg. 78824 (Dec. 17, 2015); see also Public Staff Roundtable on Elements of Regulation Automated Trading; Reopening of Comment Period, 81 Fed. Reg. 36484 (June 7, 2016).

<sup>3</sup> See Letter from CME Group to CFTC re Notice of Proposed Rulemaking on Regulation Automated Trading (RIN 3038-AD52), dated March 16, 2016.

<sup>4</sup> We have participated in the Futures Industry Association (“FIA”) working group on Regulation AT and are supportive of the efforts and dialogue of the FIA coalition. The positions we articulate in this letter are generally consistent with the FIA’s comment letter filed in response to the reopening of the comment period for Regulation AT.

CME Group is committed to protecting the integrity of our markets. CME Group’s ongoing self-regulatory efforts focus on the same goal as the Commission’s Proposal—reducing risks to market integrity from Algorithmic Trading.<sup>5</sup> We have as great a stake in this goal as the Commission; market integrity is essential to our business.

We share the Commission’s desire to have effective controls in place to protect our markets from disruptions caused by Algorithmic Trading. However, in order to achieve this mutual goal, we believe the Proposal needs to be substantially refined. We urge the CFTC to consider the changes suggested in our comment letters in order to enhance the current oversight and regulation of Algorithmic Trading.

CME Group believes that the Proposal contains unrealistic expectations regarding the role of DCMs. Regulation AT, as proposed, would require DCMs to “prevent” all Algorithmic Trading Disruptions<sup>6</sup> and Algorithmic Trading Compliance Issues<sup>7</sup>; this standard is both unreasonable and unworkable. The Proposal would also require DCMs to incur significant costs to review AT Persons’ (as defined in the Proposal) and clearing futures commission merchants’ (“FCM”) annual compliance reports, thereby assigning to DCMs a de facto role as a compliance officer of sorts for certain market participants—a role well beyond the market self-regulation Congress envisioned for DCMs, as reflected in the Core Principles it enacted in Section 5(d) of the Commodity Exchange Act (“CEA”).

In this letter, CME Group recommends that the Commission adopt rules that focus solely on mitigating the effects of Algorithmic Trading Disruptions. Consistent with this focus, we suggest revised definitions of “Direct Electronic Access” (“DEA”)<sup>8</sup> and “AT Person”<sup>9</sup> that would enable the CFTC to focus on the potential risks Algorithmic Trading might pose to our markets. We also describe how those definitions could fit into a framework that applies market risk controls which are reasonably designed to mitigate the effects of an Algorithmic Trading Disruption to all orders resulting from Algorithmic Trading.

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<sup>5</sup> As used herein, “Algorithmic Trading” has the meaning contained in section II.A, unless otherwise noted.

<sup>6</sup> As used herein, “Algorithmic Trading Disruption” has the meaning contained in the Proposal (except that the definition of “Algorithmic Trading” contained therein would have the meaning contained in section II.A of this letter).

<sup>7</sup> As used herein, “Algorithmic Trading Compliance Issue” has the meaning contained in the Proposal (except that the definition of “Algorithmic Trading” contained therein would have the meaning contained in section II.A of this letter).

<sup>8</sup> As used herein, “DEA” has the meaning contained in section I.D, unless otherwise noted.

<sup>9</sup> As used herein, “AT Person” has the meaning contained in section I.E, unless otherwise noted.

## I. CONCERNS WITH PROPOSAL

### A. Regulation AT should not require DCMs to prevent Algorithmic Trading Disruptions or Algorithmic Trading Compliance Issues.<sup>10</sup>

The Proposal appears to require DCMs to prevent Algorithmic Trading Disruptions. As the Chairman himself observed in the adopting release to the Proposal, no control—like no rule—can always prevent disruptions and other operational problems that may arise from Algorithmic Trading.<sup>11</sup> We agree. As a result, we believe the “prevent” standard is unachievable. Instead, we urge the Commission to adopt a standard that requires DCMs to implement tools to mitigate the effects of an Algorithmic Trading Disruption. Any final rule text and accompanying preamble should consistently articulate this achievable objective for DCMs.

Regulation AT also appears to require DCMs to prevent Algorithmic Trading Compliance Issues.<sup>12</sup> The Proposal would require DCMs to prevent an event that causes the Algorithmic Trading<sup>13</sup> of an AT Person<sup>14</sup> to operate in a manner that does not comply with the CEA or the rules and regulations thereunder, the rules of any DCM to which such AT Person submits orders through Algorithmic Trading, the rules of any registered futures association of which such AT Person is a member, the AT Person’s own internal requirements, or the requirements of the AT Person’s clearing member. We oppose this requirement for two main reasons. First, as discussed in subsection C below, we believe Regulation AT generally should not attempt to address Algorithmic Trading Compliance Issues, and should instead focus on deterring Algorithmic Trading Disruptions. Second, imposing this type of universal compliance obligation on DCMs is a fundamental departure from DCMs’ traditional self-regulatory role built upon adopting and enforcing rules. DCMs have never been asked before to guarantee the universal compliance of certain market participants because such a requirement would be unrealistic and unreasonable, let alone incredibly costly.

DCMs primarily detect and deter rule violations, including in areas of misconduct that implicate Algorithmic Trading. In that role, DCMs set rules covering a broad range of possible misconduct for all of their market participants to follow. DCMs also have effective systems in place to enforce those rules, as warranted. DCMs do not, however, act as compliance officers that prevent market participants from violating DCM rules. Requiring a DCM to prevent Algorithmic Trading Compliance Issues could complicate that DCM’s ability to perform its enforcement function for the following reason: any DCM enforcement action could be an implicit admission by the DCM that it failed to comply with its obligation to prevent an Algorithmic Trading Compliance Issue. Thus, the Commission should remove the requirement that DCMs prevent Algorithmic Trading Compliance Issues.

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<sup>10</sup> This section addresses Roundtable agenda item 3.

<sup>11</sup> See Proposal at 78943.

<sup>12</sup> See proposed § 40.20 (requiring a DCM to implement pre-trade and other risk controls reasonably designed to prevent an Algorithmic Trading Compliance Issue).

<sup>13</sup> As used in this sentence, the term “Algorithmic Trading” has the meaning contained in the Proposal.

<sup>14</sup> As used in this sentence, the term “AT Person” has the meaning contained in the Proposal.

B. Requiring DCMs to review and evaluate annual compliance reports, policies, and procedures and enforce compliance with Regulation AT, or any alternative DCM-based compliance regime, is unworkable and beyond the scope of a DCM's role.<sup>15</sup>

As we stated in our First Regulation AT Comment Letter, we believe the Commission's proposed requirement that AT Persons<sup>16</sup> and clearing FCMs prepare and submit extensive annual compliance reports to DCMs creates an unnecessary administrative burden on all parties involved without providing significant benefit to market integrity. There are many reasons that support removing this aspect of the Proposal. First, DCMs could never obtain the information about an AT Person's proprietary strategies, employees, traders, or Algorithmic Trading systems necessary to meaningfully assess the AT Person's compliance with Regulation AT. Furthermore, were it possible to obtain that information, this level of invasion by a DCM into an AT Person's business would be unprecedented and would provide a great incentive for an algorithmic trader to avoid AT Person status. Second, despite the absence of the necessary information, a DCM would seemingly be misperceived to be endorsing the policies, procedures, risk controls, and risk control parameters by remaining silent after receiving the compliance report. Third, the obligation to review and evaluate (1) annual compliance reports, policies, procedures, risk controls, and risk control parameters for each AT Person trading on one of the four Exchanges, and (2) annual compliance reports and programs for establishing and maintaining the required pre-trade risk controls for each clearing FCM that is a clearing member for an AT Person trading on one of the four Exchanges, would add significant costs to CME Group. CME Group cannot currently measure the costs of that burden given that it is unclear how many AT Persons and CME Group Exchange clearing members will be captured by the Commission's final regulation, nor is it clear what ultimate obligations the Commission will impose on AT Persons and CME Group Exchange clearing members that a DCM would be required to monitor and enforce.<sup>17</sup> However, as a completely new compliance burden, CME Group would estimate that the cost would be substantial with little corresponding benefit. Fourth, an AT Person that trades on multiple DCMs would be subject to duplicative and potentially conflicting supervision by each DCM; similarly, a clearing FCM that is a clearing member for one or more AT Persons that trade on multiple DCMs would be subject to duplicative and potentially conflicting supervision by each DCM. And finally, the compliance reports are a summary look-back at the prior year and would do little to mitigate any imminent disruption.

As the Commission is well aware, the Exchanges rigorously scrutinize trading on our markets each day pursuant to CME Group's commitment to protecting the integrity of our markets in compliance

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<sup>15</sup> This section addresses Roundtable agenda item 3.

<sup>16</sup> As used in this paragraph, the term "AT Person" has the meaning contained in the Proposal.

<sup>17</sup> In our First Regulation AT Comment Letter, CME Group did estimate the costs to DCMs of complying with the Proposal's requirement that DCMs periodically review AT Person (as defined in the Proposal) and clearing FCM compliance reports and books and records and to identify and remediate any insufficient mechanisms, policies, and procedures discovered. At the Roundtable, however, Commission staff discussed alternatives to the AT Person definition that could affect the number of AT Persons and additional burdens that Regulation AT might impose upon DCMs, including a "DCM-based compliance regime." These changes would affect CME Group's estimated costs of complying with Regulation AT. Without more precision from the Commission regarding the alternatives, CME Group cannot estimate the costs to DCMs of the alternatives discussed at the Roundtable.

with existing DCM core principle requirements. These market monitoring processes routinely review market events and conduct which might be considered disruptive. When an Exchange investigates such activity, it will review a participant's controls and its policies and procedures. If an Exchange finds that a participant has violated Exchange rules, or has acted improperly, the Exchange takes appropriate disciplinary action.

To the extent verification of an AT Person's compliance is needed, we believe the clearing member who granted DEA to the AT Person ("gatekeeper clearing member") would be better positioned to accept a certification of compliance from its customer as a condition precedent to granting that customer DEA. FCMs have obligations to know their customers. Each person interested in using DEA (and thus, becoming an AT Person) must be authorized to do so by its gatekeeper clearing member. In fact, at the Roundtable, clearing members discussed the robust due diligence they perform before allowing a customer to use DEA. Due to their extensive know-your-customer obligations and onboarding programs, gatekeeper clearing members are in the best position to receive an appropriate pre-access certification of compliance from their AT Person customers. In turn, the AT Person is in the best position to evaluate and monitor its Algorithmic Trading. The certification process will help to ensure that the AT Person is aware of and has complied (or will comply) with its responsibilities under Regulation AT. Furthermore, this certification would be available to DCMs investigating a market participant's Algorithmic Trading.

CME Group also believes that the DCM-based compliance regime that Commission staff briefly mentioned at the Roundtable is inadvisable and unworkable. If the Commission believes it is not sufficiently resourced to monitor all AT Persons' compliance with the requirements of Regulation AT, the answer is not to require a DCM to act in this new internal compliance officer type of role. Rather, the answer is to apply appropriate risk controls and related development, testing, and monitoring requirements to such AT Persons subject to meaningful checks and balances through certifications in the gatekeeper clearing member process of gaining market access.

C. Regulation AT should focus on mitigating Algorithmic Trading Disruptions, not preventing or mitigating Algorithmic Trading Compliance Issues.<sup>18</sup>

Regulation AT should not address both Algorithmic Trading Disruptions and Algorithmic Trading Compliance Issues, as proposed. Our suggested revisions to the Proposal's definition of DEA, discussed in detail in subsection D below, would enable the Commission to adopt a regulation that focuses on the risk of market disruptions presented by Algorithmic Trading. As we stated in our First Regulation AT Comment Letter, it is unclear to us what risks the Commission is trying to address in its Proposal. CME Group believes that a refined focus on the risk of market disruptions (i.e., Algorithmic Trading Disruptions) would enable the Commission to establish a coherent and meaningful framework to address the risks presented by Algorithmic Trading.

Including Algorithmic Trading Compliance Issues in Regulation AT is unnecessary and leads to confusion. All algorithmic traders are already required to comply with the CEA, CFTC Regulations, and DCM rules. Therefore, requiring an AT Person (as defined in the Proposal) and a DCM to implement pre-

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<sup>18</sup> This section addresses Roundtable agenda items 1-4.

trade and other risk controls reasonably designed to prevent an Algorithmic Trading Compliance Issue as part of Regulation AT is duplicative of existing statutory and regulatory requirements. Furthermore, it is unclear how the same pre-trade and other risk controls can be reasonably designed to address both Algorithmic Trading Disruptions and Algorithmic Trading Compliance Issues, as the Proposal would require.<sup>19</sup> For example, the risk controls that would mitigate the effects of an Algorithmic Trading Disruption are unlikely to prevent fraud or price manipulation. CME Group believes that Regulation AT should instead focus solely on the shared objective of mitigating Algorithmic Trading Disruptions.

D. The Commission should revise its proposed definition of DEA.<sup>20</sup>

CME Group believes that the Commission's definition of DEA, as proposed, is unworkable. The definition of DEA is a foundational element in establishing who is an AT Person under the Proposal. But as proposed, the definition of DEA risks capturing no one. No customer may access an Exchange electronically without the authorization of a CME Group Exchange clearing member. Currently, all customer electronic orders are subject to an FCM clearing member's financial controls pursuant to Regulation 1.73. In that sense, all customer electronic orders are "routed through" an FCM clearing member of a DCO to which the DCM submits transactions for clearing. We do not believe the Commission intends its definition of DEA to yield no AT Persons.

On the other hand, if the Commission fashions Regulation AT's DEA definition after Regulation 38.607, as Commission staff suggested at the Roundtable, the Commission risks capturing almost everyone. Our experience with Regulation 38.607 indicates that a DEA definition based on Regulation 38.607 would capture all orders interacting with the bid/ask prices published by an Exchange match engine, which would amount to all orders except floor orders. As a result, Regulation 38.607 is not sufficiently precise to serve as a basis for determining the scope of Regulation AT.

CME Group believes that the Commission should revise the proposed definition of DEA to focus on the application of market risk controls at the clearing member level. Specifically, the definition of DEA should focus on whether a person's order passes through market risk controls administered by the gatekeeper clearing member. CME Group believes that the definition of DEA should be "*an arrangement where a person electronically transmits an order to a designated contract market without the order first passing through market risk controls administered pursuant to § 1.82 [as revised<sup>21</sup>] by the member of a derivatives clearing organization granting such person electronic access to the designated contract market.*"

Our definition of DEA clarifies the Commission's proposed definition in two important respects. First, our definition eliminates the ambiguous term "routed through" and replaces it with the concept of applying market risk controls administered by the gatekeeper clearing member. When using the term

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<sup>19</sup> See proposed § 1.80 (requiring an AT Person (as defined in the Proposal) to implement specific pre-trade risk controls and other measures reasonably designed to prevent an Algorithmic Trading Event); proposed § 40.20 (requiring a DCM to implement specific pre-trade and other risk controls reasonably designed to prevent an Algorithmic Trading Disruption or an Algorithmic Trading Compliance Issue).

<sup>20</sup> This section addresses Roundtable agenda items 1 and 2.

<sup>21</sup> See *infra* section II for a discussion of revisions that the Commission should make to proposed § 1.82.

“market risk controls” in our DEA definition, we mean pre-trade risk controls and other measures, including order cancellation systems, and not those financial risk controls implemented for all orders pursuant to Regulations 1.73 and 38.607.<sup>22</sup> Using the term “market risk controls” without prescribing exactly what those controls must be, or the level of granularity at which those controls must be set, promotes regulatory innovation in that market risk controls may continue to evolve with, and adapt to, changing markets and technology.

Second, our definition clarifies which clearing member’s controls are relevant. The definition of DEA should hinge on the clearing member who granted market access to the algorithmic trader (i.e., the gatekeeper clearing member). No person may have electronic access to a DCM without the express permission of a clearing member that financially guarantees such person’s trades. Such clearing member is not necessarily an FCM (if, for example, the clearing member is clearing its proprietary business only);<sup>23</sup> thus, the Commission should use the term “clearing member” instead of “FCM.”

E. The Commission should use the revised definition of DEA to determine who is an AT Person.<sup>24</sup>

CME Group believes that the Commission should use our proposed definition of DEA to establish who is an AT Person. An AT Person, accordingly, should be defined as “a person engaged in Algorithmic Trading through Direct Electronic Access.” This AT Person definition focuses on identified risks rather than attempting to reverse engineer a definition that will yield a targeted number of new registrants. For that reason, CME Group also opposes using quantitative measures to establish the universe of AT Persons.

Existing registrants engaged in Algorithmic Trading should not be AT Persons unless they use DEA. As we discussed in our First Regulation AT Comment Letter,<sup>25</sup> the Commission’s Proposal treats registrants as if they pose greater risks of trading disruptions and compliance issues than non-registrants without articulating a reason for such a distinction. If an *unregistered* algorithmic trader and a *registered* algorithmic trader (such as a commodity trading advisor or a commodity pool operator) each engage in Algorithmic Trading (as defined in the Proposal) and send their orders through the controls of a DCO clearing member, the Proposal would require the *registered* algorithmic trader to comply with the burdens associated with AT Person status, but the *unregistered* algorithmic trader would not be subject to those burdens. Courts have recognized that, as a general matter of administrative law, “an agency cannot treat similarly situated entities differently unless it supports the disparate treatment with

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<sup>22</sup> While there may be some overlap in certain controls, CME Group views risk controls reasonably designed to mitigate the effects of an Algorithmic Trading Disruption as being targeted at risks which are distinct from those targeted by the financial risk controls currently required to be implemented by FCMs.

<sup>23</sup> Under this DEA definition, a clearing member applying its own risk controls to its proprietary orders would not be an AT Person. However, that clearing member would still be expected to comply with testing and monitoring requirements, as discussed in section II.C below.

<sup>24</sup> This section addresses Roundtable agenda items 1 and 2.

<sup>25</sup> See pages 3-4 of the First Regulation AT Comment Letter.



a reasoned explanation and substantial evidence in the record.”<sup>26</sup> Accordingly, the Commission needs to at least articulate a reasoned basis for treating non-DEA algorithmic traders differently based on existing registration status. Otherwise, the Commission’s disparate treatment cannot be upheld as a matter of administrative law.<sup>27</sup> The Commission can avoid this result by adopting our suggested definition of an AT Person, which would ensure that all algorithmic traders using DEA, whether registered or unregistered, are subject to the same standards.

CME Group believes that our proposed definition of an AT Person will result in capturing those market participants who choose not to use a gatekeeper clearing member’s market risk controls for various reasons, including that the algorithmic trader believes its own risk controls are more sophisticated. We believe that if the Commission adopts more reasonable requirements for AT Persons, particularly with respect to Regulation 1.81 as discussed in subsection F below, some algorithmic traders will prefer to continue using their own market risk controls and thus be registered as AT Persons. The Commission may thus ensure that the AT Person definition does not lead to a null set by imposing more reasonable requirements upon AT Persons.

F. Not all AT Persons could comply with the one-size-fits-all requirements in Regulation 1.81.<sup>28</sup>

Regulation 1.81 imposes development and testing, monitoring, and compliance standards for all AT Persons’ Algorithmic Trading systems. However, the Proposal fails to appreciate that, regardless of the ultimate definition of AT Person that is adopted, the Algorithmic Trading systems employed by an AT Person may vary widely in terms of source, size, and complexity. These factors directly affect the AT Person’s ability to meet the standards prescribed in Regulation 1.81. For example, if an AT Person’s Algorithmic Trading systems are developed and licensed by a third-party software provider, the AT Person would have no control over the development environment or testing of source code—only the software developer would. Furthermore, the AT Person would not be able to document the design of, or changes to, the source code because such information is proprietary intellectual property of the software developer. The AT Person only could confirm that its *operation* of third-party Algorithmic Trading systems had been subject to appropriate testing and documentation. Accordingly, Regulation 1.81 should be revised to incorporate a reasonability standard requiring policies and procedures for development and testing, monitoring, and compliance that are commensurate with the source, size and complexity of an AT Person’s systems.

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<sup>26</sup> See, e.g., *Lilliputian Sys., Inc. v. Pipeline & Hazardous Materials Safety Admin.*, 741 F.3d 1309, 1313 (D.C. Cir. 2014) (internal quotations and citations omitted).

<sup>27</sup> See *id.* (remanding agency rule where agency failed to explain why its rule prohibited flammable-gas fuel cell cartridges in checked baggage but did not prohibit medicinal and toilet articles containing flammable gas in checked baggage); see also *Etelson v. Office of Personnel Management*, 684 F.2d 918, 926-927 (D.C. Cir. 1982) (holding that agency’s application of different standards to government attorneys and private attorneys in context of evaluating candidates for administrative law judge positions “is arbitrary and cannot stand” and stressing that “Government is at its most arbitrary when it treats similarly situated people differently.”).

<sup>28</sup> This section addresses Roundtable agenda items 3-4.



G. The source code open access requirement raises serious confidentiality concerns.<sup>29</sup>

The CFTC has not demonstrated any need for the proposed requirement that an AT Person (as defined in the Proposal) make its source code and related history available to any representative of the CFTC or the Department of Justice for any reason, let alone a need that outweighs the cost and confidentiality concerns attendant to such a requirement. Currently, if the CFTC has reason to believe that it needs access to a market participant's source code for a legitimate law enforcement purpose, it can obtain the code subject to adequate confidentiality protections.<sup>30</sup> CME Group has found this kind of targeted access to source code to be more than sufficient for its own investigatory and disciplinary purposes.

**II. OVERVIEW OF CME GROUP'S PROPOSED MARKET RISK CONTROL FRAMEWORK**<sup>31</sup>

CME Group requests that the Commission consider the following alternative framework for Regulation AT. We believe this framework provides a refinement that is largely aligned with the Commission's proposal for mitigating the market risks posed by Algorithmic Trading—i.e., Algorithmic Trading Disruptions. Moreover, our framework would further enhance market integrity by requiring market risk controls and testing and monitoring standards for *all* persons engaged in Algorithmic Trading, not just AT Persons, as the Commission has proposed.

A. Definitions

AT Persons would be defined as persons engaged in Algorithmic Trading through DEA. DEA would be defined based on whether an Algorithmic Trading order passes through market risk controls administered by the gatekeeper clearing member.<sup>32</sup> Algorithmic Trading would be defined consistent with the definition proposed in the FIA working group letter.

B. Market Risk Controls

Two layers of market risk controls would apply to all Algorithmic Trading orders. The first layer would be administered by either an AT Person or the gatekeeper clearing member, and could be developed internally or obtained from an independent third-party source (such as the DCM or a software provider). The second layer would be developed and administered by the DCM. Both layers of market risk controls must be reasonably designed to mitigate the effects of Algorithmic Trading Disruptions, and set at a level of granularity appropriately tailored to the underlying nature of the Algorithmic Trading activity such that the risk mitigation standard is met. No specific market risk control would be required to be used. Rather, the rules would establish acceptable practices that market participants could follow in order to meet the applicable risk mitigation standard, consistent with the

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<sup>29</sup> This section addresses Roundtable agenda item 5.

<sup>30</sup> See CEA § 8.

<sup>31</sup> This section addresses Roundtable agenda items 1-4.

<sup>32</sup> Registration of AT Persons would be deferred pending the implementation of, and experience with, the framework's system of market risk controls.

Commission's history of establishing acceptable practices in other areas of DCM core principle compliance.

The administration of the first layer of market risk controls is key to the definitions under CME Group's proposal—all gatekeeper clearing members (including with respect to proprietary accounts) would be required to *make available* and administer market risk controls in a manner that complies with the applicable risk mitigation standard. However, the algorithmic trader being granted electronic access to the DCM would have discretion whether to use such market risk controls. If the trader opts to send its Algorithmic Trading orders through market risk controls administered by the gatekeeper clearing member before such orders reach the DCM's matching engine, then the trader would not have DEA and, therefore, would not be an AT Person; however, if the trader does not opt to send its Algorithmic Trading orders through market risk controls administered by the gatekeeper clearing member, then the trader would have DEA and, therefore, would be an AT Person.

### C. Development, Testing, and Monitoring Standards

All persons engaged in Algorithmic Trading (including clearing members for their proprietary accounts) would be subject to development, testing, and monitoring standards with respect to their Algorithmic Trading systems. Algorithmic Trading systems and market risk controls of AT Persons would be subject to federal rules under a less-prescriptive version of Regulation 1.81, revised to address the concerns discussed in section I.F above. The senior most person responsible for Algorithmic Trading at the AT Person would be required to certify annually to the gatekeeper clearing member that the AT Person implements market risk controls that materially comply with Regulation 1.80, and that the AT Person materially complies with the requirements of Regulation 1.81.

Algorithmic Trading systems of non-AT Persons (i.e., those traders whose Algorithmic Trading orders pass through the market risk controls of their gatekeeper clearing member) would be subject to the gatekeeper clearing member's onboarding due diligence requirements under Regulation 1.11, which could include a certification that the trader's Algorithmic Trading systems meet the standards in Regulation 1.81 with respect to development, testing, and monitoring.<sup>33</sup>

Where any person utilizes third-party systems to develop or test Algorithmic Trading systems and/or market risk controls, we would expect that the developers of such software ultimately would be willing to provide the AT Person or non-AT Person engaged in Algorithmic Trading the information it needs to be comfortable that appropriate testing was conducted in accordance with the standards in Regulation 1.81 such that the algorithmic trader could provide any required certification to a gatekeeper clearing member. For the software provider to fail to do so would risk the value of its systems.

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<sup>33</sup> The DCM would implement a version of Regulation 1.11 into its rulebook that is applicable to all clearing members in order to ensure that Algorithmic Trading systems used for the proprietary accounts of clearing members are subject to the same development, testing, and monitoring standards as those systems used by other non-AT Person algorithmic traders.

We are happy to discuss any questions the Commission or its staff might have with respect to the comments contained in this letter. Please do not hesitate to contact me at (312) 435-3687 or via email at [Bryan.Durkin@cmegroup.com](mailto:Bryan.Durkin@cmegroup.com).

Sincerely,



Bryan T. Durkin  
Chief Commercial Officer

cc: Chairman Timothy G. Massad  
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