June 24, 2016

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

VIA ONLINE SUBMISSION

Re: Regulation Automated Trading, Notice of Proposed Rulemaking, RIN 308-AD52

Dear Secretary Kirkpatrick:

The Minneapolis Grain Exchange, Inc. ("MGEX" or "Exchange") thanks the Commodity Futures Trading Commission ("CFTC" or "Commission") for hosting a Roundtable on June 10, 2016 ("June Roundtable") on the above referenced matter (the "Rulemaking"), as well as for re-opening the comment period for the Rulemaking.

Introduction

It is paramount for MGEX, as a Designated Contract Market ("DCM") and Derivatives Clearing Organization, that any final Rulemaking be workable in practice, provide articulable and measurable benefits, and does not create unnecessary and onerous burdens. While MGEX was grateful that the Commission hosted the June Roundtable to discuss some elements of the Rulemaking, there is still a significant amount of understanding and consensus to be achieved before a final rulemaking should be issued. For example, it remains unclear whom should be included in the universe of AT Persons, how Algorithmic Trading should be defined, and how to address independent, third-party software vendors who have an integral role in developing and deploying trading technologies/systems.

After having opportunity to review comment letters submitted by other DCMs and industry participants, as well as observing the June Roundtable, MGEX provides the following comments:

1. **Scope of Rulemaking**: MGEX remains convinced that the Commission will have more success in achieving its objectives by limiting the final Rulemaking to pre-trade risk controls. The Commission should reserve other elements of the

130 Grain Exchange Building 400 South 4th Street Minneapolis, MN 55415-1413
awysopal@mgex.com 800.827.4746 612.321.7141 Fax: 612.339.1155 *equal opportunity employer*

proposed Rulemaking, such as registration, for potential subsequent rulemakings, as more will be learned from assessing the value and effectiveness of broad application of pre-trade risk controls.

2. **Definitions**: MGEX believes that the Commission is too narrowly focused on how to properly define terms such as AT Person, Direct Electronic Access, and Algorithmic Trading. These terms are unnecessary to establish a workable paradigm and regulatory framework under which pre-trade risk controls are developed and deployed. Pre-trade risk controls should be the first step of a sequenced effort by the Commission to modernize its rules to better reflect the evolving era of electronic trading. As demonstrated during the Roundtable, there are serious concerns with the proposed definitions and little consensus about how to improve them.

3. **Pre-Trade Risk Controls**: MGEX believes a principled-based approach to pre-trade risk controls that builds upon existing controls that the industry has developed will best achieve the Commission's objective of reducing the risk of market disruption that may be caused by electronic trading systems. MGEX also believes that DCMs, FCMs, and market participants should all have some level of responsibility over the development, deployment, and use of pre-trade risk controls. Each market participant needs to have pre-trade risk controls applied to electronically submitted orders, but how that is accomplished should depend on the circumstances.

4. **Development, Testing, Deployment, and Monitoring of Trading Systems**: The Commission needs to adequately address the role of third-party software vendors in the development, testing, deployment, and monitoring of trading systems. If no changes are made to proposed rule 1.81, many market participants may find it impossible to comply. Otherwise, it will discourage ongoing and future use of third-party software vendors, many of whom have made significant contributions to the integrity of the modern electronic trading universe.

5. **Source Code**: The Commission has received a nearly unanimous message from DCMs and industry actors that the source code provision is unprecedented and that no legitimate justification has been provided as to why the existing subpoena process is insufficient. MGEX believes that industry participants are sincere and justified in their fear that this provision would jeopardize their most valuable asset: intellectual property and trading strategies. Accordingly, this provision should be removed in its entirety from the Rulemaking.

6. **Additional Discussion and Analysis is Needed**: MGEX strongly believes that additional roundtables and analysis is needed for many elements of this Rulemaking, including topics there were and were not included during the June Roundtable. While MGEX understands that the Commission has been working on the framework for RegAT since 2013, the Commission should not promulgate rules simply because considerable effort has been expended.

MGEX thanks the Commission in advance for reviewing this comment letter. MGEX shares the Commission's goal of improving this Rulemaking. Because this Rulemaking has profound implications, impacting the daily and strategic operations of virtually every player in the industry, it is important that the Commission arrive at sensible rules that confer measurable benefit without causing disproportional burden.

1. **Scope of Rulemaking**

While scope of the Rulemaking was not included on the June Roundtable agenda, MGEX believes that it warrants discussion. MGEX fears that many components of the Rulemaking have not been fully and thoroughly vetted. Indeed, the June Roundtable only covered a fraction of the Rulemaking. For the subjects that were covered, it seems more issues were discovered than resolved. This does not provide confidence that other areas of the Rulemaking are sound.

The Commission, like any industry actor, has time and resource constraints. On one hand, what the Commission is trying to accomplish with this Rulemaking should be applauded. As Commissioner Giancarlo observed at the June Roundtable, "The electronification of markets over the past 30 to 40 years and the advent of exponential digital technologies have altered financial businesses, trading and entire industries, with far ranging implications for capital formation and risk transfer". Despite the changes, Commissioner Giancarlo noted that "CFTC rules have stayed pretty much the same". Few would disagree that the Commission needs to comprehensively update its rules in response to the modern era of trading that is characterized by the heavy use and reliance of technology. Even if the Commission had unlimited resources and time, however, it would be dauntingly difficult to modernize CFTC rules in a single Rulemaking when technological changes it is responding to occurred over decades. MGEX strongly believes that the monumental task of aligning CFTC rules with the electronification of markets should be done deliberately, in a sequenced, methodical fashion.

As articulated in its previous Comment Letter (submitted on March 16, 2016), MGEX strongly believes that getting pre-trade risk controls right is the logical first step of a comprehensive plan to update CFTC rules. This is a risk-based calculation as much as it is derived from common sense. The electronification of markets has created risks that have the potential to cause market impacts or disruptions. This risk is meaningful, as market disruptions have the ability to cause significant financial loss and even potentially the default of a market participant. To mitigate such risk, technology must be effectively employed that uses controls or safeguards. Indeed, DCMs and others in the industry have developed and deployed pre-trade risk controls to mitigate the risk presented by trading systems. This was done out of self-interest. The Commission should create a regulatory paradigm that builds upon the work the industry has already done. Once that is done – and there is therefore a heightened degree of confidence that trading systems are operationally sound – the Commission can proceed to other areas included in the Rulemaking, such as potential changes to the registration regime, rules on the development and testing of trading systems, and rules on a DCM's market maker

program, among others.

2. Definitions

a. AT Person

MGEX strongly believes that the Commission's definition of AT Person is flawed because it is not risk based. The June Roundtable focused on what quantitative measures may be used to define the population of AT Persons. The June Roundtable, unfortunately, did not reveal any metric that could be confidentially used to filter for the "correct" universe of persons. This is largely because quantitative measures can be misleading or have no relationship to risk.[1] This raises a fundamental question of why there is a proposed definition of AT Person at this time. It is ostensibly used to capture a number of market participants that need to register. But, MGEX strongly believes that if a definition of AT Person is needed, it should be used to capture a limited segment of market participants that have exceptional risk profiles that would not be properly mitigated by DCM or FCM provided controls.

b. Direct Electronic Access

MGEX believes that the proposed definition of Direct Electronic Access ("DEA") needs to be clarified such that it is limited to the following situation: a market participant who uses an electronic system to submit an order via an API or other electronic means directly to a DCM matching engine, without the order being first subjected to pre-trade risk controls that are independently applied by any other entity, including a FCM, DCM, or third-party software vendor.

MGEX strongly believes that *any* order that is submitted electronically should be subject to pre-trade risk controls, as any order has the potential to present risk. That said, by clarifying the definition of DEA as described above, the Commission would be able to capture electronically submitted orders that present increased risk. Under this approach, if additional regulatory measures are needed for market participants with DEA, they could be applied in a more appropriately targeted manner.

3. Pre-Trade Risk Controls

The Commission's approach for pre-trade risk controls must be principled-based and build upon the existing safeguards that the industry has developed and put into production use. The objective of a principles-based regulatory framework should be to ensure that effective pre-trade risk controls are applied to every order that is electronically submitted to a DCM. Further, whomever is in the best position to apply and calibrate controls should

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[1] During the Roundtable, there was discussion about the potential flaws of relying on quantitative metrics. It was noted that quantitative measures are difficult to utilize because they vary from market-to-market and over time horizons. Also, it is difficult to accurately draw conclusions about the risk of trading activities simply by looking at trade volume or frequency. It was observed that a market participant who only submits a few messages each day might present more risk than a market participant who submits numerous messages each minute.

be charged with such a responsibility. Also, it is important to avoid duplication of controls at various stages of an order's lifecycle. Finally, it is important that rules be written such that the obligations are to *mitigate* and not *prevent* risk of market disruption, as the complete prevention of disruption is not feasible.

It is better for the ongoing and future development of pre-trade risk controls that numerous parties be encouraged to develop and implement them. DCMs should have responsibility for providing some minimum, basic controls to FCMs because DCMs possess knowledge of their matching systems, and therefore know what measures are appropriate to mitigate risk relating to the use of the matching systems. But, the responsibility should not end with DCMs. Market participants should also have responsibility for development of controls if they are not utilizing ones provided by a DCM. Also, FCMs may need to develop controls of their own, to manage risks that may present from their own systems or the combination of their own system with a market participant's and/or DCM's system. As was evident in the June Roundtable, there are various means by which an order is transmitted to a DCM matching engine. A truly principles-based framework will make it easier to ensure that all the means by which market participants access markets are captured. The Commission should modify the Rulemaking to require that FCMs and market participants, in addition to DCMs, have obligations relating to the development of pre-trade risk controls.

Under a principles-based framework, the entity in the best position to effectively administer or apply a control should be charged with that responsibility. A DCM does not know the intricacies of every market participant, including their trading systems and trading strategies. A DCM, therefore, is not in a good position to know how to best apply controls, including at which granular level. As such, a DCM should not be obligated to calibrate controls for a market participant. A FCM, on the other hand, is in an optimal position to calibrate controls for a market participant because it has an understanding of the market participant, and has an obligation to know their customer. Likewise, a market participant who builds its own systems and does not rely on FCM to administer controls independently is most knowledgeable about the risks it may be presenting, and therefore should be obligated to ensure that appropriate pre-trade risk controls are applied to its electronically submitted orders. Also, it is important that any decisions made about whom should be applying controls takes into consideration that controls should not be duplicated across an order's lifecycle. The Commission should remove any requirement that a DCM administer or calibrate controls for market participants, and instead require that a FCM be responsible for administering controls for all orders for which they are financially responsible.

With respect to the specific risk controls that should be utilized, the Commission should refrain from having prescriptive rules that identify the exact controls that must be used. The Commission rightfully looked to the existing controls in use by the industry when crafting this Rulemaking. But, if a regulatory framework is to have longevity and the ability to respond to emerging or evolving technology, it must be flexible and based on principles. Accordingly, the Commission's final Rulemaking should be similar to the approach taken with Core Principles. It should identify principles or goals, and require that pre-trade risk controls be used to achieve those principles or goals. MGEX would support listing certain

controls as examples of controls that may meet regulatory obligations, but they should not be prescriptive elements of a final rule.

Regardless of the regulatory framework and approach the Commission takes with respect to pre-trade risk controls, the Commission should avoid setting the impossible goal of *preventing* market disruption altogether. While the Commission and industry participants should strive to prevent market disruption, no amount of technology and/or human oversight can be foolproof. This is especially true when technology changes rapidly, and protective measures sometimes naturally have to catch-up to where development has evolved. Instead of having this impossible standard that will only result in actors being penalized even though they are doing everything they can do to protect the integrity of markets, the Commission should orient rules around *mitigating* market disruption and encourage development and regular self-evaluation.

4. **Development, Testing, Deployment, and Monitoring of Trading Systems**.

MGEX is sympathetic with the concerns raised by others that the Rulemaking has overlooked the important role third-party software vendors play and the practical and legal difficulties many entities that use third-party software would have complying with proposed rule 1.81. Due to licensing or other legal agreements between a market participant and third-party software vendor, the market participant may not have possession or control over the code such that it would be able to meet the requirements of proposed rule 1.81.[2] The June Roundtable addressed, but did not resolve, this issue. Until these issues are resolved, it would be problematic to make them effective.

5. **Source Code**

MGEX strongly supports others in the industry, for which there is a nearly unanimous voice, that the source code requirement is unprecedented and unwarranted and should be removed from this Rulemaking in its entirety. MGEX is concerned that the Commission has proposed this requirement without articulating why the existing legal process (i.e., obtaining a subpoena) is insufficient, nor is it proposing this requirement because of a legislative mandate. There is little controversy over whether the Commission should, under certain circumstances, have means to obtain and review source code. To be sure, there would be legitimate reasons for the Commission to seek a subpoena to review and analyze source code. But that, in and of itself, is not a justifiable reason to jettison existing, recognized legal procedures. The Commission should take seriously the concerns raised by industry participants that routine access to and subsequent possession and storage of

[2] For example, one requirement would be to test any code changes prior to their use in a production environment. But, a user of third-party software may be unable to test *all* source code changes due to practical or licensing constraints. At most, a user may be able test changes over which they have direct control. For example, a user might be able to modify a trading strategy via the software's graphical user interface, which in turns impacts the parameters of an order that is submitted electronically. But, that would not be a change to source code. In addition, there is a requirement to maintain iterations of code – to have audit trails of all changes. If a market participant is using third party software and has no right to possess copies of code, there are serious questions as to how the market participant would be able to preserve and produce relevant data or documentation.

source code would jeopardize a market participant's most valuable asset: its proprietary trading strategies. If a reasonable observer assumes that the concerns are serious and compares it against the benefit it has articulated for this proposed requirement, MGEX believes that the observer would conclude the benefit is vastly overweighed by the detriment it would cause.

6. **Additional Discussion and Analysis is Needed**

MGEX is concerned that this Rulemaking has not matured enough through the comment period and June Roundtable for it to become final. As observed in the comment letters received to date and the June Roundtable, there are disagreements among industry participants, let alone between industry participants and the Commission. These disagreements spring not from a desire to avoid new regulatory obligations, but rather to ensure that the Commission promulgates workable, sensible rules that actually protect markets from the risks posed by the electronification of the markets. The fact DCMs and others have been on the forefront of developing pre-trade risk controls, and even requiring their use, demonstrates that this subject matter has captivated not only their attention, but their time and resources.

MGEX fears that there is a sense of urgency to issue final rules, in part because there is a desire to show accomplishments after so much effort has been expended, and not because practical, solid rules have been drafted. MGEX recognizes the tremendous effort the Commission has undertook since 2013 to get to this point. The Commission has started an important dialogue, received industry input, held roundtables, and produced analysis, among other things. There is now a much better understanding of what the Commission is proposing. But, we have not arrived where we should be prior to issuing final rules: a solid understanding of how the rules would work in practice, even if there are grievances about the regulatory burdens they may cause. As such, more dialogue and understanding is needed. Not only do industry participants need better guidance on how the rules would work in practice, but MGEX believes there is still room to improve the rules.

MGEX also believes that the Commission could benefit just as much as industry actors by breaking this Rulemaking into several rulemakings and addressing one topic at a time. Indeed, this Rulemaking touches numerous subject matters, including the following:

1. Pre-trade risk controls;
2. Source code retention;
3. Development, testing, and monitoring of "Algorithmic Trading Systems";
4. DCM-provided test environments;
5. DCM oversight of market participants' compliance programs;
6. Registration with the Commission;
7. DCM's market maker or trade incentive programs;
8. Self-trade prevention;
9. Public disclosure of DCM's matching engine; and
10. DCMs providing "system heartbeats".

The scope of this Rulemaking is likely unprecedented in scope, especially considering that, unlike Dodd-Frank related regulations, it did not spring from new legal authority. As advocated before, pre-trade risk controls are a logical first step of a broader effort to update CFTC rules. Under such an approach, the Commission and industry participants would be able to focus their limited time vetting a limited number of rules. This will increase the likelihood that constructive feedback is incorporated. Also, by having separate rulemakings, impacted market actors will have more success complying, since they would be able to incrementally incorporate effective processes and procedures. As MGEX can attest to, it can be incredibly difficult for any regulated entity to comply with sweeping changes in one behemoth rulemaking.

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If you have any questions or concerns regarding this letter, please feel free to contact me at (612) 321-7141 or awysopal@mgex.com. Thank you for your attention to this matter.

Sincerely,

Adam Wysopal
Associate Corporate Counsel

cc: Mark G. Bagan, President & CEO, MGEX
Layne G. Carlson, Treasurer & Corporate Secretary, MGEX
Chairman Timothy G. Massad, CFTC
Commissioner Sharon Y. Bowen, CFTC
Commissioner J. Christopher Giancarlo, CFTC