



June 24, 2016

Mr. Christopher Kirkpatrick  
Secretary of the Commission  
Office of the Secretariat  
Commodity Futures Trading Commission  
3 Lafayette Centre  
1155 21st Street, N.W.  
Washington D.C. 20581

**RE: Nadex Comment on Roundtable Discussion Regarding Proposed Regulation  
Automated Trading**

Dear Mr. Kirkpatrick,

The North American Derivatives Exchange, Inc. (“Nadex” or the “Exchange”) is a retail focused designated contract market (“DCM”) and derivatives clearing organization (“DCO”) registered with the Commodity Futures Trading Commission (the “Commission”), listing small (\$100), fully collateralized contracts for trading by our non-intermediated self-directed (a/k/a “retail”) members. Nadex is grateful the Commission has reopened the comment period pertaining to Regulation AT, and for the opportunity to address the proposed amendments.

During the roundtable discussion held on Friday, June 10, 2016, the Commission requested comment on whether the definition of Direct Electronic Access (“DEA”) as set forth in the December 17, 2015 proposed Regulation 1.3(yyyy) is overly broad, thereby encompassing unintended market participants, and if so, how the definition should be amended to accurately capture the intended population. The proposed definition of DEA is as follows:

1.3(yyyy) - an arrangement where a person electronically transmits an order to a DCM, without the order first being routed through a separate person who is a member of a DCO to which the DCM submits transactions for clearing.

Nadex contends that the proposed definition of DEA is overly broad and does not take into account retail traders who are both DCM and DCO members, as in the case of Nadex’s client base. In its January 16, 2014 interpretive letter, the Division of Clearing and Risk found all Nadex members to be “clearing members” of the DCO. Because an individual Nadex member who submits an order to the DCM is himself a clearing member of the DCO, the individual does not route the order through a *separate* person who is a clearing member. According to the language of the proposed definition, all Nadex members, the overwhelming majority of whom are individual natural persons, would have DEA to

North American Derivatives Exchange, Inc., 311 South Wacker Drive, Suite 2675, Chicago, IL 60606

US Toll-Free +1 (877) 77 NADEX info@nadex.com www.nadex.com

the Exchange. This is in direct contradiction to the Commission's assumption that it "expects that such trading will be performed by entities, not natural persons," and could potentially encompass thousands of individual retail market participants, rather than the few hundred entities originally estimated by the Commission.

The Commission requested comment on whether the definition currently set forth in Regulation 38.607 should replace the proposed DEA definition. Regulation 38.607 defines DEA as "allowing customers of FCMs to enter orders directly into a DCM's trade matching system for execution". Nadex believes this definition is appropriate, and accomplishes the Commission's goals without being overly broad. Nadex points out that this definition is limited to customers of FCMs, and accordingly, Nadex's members would not be considered to have DEA and therefore not subject to Regulation AT. Nadex does not believe that the Commission intended to include its members in the population subject to the Regulation. Unlike customers of FCMs who submit orders directly on the DCM, the identities of all Nadex members have already been screened and verified, therefore, Nadex knows exactly who is submitting orders directly on the Exchange. Furthermore, Nadex has protections in place, such as fully collateralized trading, a wash trade blocker, and an automated order submission limiter, to prevent the type of trading disruptions and compliance breaches the Commission seeks to avert. The 38.607 definition, and the registration with which those pertinent FCM customers would need to comply makes sense as the DCM knows its members who directly access their market, while it may have less information and control over those FCM customers who are bypassing any controls the FCM may have in place. Additionally, Nadex believes this definition is appropriate to maintain consistency throughout the Regulations and mitigate the potential for noncompliance due to misunderstanding of terms and applicability.

In lieu of 38.607, Nadex proposes two alternate amendments to the 1.3(yyyy) DEA definition which would narrow the scope of the applicable population while retaining those participants with whom the Commission is most concerned. First, Nadex would amend the definition as follows:

Direct Electronic Access means an arrangement where a person electronically transmits an order to a DCM, without the order originating with, or first being routed through a ~~separate~~ person who is a member of a DCO to which the DCM submits transactions for clearing.

This suggested language would exclude those participants whose orders either originate with a self-clearing member, or are routed through a clearing member, who has been vetted by the DCO and found acceptable to receive clearing member privileges. The clearing member guarantees and assumes financial responsibility for the orders routed through it, and the resulting trades are further protected by the clearinghouse guaranty fund in the event of a clearing member default. Thus, in addition to the controls the DCM is required to have in place to prevent market disruption under Core Principle 4, an order originating with or first routed to a clearing member provides an added layer of protection. The DCO should have the ability to stop the order flow from the participant in the event of algorithmic trading disruption. Specifically with respect to Nadex, when a clearing member attempts to submit an order to the DCM, Nadex as the DCO cap-checks the member's settlement account to ensure sufficient

North American Derivatives Exchange, Inc., 311 South Wacker Drive, Suite 2675, Chicago, IL 60606

US Toll-Free +1 (877) 77 NADEX info@nadex.com www.nadex.com

funds exist to fully collateralize a resulting trade, before the order reaches the DCM. If insufficient funds exist, the order is blocked.

By excluding the particular subset of participants who are either self-clearing or route orders to a clearing member, the Commission would alleviate the costly, redundant, and unnecessary burden Regulation AT would place on those individuals and entities who are already within the purview of a regulated clearinghouse, and subject to extensive regulatory requirements.

Alternatively, to further bring the scope of those participants subject to Regulation AT in line with the Commission's original estimate, the following language is proposed:

Direct Electronic Access means an arrangement where a person, who is not a member of the DCM or DCO, electronically transmits an order to a DCM, without the order first being routed through a separate person who is a member of a DCO to which the DCM submits transactions for clearing.

This suggested language would exclude both DCM and DCO members from the requirements of Regulation AT. In addition to the reasons described above with respect to the protections of a DCO, DCM members are known by the DCM, subject to the DCM's Rules, and monitored in real-time by the DCM. The DCM itself is currently required by Core Principles 4 and 20 to have measures in place that prevent system disruptions and promote system safeguards. Furthermore, in the event a market participant is granted direct access to the markets, it is unlikely the DCM would permit such access without knowledge that the participant is associated with a clearing member who agrees to guarantee their transactions.

Limiting Regulation AT to participants who do not have the protections of a DCO, whether the participant is the clearing member or first routes orders to the clearing member, and participants who are not DCM members, subject to the DCM's Rules and under the DCM's surveillance captures the participants with whom it appears the Commission is most concerned, and alleviates the burden on participants who are already under the oversight of a DCO or DCM and pose less risk to the markets.

The CFTC staff's discussion points for the June 10 roundtable solicit comment on specific questions with respect to 38.607 and 1.3(yyyy). Nadex addresses those questions under sections 2 and 3 which are the most relevant to its business.

Section 2 – Existing Commission regulation §38.607 requires DCMs to provide, for use by FCMs, certain systems and controls in connection with customers' DEA to the exchange. In the context of §38.607:

- a. How do DCMs, FCMs, and other panelists or commenters interpret the population of market participants subject to §38.607?

The definition in 38.607 specifically references "customers of FCMs". Nadex interprets this definition pursuant to its literal text, as it presumes the Commission intended the definition to apply only to those participants who are "customers".

North American Derivatives Exchange, Inc., 311 South Wacker Drive, Suite 2675, Chicago, IL 60606

US Toll-Free +1 (877) 77 NADEX info@nadex.com www.nadex.com

- b. What types of market participants make use of DEA, and what kinds of trading strategies do they typically pursue?

While all of Nadex's non-intermediated retail traders have direct access to the market, none of them would make use of "DEA" as that term is defined in Regulation 38.607 as they are both exchange and clearing members, and not "customers".

- c. For DCM and FCM panelists or commenters, approximately what percent of market participants use DEA?

Currently 100% of Nadex's market participants are both exchange and clearing members, and have direct electronic access to the markets. However, according to the definition of DEA in Regulation 38.607, these market participants would not be subject to registration requirements because they are not "customers" of an FCM. Nadex does not currently have FCM members, however, even if it did the FCM's customers would not be subject to registration according to the definition of DEA in Regulation 38.607. The customers of a Nadex member FCM would trade through the FCM, who is both an exchange and clearing member. FCM customers would not submit orders directly to the Nadex market. Therefore, according to 38.607, 0% of Nadex's market participants use DEA.

- d. How do these market participants with DEA connect to the DCM (e.g., through APIs, GUIs, AORS, services provided by an exchange or a third party such as an ISV)?

Nadex's exchange and clearing members access its markets via API or the Exchange's proprietary trading front end.

Section 3 – If the Commission were to adopt final rules for Regulation AT including a final definition of DEA in §1.3(yyyy), should the Commission use the definition of direct electronic access in §38.607 rather than the definition proposed in 1.3(yyyy)? Why, or why not?

Nadex proposes the definition of DEA in §38.607 be substituted for the proposed definition in 1.3(yyyy). The 38.607 definition was specifically tailored to address those market participants who bypass the systems and controls put in place by the FCM and gain direct access to the markets. In doing so, the DCM has no knowledge as to the safety of the trading systems being used. The purpose of Regulation AT is to prevent or mitigate the effects of a potential error in a trading algorithm, however, DCMs already have an obligation to prevent market disruption under Core Principle 4. Accordingly, 38.607 captures the appropriate set of participants without creating duplicative and burdensome regulation.

- a. What are the differences in the sets of market participants captured by each definition?

Section 38.607 is narrowly drafted to encompass participants not already under the direct review of the DCM, and who are able to circumvent system controls designed to prevent market disruption by directly accessing the market. Conversely, 1.3(yyyy) broadly encompasses participants - and in particular, natural persons – who are exchange and/or clearinghouse members, subject to the controls the DCM has put in place and who pose no systemic risk to the industry.

North American Derivatives Exchange, Inc., 311 South Wacker Drive, Suite 2675, Chicago, IL 60606

US Toll-Free +1 (877) 77 NADEX info@nadex.com www.nadex.com

Nadex commends the Commission for its ongoing efforts to protect all market participants, however, the broad scope of the proposed DEA definition actually causes harm to participants and the industry with respect to the exorbitant costs and labor of those tasked with implementation and compliance review of the Regulation, including the Commission, for participants who pose at best a limited risk to the markets. Nadex respectfully requests that the definition of DEA as set forth in 38.607 prevail, or that the scope of 1.3(yyyy) be narrowed.

Thank you for consideration of these comments, and please do not hesitate to contact us should you have any questions in this regard.

Sincerely,

A handwritten signature in black ink, reading "Timothy G. McDermott". The signature is written in a cursive style with a large, stylized initial 'T'.

Timothy G. McDermott  
Chief Executive Officer

North American Derivatives Exchange, Inc., 311 South Wacker Drive, Suite 2675, Chicago, IL 60606

US Toll-Free +1 (877) 77 NADEX info@nadex.com www.nadex.com