

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

Re: Proposed Rulemaking on Regulation Automated Trading (“Regulation AT”)  
(RIN 3038-AD52)

Dear Mr. Kirkpatrick:

Hudson River Trading LLC (“Hudson River Trading”) appreciates the opportunity to submit a second comment letter on the Commodity Futures Trading Commission’s (the “Commission”) proposed rulemaking on Regulation AT. Hudson River Trading remains supportive of the Commission’s objective to update regulations in order to recognize and adapt to modern, automated markets; however, we remain concerned by the Commission’s desire to bypass important protections provided by current due process when obtaining access to trading firms’ source code.

As proposed, Regulation AT would include source code under the Commission’s Rule 1.31, thereby requiring AT Persons to make source code available for inspection without a subpoena by the Commission and the Department of Justice. Further, AT Persons would be required to make their source code available to a third party “technical consultant” at all times.

In the proposed rulemaking, the Commission fails to provide a sufficient justification or rationale for eliminating these important protections of firms’ intellectual property. We appreciate the Commission’s desire for strong retention requirements, but we continue to have grave concerns regarding the overall approach of source code provision. In this letter we respectfully highlight and respond to some of the public statements made about the source code provision that continue to concern us.

### **Reconstructing Market Events**

In several public statements, the Commission’s Chairman, Timothy Massad, has stated the need for the Commission to have access to automated traders’ source code in order to “reconstruct market events.”<sup>1</sup> However, the Commission has failed to state how source code would be useful

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<sup>1</sup> See <http://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-44>, <http://www.bloomberg.com/news/articles/2016-03-16/regulator-pledges-to-keep-secrets-for-high-frequency-traders>, <http://www.ft.com/intl/cms/s/0/d6558728-ebba-11e5-9fca-fb0f946fd1f0.html#axzz4BTxv88N>, <http://www.americanbanker.com/bankthink/cftc-rule-gives-regulators-end-run-around->

in doing so. In fact, reviewing source code would provide little to no insight into why a market event happened or why a firm responded the way it did. For example, a firm's source code might reveal its detailed methodology for pricing a product and its strategy for managing orders. However, the source code will provide little information about how a firm priced a particular order or why a firm entered or canceled a particular order as the strategy is dependent on the inputs (e.g., market data) that it processes in order to make pricing and order entry or cancellation decisions. In order to reconstruct market events, the firm's orders, trades and cancels would reveal how it behaved and would provide much deeper insight into the event.

The Commission currently has access to all orders, trades and cancels through its regulatory authority over designated contract markets ("DCMs"). In addition, maintaining order and trade blotters are part of a registrant's books and records obligation and the Commission receives trade information daily from the DCMs, which allows it to review market activity. Currently, in its review of such information, the Commission may find that a firm's (or multiple firms') behavior during a market event requires further scrutiny, at which point it would likely send the firm a regulatory inquiry in order to gather information. Such an inquiry does not imply any wrongdoing and is aimed at gathering information. It would be inappropriate to request source code at the information gathering stage of an investigation. However, to the extent that the information has led to a formal investigation, obtaining source code to demonstrate a particular behavior or intent could be useful and by this point in an investigation, the Commission would have sufficient cause to issue a subpoena to require the firm to make its source code available.

### **Source Code is Qualitatively Different than Books and Records**

Chairman Massad has also stated that source code is not "qualitatively different" from other records to which regulators have historically had access.<sup>2</sup> In addition, the Commission's Head of Enforcement, Aitan Goelman, stated that "[w]e have a whole universe of information that companies would be furious if it were ever made public or their competitors got a hold of. Although these algorithms are different sets of information, they are not different in kind. They are no more sensitive, confidential or revealing of the secret sauce than a lot of the stuff we have."<sup>3</sup>

Respectfully, such statements reflect a clear misunderstanding of the difference between source code and what has historically been prescribed as "books and records." Books and records generally include historical business records including customer account records, accounting records, trade blotters and communications records. While firms consider much of this information confidential and would not want the information to be made public, it generally does not include intellectual property. For example, if a firm's orders, trades and cancels were made public, it would not allow a competitor to copy a firm's strategy. It might provide a competitor with a general idea of what a firm does, but not how it does it. If such information were to be made public, it would be unlikely to harm the firm's business. Source code, on the other hand, represents a firm's intellectual property and trade secrets. It represents a firm's ongoing strategy

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[fourth-amendment-1080229-1.html](#) and <http://www.wsj.com/articles/cftcs-timothy-massad-critics-misconstrue-plan-to-access-traders-code-1463995800>.

<sup>2</sup> *Ibid.*

<sup>3</sup> See POLITICO Pro Q&A: CFTC's Aitan Goelman, Patrick Temple-West, May 27, 2016.

rather than records of its historical actions. In contrast to books and records, if source code were made public, a competitor could simply copy it and replicate a firm's strategy, which would irreparably harm such firm's business.

In addition, requiring a firm's source code is similar to requiring manual traders to document a detailed rationale for every trade they make, including the information they evaluated, the analysis performed, as well as their insights in the investment process. While this information would provide insight into the trade at question, it would also provide insight into the trader's rationale, the information they use to make decisions and the analysis and insights they may use in the future. Revealing such information could harm the firm going forward.

### **Retention of Source Code**

Finally, Chairman Massad and Head of Enforcement Goelman have pointed to rare events such as market disruptions and enforcement actions to justify the Commission's access to source code. However, in the rare event that the Commission requires access to source code, they need to ensure it is there.<sup>4</sup> Such statements support an approach that requires retention of source code, but maintains the current due process afforded to firms. To date, we are not aware of any statements as to the rationale for or benefit of eliminating the process of issuing a subpoena. Given the expected rarity of requiring a subpoena and the relative ease of obtaining a subpoena along with the importance of allowing firms to protect their intellectual property, requiring a subpoena is a reasonable approach to providing the Commission access to source code.

Rather than focusing on bypassing the current due process for access to source code, we believe the Commission should retain existing due process and focus on ensuring that relevant source code is retained in an accessible manner in the rare event that the Commission requires access to it. Requiring source code retention and the use of a source code repository will ensure that when the Commission requires access, it will know the state of a firm's source code at any given time, what changes were made and when they were made. Further, when the Commission does request source code under a subpoena, it should ensure that the process by which it reviews source code respects the sensitivity of firms' intellectual property.

### **Conclusion**

Source code should require important protections, including an obligation to obtain a subpoena. Further, we believe that safeguards to ensure that source code is not compromised should be adopted for those instances where access to source code is granted through a subpoena. For example, any review of source code should be in a secure environment that does not require the source code to leave the firm's premises. While we do not believe that source code should be subject to Rule 1.31, we believe it is preferable to require firms to create and enforce reasonable policies and procedures designed to ensure that AT Persons track development of material changes to ATS source code and ensure that these records are retained for a reasonable period of time. We believe there is a reasonable way to ensure that the CFTC can access the source code they need at the appropriate time while also maintaining the important protections provided by

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<sup>4</sup> See *Ibid* and <http://www.americanbanker.com/bankthink/cftc-rule-gives-regulators-end-run-around-fourth-amendment-1080229-1.html>

the subpoena process. We recommend that the Commission work with market participants on ways that this balance can be achieved.

We appreciate the opportunity to provide comments on the proposed Regulation AT. Please do not hesitate to contact me if you have any questions or would like to discuss.

Sincerely,

/s/ Adam Nunes

Adam Nunes  
Head of Business Development