



June 24, 2016

Via Electronic Submission

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

**Re: Comments in Response to Proposed Source Code Provisions of
Regulation Automated Trading (RIN 3038-AD52)**

Dear Mr. Kirkpatrick:

KCG Holdings, Inc. (“KCG”) appreciates the opportunity to respond to the Commodity Futures Trading Commission (the “Commission” or “CFTC”) and submit comments regarding aspects of proposed Regulation Automated Trading (“AT”)¹ discussed during the CFTC’s June 2016 roundtable. While we support the overall objectives of Regulation AT, we are concerned about its treatment of proprietary source code and believe the Commission should remove the source code provisions from the final version of Regulation AT.

I. KCG Background

KCG is a global financial services firm that offers market participants a range of services designed to address their trading needs across asset classes, product types and time zones. As an independent electronic market maker, KCG combines advanced technology with exceptional client service to deliver greater liquidity, lower transaction costs, improve pricing, and provide execution choices. We trade on various US and foreign futures exchanges, including the CME Group exchanges and ICE Futures US. We actively trade major futures products including Treasury Futures, Energy Futures, Index Futures, Eurodollar Futures and futures on hard and soft commodities.

¹ 80 Fed. Reg. 242 (Dec. 17, 2015) (the “Proposing Release”).



II. Discussion

KCG Supports the Overall Objectives of Regulation AT. As noted by the Commission in the Regulation AT Proposing Release, U.S. derivatives markets have largely completed transitioning from very manual processes to highly automated trading and trade matching systems. Given this evolution, KCG supports the CFTC's overarching goal in proposing Regulation AT "to update Commission rules in response to the evolution from pit trading to electronic trading."²

KCG believes the highly automated nature of today's trading environment bestows numerous benefits to the marketplace – including narrower spreads, greater efficiency, improved liquidity, and better price discovery – however we also recognize that increased levels of automation do introduce potential operational risks that require careful consideration by the Commission, trading venues, and market participants. To that end, the updated rules contained in the Commission's Regulation AT proposal are focused on mitigating risks arising from algorithmic trading activity, increasing transparency around designated contract market ("DCM") electronic trade matching platforms and incentive programs, and promoting the use of self-trade prevention tools. Specifically with respect to automated trading firms, under proposed Regulation AT such firms would be required to, among other things: (1) register with the CFTC; (2) implement pre-trade and other risks controls (*e.g.*, kill switches) to address the risks of algorithmic trading; and (3) implement standards for development, testing and monitoring of algorithmic trading systems. Many of the proposals contained within Regulation AT are sensible iterations that build upon existing industry best practices or existing rules or policies in the U.S. derivatives and other markets.

The Treatment of Source Code Proposed Under Regulation AT Should Be Revised. Although we broadly support the CFTC's goal of updating its rules framework to ensure that its regulatory standards and industry practices properly address current and foreseeable risks arising from automated trading, KCG is very concerned about the treatment of proprietary source code under Regulation AT as proposed. Specifically, the proposal would impose a requirement for market

² Proposing Release at p. 78827.



participants subject to the rule to make a source code repository available for routine inspection by CFTC and DOJ staff without the necessity of a subpoena. We do not support this sharp break from established practice around the treatment of source code by the Commission as well as other government agencies.

Regulation AT Proposal Regarding Source Code. As proposed, Regulation AT would require firms that engage in algorithmic trading to maintain copies of all proprietary source code in data repositories and make it available for inspection in accordance with the CFTC's standard record-keeping requirement of Rule 1.31 (CFTC's "books and records rule"). As such, source code would be available to a third-party technical consultant at all times and available to CFTC and the U.S. Department of Justice staff upon request at any time for any reason without subpoena or other process of law. Regulation AT as proposed would essentially treat proprietary source code as a standard books and records item and allow on-demand access by any representative of the CFTC or DOJ at any time.

Source Code is Not a Standard Books and Records Item. Unlike ordinary books and records, which primarily consist of historical trading-related records that do not contain or represent trade secrets and are not likely to damage a firm if disclosed (e.g., trade confirmations), source code is not solely backward looking. Source code is highly sensitive and proprietary information that, as noted by Commissioner Giancarlo, represents both current and future trading strategies³ and typically constitutes the core intellectual property of a trading firm. Given the level of competition that exists in the market today, many market participants view their proprietary source code as the biggest determinant of the success or failure of their business. Due to this importance, trading firms typically employ numerous and overlapping safeguards designed to protect against unauthorized disclosure and use of their proprietary source code by their internal staff, including but not limited to:

- Restricting employees permitted to access source code and/or monitoring employee access;
- Limiting source code access solely to on-site access;
- Restricting against remote access to source code;

³ Proposing Release at p. 78947.



- Utilizing encryption protection for source code;
- Enforcing employee non-compete obligations;
- Requiring employees to execute intellectual property agreements; and
- Imposing strict employee confidentiality requirements.

Simply put, maintaining the confidential nature of proprietary source code is vital for a trading firm because unauthorized disclosure could be devastating to the firm's business model.

Given the sensitive nature of source code, it is not surprising that there is no precedent for the CFTC or other government agency to treat source code as a standard books and records item and to subject it to routine examination and provision to any representative of the CFTC or DOJ. The SEC and FINRA staff do not typically request and examine source code as part of a standard examination of a firm's trading records.

Source Code Access Should Continue Under the Current Process. There is no disagreement that trading firms should provide regulators, including the CFTC, with reasonable access to proprietary source code when appropriate. But because of the highly sensitive and confidential nature of source code and the potentially devastating impact of unauthorized disclosure, it is important that regulatory access be limited to compelling circumstances regarding potential material regulatory violations of law.

KCG believes the approach to requesting and reviewing source code that is currently followed by the Commission as well as other regulators is appropriate. Currently, if CFTC staff wish to review source code, they may either request voluntary production by the trading firm that owns the source code subject to agreed-upon restrictions or they may request the source code via a validly issued subpoena pursuant to a formal investigation. This approach allows the source code owner the ability to agree to certain controls, protections and/or restrictions around source code access or to petition for appropriate protections. This process provides the Commission with the tools necessary to obtain source code while providing trading firms with due process and other important legal protections for their valuable intellectual property.



Regulatory access to source code should be subject to protections and controls designed to provide the highest degree of security to source code owners, including:

- Access either voluntarily upon CFTC request or pursuant to a subpoena as part of an active formal investigation;
- On-site review only;
- Access via a limited number of computers;
- Documentation around access by CFTC staff;
- Imposing a one-year “cooling off” period for CFTC staff accessing source code during which they may not work at a trading firm that is subject to Regulation AT;
- Restrictions around copying of source code and use of other devices when reviewing source code;
- Agreement by CFTC staff reviewer(s) to treat source code as strictly confidential information; and
- Trading firm ability to monitor source code review by CFTC staff.

The Risk of On-Demand Source Code Access Outweighs Any Potential Benefit. Treating source code as an ordinary books and records item for a trading firm and thus allowing it to be accessed by any representative of the CFTC or DOJ at any time for any reason unnecessarily creates and increases risks to trading firms providing access to their code. The tight controls trading firms maintain around their proprietary source code are essentially lost and useless once the code is shared with regulators or third party consultants. As noted previously, source code represents a firm’s future trading strategies and unauthorized disclosure of code could potentially destroy a firm’s business. The Regulation AT Proposing Release does not explain why CFTC or DOJ staff access to source code under the current subpoena process is insufficient or what problem the new source obligation proposed under Regulation AT would solve. Given the concerns stated above, the lack of justification for a new and unprecedented requirement, and the fact that an appropriate mechanism already exists for source code access, it seems clear that the risks (and costs) of allowing on-demand access to proprietary source code outweigh any potential benefit.



III. Conclusion

For the reasons noted above, the Commission should remove the source code provisions from the final version of Regulation AT proposal.

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KCG greatly appreciates the opportunity to comment on Regulation AT and would be pleased to discuss these comments in greater detail. If you have any questions, please do not hesitate to contact me at 646-428-1615 or jmccarthy@kcg.com.

Sincerely,

A handwritten signature in black ink, appearing to read "John A. McCarthy", with a stylized flourish extending to the right.

John A. McCarthy
General Counsel