



June 24, 2016

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

VIA ELECTRONIC SUBMISSION

Re: *Public Staff Roundtable on Elements of Regulation Automated Trading, RIN 3038-AD52*

Dear Secretary Kirkpatrick:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (“**Working Group**”), the Commodity Markets Council (“**CMC**”), and the Electric Power Supply Association (“**EPSA**”) (collectively, the “**Commercial Market Participants**”), Sutherland Asbill & Brennan LLP hereby submits this comment letter in response to the Commodity Futures Trading Commission (the “**CFTC**” or “**Commission**”) reopening the comment period for the Notice of Proposed Rulemaking, *Regulation Automated Trading* (“**Regulation AT**” or “**Proposed Rule**”),¹ in connection with the Commission’s June 10, 2016 Public Staff Roundtable on Elements of Regulation Automated Trading (“**Roundtable**”).²

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group considers and responds to requests for comment regarding regulatory and legislative developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

CMC is a trade association that brings together exchanges and their industry counterparts. Its members include commercial end-users that utilize the futures and swaps markets for

¹ See *Regulation Automated Trading*, Notice of Proposed Rulemaking, 80 Fed. Reg. 78,824 (Dec. 17, 2015).

² See *Public Staff Roundtable on Elements of Regulation Automated Trading; Reopening of Comment Period*, 81 Fed. Reg. 36,484 (June 7, 2016).

agriculture, energy, metal, and soft commodities. Its industry member firms also include regular users and members of swap execution facilities (each, a “SEF”) as well as DCMs, such as the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures US, Minneapolis Grain Exchange, NASDAQ Futures, and the New York Mercantile Exchange. Along with these market participants, CMC members also include regulated derivatives exchanges. The businesses of all CMC members depend upon the efficient and competitive functioning of the risk management products traded on DCMs, SEFs, and over-the-counter markets.

EPSA is the national trade association representing leading competitive power suppliers, including generators and marketers. These suppliers, who account for nearly 40 percent of the installed generating capacity in the United States, provide reliable and competitively priced electricity from environmentally responsible facilities. EPSA seeks to bring the benefits of competition to all power customers. EPSA members utilize a broad variety of commercial tools to ensure the reliable delivery of natural gas, oil, power, and other nonfinancial commodities to their facilities and plant assets located throughout the United States.

The Commercial Market Participants appreciate the additional opportunity to submit comments on the Proposed Rule and the Commission’s continued efforts to seek input from market participants before it finalizes any rules on automated trading. The Commercial Market Participants’ comments provided herein supplement the March 16th Comments previously submitted in this rulemaking proceeding.³

II. COMMENTS OF THE COMMERCIAL MARKET PARTICIPANTS.

A. Defining the Population of AT Persons.

1. The Commission Should *Not* Adopt a Quantitative Approach to Establish the Population of AT Persons.

As users of commodity derivatives, the Commercial Market Participants support the Commission’s efforts to ensure that automated trading is subject to appropriate pre-trade risk and other controls that protect the integrity of commodity markets. However, as reflected by the panelists at the Roundtable, the use of a “one-size-fits-all” quantitative measure is not a workable solution for establishing the population of AT Persons and, therefore, should not be pursued by the Commission.⁴

The use of a quantitative measure cannot be applied in an appropriately limited manner to identify the universe of market participants engaged in automated trading that presents the type of systemic risk that Regulation AT seeks to protect against. In this respect, the Commercial Market Participants are concerned that the use of a quantitative measure could (i) capture a

³ See The Commercial Energy Working Group and Commodity Markets Council, Joint Comment Letter on *Regulation Automated Trading*, Notice of Proposed Rulemaking, RIN 3038-AD52 (Mar. 16, 2016) (“**March 16th Comments**”).

⁴ See Roundtable, Panel II discussion, *available at* <https://www.youtube.com/watch?v=LKxRMIROkyw&feature=youtu.be>.

significant number of market participants whose use of automated trading functionality does not present systemic risk or (ii) allow market participants using automated trading in a manner that presents systemic risk to avoid Commission oversight.

The following example highlights the limitations inherent in the use of a quantitative measure for establishing the population of AT Persons, demonstrating the potential for market participants whose automated trading activities present legitimate systemic risk to evade capture under a quantitative threshold and, thus, avoid Commission oversight as an AT Person.

Example. A message frequency threshold would not capture a market participant whose algorithmic trading activity sent only a few messages to the DCM even though the activity lacked risk controls and resulted in a high volume of trades. On the other hand, the use of a message frequency threshold would capture a market participant whose algorithmic trading activity sent a lot of messages to the DCM but consisted of few fills and a low trade volume and had appropriate risk controls in place.

Importantly, the use of a quantitative measure for establishing the population of AT persons does not adequately account for critical qualitative considerations, particularly the unique dynamics and operations of different commodity markets. For instance, where market environments are characterized by low liquidity, transacting through the use of automated trading at any trade volume or message frequency level without adequate risk controls could cause market disruptions.

Moreover, a quantitative approach is limited by its static nature. Recognizing the continued evolution of trading technology and practices (and system risks presented thereby), a static measure designed to identify the population of AT Persons could become obsolete soon after implementation and would require the CFTC to revise the metric frequently. Such frequent revision would strain the Commission's scarce resources, create regulatory uncertainty for market participants, and increase costs for market participants to update their IT systems and monitoring practices accordingly, which could cause a lag in the markets and reduce liquidity.

In light of the foregoing, the Commercial Market Participants recommend that the Commission decline to adopt a quantitative approach and instead focus its resources and efforts on (i) identifying market participants whose automated trading activities present a legitimate threat of systemic risk to commodity markets, and (ii) requiring the application of appropriate controls to mitigate such risks.⁵ If, however, the Commission ultimately decides to adopt a quantitative approach for establishing the population of AT Persons, it must, at a minimum, coordinate with designated contract markets ("DCMs") to collect and analyze data on automated

⁵ See CME Group, Inc., Comment Letter on *Regulation Automated Trading*, Notice of Proposed Rulemaking, RIN 3038-AD52, at 8 (Mar. 16, 2016) (the most prudent course of action for regulating automated trading is to promulgate principles-based rules enabling market participants to adapt proactively with the changing times instead of prescriptive requirements that do not enable DCMs or other market participants to identify and address evolving risks in commodity markets) ("**CME Comments**").

trading to determine the appropriate quantitative metric and solicit public comments on such metric before implementing it.

2. The Commission Should Adopt an Appropriately Tailored Definitional Approach for Establishing the Population of AT Persons.

A narrowly tailored definitional approach will be more effective than any quantitative measure to protect market integrity against the systemic risks posed by algorithmic trading. In this respect, the Commercial Market Participants reiterate support for the adoption of such a definitional approach, so long as the definitions of “direct electronic access” (“**DEA**”) and “algorithmic trading” (“**AT**”) appropriately limit the application of Regulation AT, as described in the March 16th Comments.

The DEA definition set forth in proposed CFTC Regulation 1.3(yyyy)⁶ is overly broad and will needlessly capture persons routing their orders to a DCM through several layers of risk and operational controls simply because their orders are not routed directly through the infrastructure owned or operated by a futures commission merchant (“**FCM**”). In this respect, the proposed DEA definition would capture persons who route their orders through the infrastructure owned and operated by DCMs⁷ or Independent Software Vendors (“**ISVs**”), which represents a substantial percentage of commodity market participants, even though risk and operational controls apply to their infrastructure and orders routed through their infrastructure.⁸ Subjecting these market participants to regulation as AT Persons is contrary to the Commission’s intent to limit the scope and applicability of Regulation AT to those market participants that pose systemic risk concerns.

For automated trading transactions utilizing ISV or DCM routing infrastructure, different layers of risk and operational controls exist throughout the transaction chain from the point at which an order exits a market participant’s order management system to the point where it is accepted into a DCM’s matching engine. The layers of risk and operational controls are administered by:

- DCMs in their role as market operators;
- ISVs, including in certain cases DCMs, that provide third-party order routing capability to a DCM’s matching engine;
- Clearing members or FCMs on behalf of their customers; and

⁶ In relevant part, proposed CFTC Regulation 1.3(yyyy) defines DEA as “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 derivatives clearing organization* to which the DCM submits transactions for clearing.” See Regulation AT at 78,844.

⁷ Examples of DCM-owned routing infrastructure include, but are not limited to, WebICE and CME Direct.

⁸ Examples of ISV-owned routing infrastructure include, but are not limited to, non-dedicated multi-broker systems provided by Trading Technologies International, Inc. and Bloomberg Tradebook Futures ISV platform.

- Market participants as part of their proprietary, internal risk management programs.⁹

The CFTC's proposed definitional approach for determining which market participants should be subject to Regulation AT does not recognize the existence of these layers of risk controls throughout the transaction chain. The Commercial Market Participants direct the Commission's attention to the CME Comments, which include a chart that illustrates the extensive set of risk controls imposed by CME, in its role as a DCM, throughout the transaction chain.¹⁰ This chart shows each risk control imposed by CME including: (i) when it is administered, (ii) by which layer of the transaction chain, and (iii) at what level of granularity.¹¹

Any definitional approach for establishing the population of AT Persons must be narrow in scope and recognize the layered set of risk and operational controls that exist along the transaction chain. Such an approach should properly limit the population of AT Persons to market participants whose automated trading orders are routed to a DCM through their own proprietary Application Programming Interface ("API") and whose orders are not subject to pre-trade risk and other controls administered by a separate person who is an FCM or clearing member of a derivatives clearing organization.¹² As provided in the March 16th Comments, the Commercial Market Participants recommend that the Commission adopt the following DEA definition:¹³

Direct Electronic Access. This term means an arrangement where a person uses its own, proprietary Application Programming Interface ("API") to electronically transmit an order to a designated contract market's API without the order first being routed through an order routing system that includes risk and operational controls under the administrative control of a separate person who is a futures commission merchant or clearing member of a derivatives clearing organization.¹⁴

Further, as described in the March 16th Comments, the proposed AT definition is overly broad and could capture basic "order management functionality" (e.g., auto spreaders, iceberg

⁹ For a more thorough description of the types of risk and other controls imposed by these entities, see the March 16th Comments, Section II.A.1.

¹⁰ CME Comments at 13.

¹¹ *Id.*

¹² The Commercial Market Participants believe that the DEA definition should not capture a market participant who develops and uses its own proprietary AT systems, so long as a clearing member or FCM routes the market participant's orders to a DCM, applying the appropriate pre-trade and other controls.

¹³ As noted in the March 16th Comments, this proposed definition is similar to the DEA definition proposed by the Futures Industry Association ("FIA"). See FIA, Comment Letter on *Regulation Automated Trading*, Notice of Proposed Rulemaking, RIN 3038-AD52, Attachment A at 6 (Mar. 16, 2016).

¹⁴ The Commercial Market Participants note that their proposed DEA definition does not include a person using its own API to electronically transmit an order to a DCM where the order is subject to controls under the administrative control of a separate person who is an FCM before the order reaches the DCM (e.g., a kill switch).

orders, sliced orders) provided by third-parties, such as ISVs or DCMs.¹⁵ As such, the Commission should narrow the definition of AT and categorically exclude basic “order management functionality” as described in the March 16th Comments. As widely acknowledged at the Roundtable during Panel I, the focus of Regulation AT should be on mitigating systemic risk to commodity markets through the use of operational and risk controls. The more narrow definitions of DEA and AT proposed in the March 16 Comments achieve this objective.

Accordingly, the Commercial Market Participants reiterate the recommendation in the March 16th Comments to define an AT Person as follows:

(xxxx) AT Person. This term means any person—

(1) Who purchases or sells solely for such person’s own account—

(i) Any commodity for future delivery, security futures product, or swap; or

(ii) Any commodity option authorized under section 4c of the Act; and

(2) Who uses Direct Electronic Access¹⁶ as defined in paragraph (yyyy) of this section, in whole or in part, to access a DCM for Algorithmic Trading.¹⁷

B. Regulations Applicable to AT Persons.

1. An AT Person Should Not Be Established by a Registration Requirement.

A registration framework will not achieve the Commission’s goals of mitigating systemic risk to markets created by the use of AT but will impose significant cost burdens to market participants and cause unintended consequences (*e.g.*, mandatory margin and enhanced recordkeeping).¹⁸ As discussed at the Roundtable, no additional regulatory benefit would be provided to the CFTC or to the markets under a registration regime given DCMs already provide transparency into the markets and can identify those using automated trading functionality. Specifically, DCMs require firms to use unique identifications for each order message sent to the DCM that identify whether the order is manually generated or generated from an automated system and whether the order is being routed by an FCM.¹⁹ DCMs also maintain this

¹⁵ See the March 16th Comments, Section II.A.2, for a more thorough description of basic “order management functionality” that could be captured by the CFTC’s proposed definition of AT.

¹⁶ The reference to “Direct Electronic Access” in this AT Person definition would reflect the Commercial Market Participants’ recommended DEA definition.

¹⁷ The reference to “Algorithmic Trading” in this AT Person definition would reflect the recommendation presented in the March 16th Comments that the AT definition include only “Automated Order Generation Systems.” See March 16th Comments, Section II.A.2.

¹⁸ For a full description of the unintended consequences that will result from requiring a person using DEA and AT, as those terms are defined by the CFTC, to register as a floor trader, see March 16th Comments, Section II.B.2.

¹⁹ See CME Group, Inc., Comments on Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, RIN 3038-AD52, at 30 and Appendix A at 7 (Dec. 11, 2013).

information in an audit trail, which is accessible to the CFTC on a daily basis.²⁰

As supported by panelists at the Roundtable, the CFTC should reject the proposed expanded definition of “floor trader” and registration framework and instead adopt a principles-based approach under Regulation AT aimed at ensuring proper controls exist to mitigate a potential AT event. In this regard, any person, whether it is a registrant or non-registrant, that has DEA and uses AT, as these terms are defined in the March 16th Comments, would be considered an AT Person and required to implement risk and other controls as required and overseen by the DCMs on which the AT Person trades.

2. DCMs Should Establish and Oversee the Appropriate Controls Required of AT Persons Trading on their Markets.

As an alternative to the proposed registration framework, DCMs under their Core Principles in existing Part 38 of the CFTC’s regulations should establish and oversee pre-trade risk and other control requirements applicable to AT Persons, as defined by the Commercial Market Participants or in the Proposed Rule, trading on the DCMs’ markets. DCMs have the expertise and are best positioned to identify, implement, and enforce the use of controls to mitigate market risks on their markets and should be permitted the flexibility under their Core Principles to continue ensuring, as they do currently, that proper controls exist for automated trading on their markets. In this regard, a DCM should be granted discretion in determining the appropriate pre-trade risk and other control requirements that should apply to an AT Person trading on its market, which may not include the full panoply of requirements provided under proposed CFTC regulations 1.80-1.84.

As described above, a tiered, robust set of risk and operational controls currently exists throughout the transaction chain for orders routed to a DCM and are overseen by the DCM. Thus, as part of this alternative proposal, a DCM may leverage and build upon existing industry risk and operational controls.²¹ Further, whether the Commission adopts its proposed definition of AT Person or the Commercial Market Participants’ proposed definition, an AT Person should not be required to develop and apply a duplicative set of pre-trade risk and other controls when using the automated trading functionality or routing infrastructure of a third-party, such as a DCM, ISV, or FCM, given the third-party already applies such controls and does not permit its customers to alter its infrastructure or software.²²

²⁰ *Id.* at 32-33.

²¹ In response to questions posed by CFTC staff at the Roundtable, the Commercial Market Participants do not believe DCMs should be required to perform any additional due diligence on FCMs or AT Persons regarding the controls they adopt other than what the DCM believes is required to mitigate risk to its market; nor should AT Persons be required to receive certifications from an ISV or an FCM or perform any additional due diligence on the ISVs or FCMs regarding the controls applied to their software or routing infrastructure. As noted by Roundtable panelists, DCMs, ISVs, FCMs, and customers already coordinate with each other to ensure automated trading is tested, monitored, and controlled, and the CFTC should permit this coordination to continue as is. *See* Roundtable, Panels III and IV, available at <https://www.youtube.com/watch?v=LKxRMIROkyw&feature=youtu.be>.

²² For a more thorough discussion addressing the standards for the development, monitoring, and compliance of AT systems, see the March 16th Comments, Section II.B.1.

Christopher Kirkpatrick, Secretary

June 24, 2016

Page 8

III. CONCLUSION.

In short, the Commercial Market Participants urge the CFTC not to adopt a quantitative approach to establishing the population of AT Persons or the proposed registration framework for regulating automated trading in commodity markets. Rather, the CFTC should narrowly tailor the definitions of DEA and AT, as proposed above in Section II.A.2 by the Commercial Market Participants, to establish the appropriate population of AT Persons. Further, AT Persons should be subject to the risk and operational controls that are established and enforced by the DCMs on which the AT Persons trade.

The Commercial Market Participants request that the Commission consider the comments set forth herein as it develops any final rule in this proceeding and expressly reserve the right to supplement these comments as deemed necessary and appropriate. For any questions, please contact the undersigned.

Respectfully submitted,

/s/ R. Michael Sweeney, Jr.

R. Michael Sweeney, Jr.

Meghan R. Gruebner

Counsel for The Commercial Energy Working Group

/s/ Kevin K. Batteh

Kevin K. Batteh

General Counsel

Commodity Markets Council

/s/ Arushi Sharma Frank

Arushi Sharma Frank

Director of Regulatory Affairs and Counsel

Electric Power Supply Association