May 1, 2017

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, Supplemental notice of proposed rulemaking, RIN 3038-AD52

Dear Secretary Kirkpatrick:

The Minneapolis Grain Exchange, Inc. ("MGEX" or "Exchange") would like to thank the Commodity Futures Trading Commission ("CFTC" or "Commission") for this opportunity to respond to the Commission's request for comment on the above referenced matter published in the November 25, 2016 Federal Register Vol. 81, No. 227 (the "Supplemental").

Introduction

MGEX, a Designated Contract Market ("DCM") and Subpart C Derivatives Clearing Organization, shares the Commission's desire to protect contract markets from the risks presented by electronic, including algorithmic, trading. Even though MGEX and the Commission desire to ensure that contract markets are secure, reliable, transparent, and robust, MGEX is convinced that the Commission's approach with RegAT has been overly broad, unduly prescriptive, and that much of its benefits are unjustified by its costs.[1]

MGEX appreciates that this Supplemental reduces or withdraws some elements of the original proposal. But, for reasons articulated below, MGEX believes that the Commission should pause this rulemaking process until current Commissioner vacancies are filled, and then proceed with a new, truly principles based approach. Specifically, MGEX believes that a Core Principle framework would be the best approach to ensure that there

[1] The term "RegAT" refers to Regulation Automated Trading, Notice of Proposed Rulemaking, published in the December 17, 2015 Federal Register Vol. 80, No. 2015, as well as the concept for a rulemaking on automated trading. When "Supplemental" is used, it is referring specifically to proposals included in the Supplemental rulemaking.

are sufficient technological controls and other risk mitigation measures in place to protect contract markets from disruptive events that may be caused by electronic trading. This streamlined approach would achieve the Commission's goals and stated benefits of RegAT at a much more manageable cost to DCMs, industry participants, and the public. In addition, a Core Principles based approach would allow for DCMs and market participants to continue to develop and adapt technology and other measures to the ever changing reality of modern contract markets.

That said, MGEX is cognizant that the Commission may want to remain on the current trajectory. Accordingly, this comment letter also addresses specific elements of the Supplemental. If the Commission does not pause the rulemaking process and then moves forward with a Core Principles based approach, MGEX asks the Commission to consider making additional refinements to RegAT prior to issuing and voting on a final rulemaking. As discussed in more detail below, MGEX believes that:

1) If the Commission proceeds with RegAT, it should do so through separate final rulemakings that are based on distinct topics, starting first with pre-trade risk controls. This phased approach would be less burdensome to implement and would better ensure that any required pre-trade risk controls are implemented effectively. Additionally, focusing first on pre-trade risk controls makes sense because of all the concepts included in RegAT, they are the most closely related to mitigating disruptive market events.

2) The Commission's approach for pre-trade risk controls as set forth in the Supplemental is superior to the initial proposal but should be less prescriptive, which would allow flexibility, more innovation, and quicker adoption of new or modified controls.

3) The Commission's proposal to use a volume threshold to determine AT Person as set forth in the Supplemental is logical. That said, there should be an additional metric to further refine the population of AT Persons so it is more closely based on the likelihood of potential risk of market disruption.

4) The Commission should completely withdraw the requirement that all DCMs establish a program to review compliance programs of AT Persons and FCMs. In the Supplemental, the Commission has reduced the requirement from one of annual reviews to periodic reviews. Having AT Persons and FCMs subject to multiple DCM reviews is unnecessarily burdensome and costly. MGEX believes that simply requiring that AT Persons and FCMs provide an attestation to each applicable DCM that they are in compliance could be as effective as DCMs periodically reviewing compliance programs.

5) Commission access to source code should be limited to the existing subpoena process.

MGEX thanks the Commission in advance for reviewing this comment letter.

1. **The Commission should restart the rulemaking process after there is a fully constituted Commission and then take a new, Core Principles based approach.**

To be sure, as initially proposed and modified by this Supplemental, RegAT would be one of the largest and most consequential rulemakings since Congress passed the Dodd–Frank Wall Street Reform and Consumer Protection Act. The makeup of the Commission, however, has changed significantly during the time that the CFTC has been considering RegAT.[2] As of the date of this Comment Letter, the Commission has an acting Chairperson, one Commissioner, and three vacancies. While this would be sufficient for quorum to approve a final rulemaking, MGEX believes the industry, the public, and the Commission would be better served if a full Commission was constituted to pass such a landmark rulemaking.[3] Accordingly, MGEX believes the Commission should at minimum pause the rulemaking process and start again after existing Commissioner vacancies have been filled.

But, after having additional time to digest and analyze RegAT, MGEX is more concerned about its breadth, prescriptive nature, and compliance costs. Much of what the Commission has proposed would either duplicate efforts that the industry has been moving towards or already taken, or impose new rigid obligations. As Acting Chairman Giancarlo explained when the Commission voted to approve this Supplemental, "when Proposed RegAT was issued, I noted that the CFTC is basically playing catch-up to an industry that has already developed and implemented risk controls and related testing standards for automated trading."[4] MGEX observes that technology, as well as policies and procedures, regarding the use of electronic trading systems have been implemented.[5] As such, DCMs and other industry participants have already and will continue to incur costs to protect against market disruption that may be caused by electronic trading. Acting Chairman Giancarlo also observed that "the marketplace has implemented effective best practices and procedures for the development and testing of automated trading systems …."[6] If RegAT was implemented as currently proposed, the

[2] When the 2013 Concept Release was issued, Gary Gensler was CFTC Chairman and Bart Chilton, Scott O'Malia, Mark Wetjen, and Timothy Massad were Commissioners. When the Original NPRM was issued on December 17, 2015, Timothy Massad was Chairman and Christopher Giancarlo and Sharon Bowen were Commissioners.

[3] Further, even if vacancies on the Commission were filled prior to the Commission voting on any final Rulemaking, any new Commissioners would have little, if any, formal engagement with the development of RegAT. If the Commission were to reset this rulemaking process, new Commissioners would have an opportunity to participate in the process.

[4] *Id.* at 85398.

[5] Interestingly, there is a paucity of evidence that market disruption events caused by electronic trading are occurring on a regular basis. This is contrasted with the overwhelming evidence that electronic, including automated and algorithmic trading, has been accelerating. It would be reasonable to infer that the infrequency of market disruption events is the result of the industry's ongoing efforts to ensure contract markets are secure, robust, open, and fair. After all, industry participants, and in particular DCMs, have an incentive to prevent market disruption from occurring.

[6] *Id.* at 85399

Commission would effectively be adding a burdensome regulatory layer for DCMs and others, or duplicating much of the effort that has already been expended. Either way, DCMs and others will be forced to bear costs for a second time without any additional benefit. In addition, new prescriptive requirement, such as reporting requirements and DCM review of compliance programs, would impose new and ongoing costs for new activities that do not have an adequately demonstrated benefit. These concerns have led MGEX to conclude that the Commission should take a new approach on RegAT – one similar to a Core Principle.

2. If the Commission proceeds with RegAT as proposed, MGEX requests that additional refinements be made before approving any final regulations.

a. The Commission should vote on distinct components of RegAT in separate final rulemakings, beginning first with pre-trade risk controls.

If the Commission decides to proceed with RegAT as it has been proposed, MGEX believes it is prudent to tackle distinct concepts in separate final rulemakings. MGEX suggests that the Commission determine the sequencing of separate rulemakings based on a prioritization of risk and need. Indeed, the Commission notes that it will be deferring "to a later date the final rules regarding self-trading and disclosure and transparency of DCM trade matching systems."[7] Moreover, the Commission inquired about delaying further consideration of the following topical areas of RegAT: greater transparency of a DCM's electronic trade matching platforms and self-trade prevention tools.[8] MGEX believes these concepts should be considered at a later date, and urges the Commission to also postpone further consideration of compliance programs and DCM market maker programs.

From MGEX's perspective, implementation of RegAT could proceed as follows. First, the Commission could finalize a principles-based approach for pre-trade risk controls. As set forth in this Supplemental, this may include the adoption of new defined terms and a requirement that additional, appropriately and clearly defined persons or entities become CFTC registrants. Second, the Commission could consider principles relating to the development, testing, and deployment of electronic trading systems. This could encompass any special considerations for source code. Third, the Commission could then consider the need for principles for compliance programs for electronic trading systems. This could include whether there is a need to involve every DCM in reviewing compliance programs of FCMs and AT Persons. Fourth, the Commission could then consider whether it is necessary, and to what to degree, a DCM needs to publicly provide additional disclosures about its match engines and platforms. Fifth, the Commission could then consider whether additional self-trade prevention measures are needed. Sixth, and last, the Commission could then consider if additional requirements for DCM market maker programs are necessary.

[7] Supplemental at 85366.
[8] *Id.*

b. The Commission's approach on pre-trade risk controls as set forth in the Supplemental should be further refined to a truly principles-based approach.

MGEX appreciates that the Commission is reconsidering its approach to pre-trade risk controls. In the Supplemental, the Commission proposes moving from a three-tier to a two-tier framework, under which every order would be subject to two layers of controls, instead of three that was proposed originally.[9] For the most part, controls would be applied at the following levels: FCM and DCM. But, some AT Persons would apply controls themselves instead of a FCM. The DCM in either case would provide a second layer, or tier, of controls. This is a notable change, and MGEX is generally supportive of it because it is a step towards reducing the prescriptive nature of the pre-trade risk control framework.

In addition, MGEX is encouraged that the Commission "intends to increase the flexibility and decrease the burden on AT Persons, FCMs and DCMs in terms of the level of granularity at which controls must be set."[10] The Commission explains that "[b]y 'as appropriate', [it] means such level or levels of granularity as are technologically feasible and reasonably effective at preventing and reducing the potential risk of an Electronic Trading disruption. … Rather, as implementation of controls at each such level becomes technologically feasible, AT Persons, FCMs and DCMs should update their practices to optimize the placement of their risk controls at the most effect level." This type of thinking reflects a principles-based approach that should be extended broadly to RegAT. And with respect to the granularity of controls, an agile regime is needed to accommodate not only the varying technological and software systems that exist today, but to remain workable for the foreseeable future as technology and software changes will undoubtedly happen.

MGEX also supports the Commission's conclusion that all electronic trading, not just algorithmic trading, presents a potential risk of market disruption and therefore should be included as part of any regulatory framework for pre-trade risk controls. Specifically, the Commission proposes that "[e]lectronic orders originating with a *non*-AT Person are subject to risk controls implemented by executing FCMs pursuant to Supplemental proposed § 1.82".[11] MGEX believes, however, that a Core Principle framework for controls would be a superior and more direct approach compared to what is currently being proposed.

Under a principles-based approach, the types of controls and layers at which controls are applied may vary between contracts and DCMs. There is, after all, diversity among contracts, trading platforms, match engines, DCMs, and market participants. Put differently, various factors come together to create the risk profile of market disruption that may be caused by electronic trading for a particular contract market. With the current proposal, there are separate regulations for AT Persons, and separate regulations for controls for all other entities. Under a truly principles-based approach, this could be

[9] Supplemental at 85353.
[10] *Id.* at 85356.
[11] *Id.* at 85355.

avoided. Instead, there could be a guiding principle that pre-trade risk controls must be implemented for all orders that are submitted electronically.[12] A one-size fits all solution is not needed to ensure that the industry continues to be proactive and responsive to the evolving nature of electronic trading. As such, MGEX recommends that the Commission continue to move in this direction and further embrace a principles-based regime for pre-trade risk controls.

c. The Commission should further evaluate the method to determine status as AT Person so it is better tied to risk and quantitatively supported.

The Commission has proposed to use a volume threshold to determine status as AT Person. As apparent from RegAT, this designation would result in increased regulatory obligations. It is therefore important that the threshold is logical and appropriate. Otherwise, the Commission may create regulatory burdens for some entities that would be difficult to justify when comparing the benefits to the costs.

While MGEX is generally supportive of the Commission's proposed volume threshold to determine AT Person status, MGEX recommends that the Commission also utilize another metric to further refine the population of AT Persons. As noted in the Supplemental, the Commission ruled out using other metrics, concluding that volume is the best metric to identify which entities should be held to requirements of AT Persons.[13] MGEX agrees that volume has some relationship to risk, but perhaps not as profoundly as the Commission does. Accordingly, MGEX recommends marrying the proposed volume threshold with another metric to further and appropriately limit the potential pool of AT Persons. MGEX believes an appropriate metric would be the number of order messages sent over a fixed period of time.

In addition, the Commission's proposed threshold of an aggregate average daily volume of at least 20,000 contracts needs more quantitative support. The Commission has not fully articulated a basis for the volume threshold. The Commission did provide that with a 20,000 contracts threshold, "there would be approximately 120 AT Persons, a portion of which would be newly registered under the amended definition of floor trader."[14] MGEX believes additional quantitative analysis is needed to better inform the public and others of the rationale for this precise metric.

As far as how an entity should determine if they have crossed the threshold, MGEX generally supports the Commission's approach in the Supplemental. The Commission proposes that each entity compute its aggregate daily contract volume over a six month period – specifically, the periods of January 1 through June 30 and July 1 through December 31. If an entity crossed the threshold during such a period, it would then be an

[12] In the Supplemental, the Commission proposes requirements that are to be applied to electronic orders that do not originate from AT Persons. These requirements largely mirror those that apply to AT Persons, as it relates to pre-trade risk controls. These parallel regulations would be unnecessary under a truly principles-based approach.
[13] Supplemental at 85342.
[14] *Id.* at 85342.

AT Person. In addition, if an AT Person does not satisfy "such volume threshold test for two consecutive semi-annual periods … then such person shall no longer be considered an AT Person."[15] MGEX supports requiring entities to determine if it crossed the threshold on a semi-annual basis, but recommends that an entity should no longer be deemed an AT Person if it does not satisfy the volume test for *any* semi-annual period, not two consecutive periods. Of course, an entity can choose to register or remain registered with NFA regardless of volume.

Further, the Commission proposes that each entity must include "their own trading volume and that of any other persons controlling, controlled by or under common control with the potential AT Person."[16] MGEX supports this standard.

MGEX also supports the Commission's anti-evasion rule as it relates to the AT Person volume threshold. The anti-evasion rule would operate to "prevent market participants from structuring transactions and legal entities in order to avoid the requirements of Regulation AT." MGEX shares the Commission's concern that an entity should not be able to circumvent the intent of the proposed volume threshold test.

d. The Commission should withdraw the requirement for DCMs to review compliance programs of AT Persons and FCMs.

MGEX appreciates that the Commission has revised its approach to the proposed DCM annual compliance report review program. The Commission has proposed to require that a DCM "periodically review AT Persons' and FCMs' programs for compliance with §§ 1.80, 1.81 and 1.82".[17] The Commission further notes that this would be "similar to their existing programs for periodically reviewing members' and market participants' compliance with audit trail recordkeeping requirements."[18] Furthermore, DCMs are to "require by rule that AT Persons and executing FCMs provide DCMs with an annual certification attesting that the AT Person or FCM complies with the requirements of §§ 1.80, 1.81 and 1.82 …."[19]

While MGEX acknowledges that the revisions proposed in the Supplemental may moderately reduce the compliance burden to DCMs, MGEX questions the benefits of the proposed review program. It would be different than anything a DCM currently does, including its audit trail compliance program. A DCM does not necessarily possess staff with the expertise or technical familiarity with the various trading systems used and strategies employed by all AT Persons or FCMs. It would therefore be challenging to intelligently and effectively review, and then pass judgement on, such compliance programs. In addition, much of the information in a report would likely be stale by the time a DCM performs its review, making the exercise of limited value.

In addition, MGEX is concerned that DCMs could potentially be exposed to liability as

[15] *Id.* at 85391.
[16] *Id.* at 85342
[17] Supplemental at 85364.
[18] *Id.*
[19] *Id.*

result of reviewing a compliance program. For example, a claim could arise that a DCM failed to properly identify and remediate an issue with an FCM's or AT Person's compliance program, and that such failure caused a market disruption event, which in turn allegedly caused a market participant to incur losses. If the Commission adopts the proposed compliance review program, MGEX requests that the Commission explicitly provide in the final rulemaking that a DCM cannot be held liable for any alleged failure to find and remediate deficiencies of an FCM's or AT Person's compliance program, including their trading algorithms. In short, a DCM should not be culpable or liable for a FCM's or AT Person's trading activities or compliance programs.

Further, since such a compliance review program could well be a new or larger task for DCMs to complete, there would be significant initial and ongoing costs. MGEX appreciates that the Commission noted that "MGEX estimated that it would need to hire at least two additional full time employees to review the reports, and that reviewing each report would take significantly longer than the 15 hours estimated in the NPRM."[20] MGEX believes that even under a periodic review program, it would still have to hire additional staff. In the end, the result is the same: investment in resources. When compared to the nominal benefit even a periodic review program would have, it becomes difficult to justify the compliance costs.

Next, MGEX still believes that a DSRO or FCM would be in a better position to review compliance programs than a DCM. The Commission, however, observed that "at this time the Commission believes that the DCM is the appropriate entity to review the compliance programs of AT Persons."[21] The Commission continued by explaining that "[t]he DCM will have a broader perspective of the entire market compared to an FCM, and is better situated to ensure that there is a consistent baseline of sufficient controls across all AT Persons and executing FCMs." A DCM may have a superior ability to look at the entire market for baseline standards, but the point of the review should not be to ensure consistency among trading entities. Instead, it should be about whether the entity is in compliance with mandated requirements and adheres to other sound practices that are tailored to its operations and risk profile. Knowledge of what others are doing does not necessarily inform a DCM that the entity's compliance program under review is sufficient. Instead, what is important to make such an evaluation is knowledge of the customer, which resides at the FCM more so than DCM.[22]

All said, MGEX recommends that the Commission withdraw 40.22(a) (the requirement for DCM's periodic review program), but maintain 40.22(d) (the requirement that DCM's have a rule that AT Persons and FCMs attest on an annual basis that they are in compliance with applicable provisions of §§ 1.80, 1.81 and 1.82). As would be the case today, if there was an apparent market disruption event that may have been caused by an errant trading system or algorithm, a DCM is already able to request compliance programs to review them. Having this attestation requirement would be useful, however, because it acts as

[20] *Id.*

[21] *Id.*

[22] Regarding a DSRO specifically, they are currently performing audits and would therefore be in a better position than a non DSRO to audit and assess compliance programs.

an incentive to have a program and the nonexistence of such a program could become material fact of a DCM's investigation.

e. The Commission should obtain a subpoena to access source code.

MGEX maintains that the Commission should follow the existing subpoena process to access source code. The Supplemental proposes that access to source code and related records would require either a subpoena or a "special call", which would require Commission approval.[23] The Commission explains that this proposal provides additional safeguards. While that may be true, MGEX still believes the constitutional protections afforded to source code outweigh the Commission's desire for expedient access. MGEX continues to support that source code should be maintained in a manner that can be made readily available, but that the Commission must obtain a subpoena to access it.

f. Responses to the Commission's other proposed or potential modifications to RegAT.

The Commission proposes several additional changes to RegAT, and also notes it is contemplating making even more. MGEX supports some of these modifications. MGEX appreciates that the Commission has removed some prescriptive and unnecessary compliance obligations. MGEX encourages the Commission to further scale back the scope of RegAT and to implement it in phases, should it decide against restarting the rulemaking process after Commissioner vacancies are filled.

The Commission proposes revising "AT Order Message" by replacing the words "change or deletion" with "modification or cancellation" since these terms are more commonly used.[24] The Commission also proposes removing the word "quote" from this definition, as it only intends the term to mean an actionable message to a DCM.[25] MGEX supports these changes, although it believes under a truly principles-based regime such a definition would be unnecessary.

The Commission proposes revising §1.82 such that "the risk control and recordkeeping requirements previously applicable to clearing member FCMs now apply to executing FCMs."[26] MGEX supports this change, and notes that this is generally consistent with a principles-based regime where the entity closest to the risk should be responsible for pre-trade risk controls.

The Commission proposes allowing AT Persons to delegate pre-trade risk control obligations to their executing FCM.[27] MGEX supports this proposal, and believes it is appropriate to allow FCMs to determine whether or not to accept such delegation.

The Commission proposes removing the requirement that AT Persons notify both their

[23] *Id.* at 85346.
[24] Supplemental at 85360.
[25] *Id.*
[26] *Id.* at 85360.
[27] *Id.* at 85360.

clearing member and DCM prior to using Algorithmic Trading. MGEX supports this removal, as it would be of little value to a DCM for an AT Person to inform them that they will be engaging in Algorithmic Trading.

The Commission is considering changes to the definition of Algorithmic Trading Compliance Issue; specifically, that it may remove references to "an AT Person's own internal rules, those of its clearing member, any DCM on which it trades, or an RFA."[28] MGEX supports removing these references. MGEX does not view it as an effective oversight strategy to potentially discipline an entity for their violation of a self-imposed internal requirement. Doing so may discourage having robust internal protocols. In addition, if there were an issue caused by algorithmic trading, MGEX believes a DCM will have other existing rules to use. As such, it would be duplicative to reference a DCM's rules in the proposed definition.

The Commission is considering changes to the definition of Algorithmic Trading Disruption; specifically, that it would eliminate "references in the definition to a disruption of an AT Person's own ability to trade, and limit the scope of the term to disruptions of the market and other's ability to trade on it." MGEX agrees with this decision. MGEX does not believe there would be a benefit to potentially subjecting an AT Person to disciplinary action merely because they experienced an internal issue that had no impact on any entities' ability to trade, or to the market itself.

The Commission is considering changes to the requirement that *all* changes to Algorithmic Trading code are tested prior to their use in production environments; specifically, the Commission is contemplating limiting testing to material changes and has withdrawn the requirement that AT Persons test "Algorithmic Trading code and related systems on each DCM on which Algorithmic Trading will occur." MGEX supports this direction. MGEX understands the importance of thoroughly testing material software changes prior to their use in a production environment. Indeed, it would be abnormal to bypass such testing. MGEX believes a requirement to test material changes in at least one production-like environment will resolve the concerns many commenters raised while still achieving the Commission's goal of reducing the risk of market disruption.

The Commission "is considering whether to eliminate certain language in the NPRM preamble regarding CFTC expectations that the person monitoring an algorithm should simultaneously be engaged in trading." MGEX understood the original NPRM to prohibit persons from being simultaneously engaged in monitoring an algorithm and trading via the algorithm. Nonetheless, MGEX believes that the Commission should not adopt any regulation that compels a natural person to monitor electronic trading systems. MGEX believes that an entity should be able to decide whether a natural person monitor is a necessary component of their compliance program or internal policies and procedures.

The Commission is "also considering whether to eliminate in its entirety NRPM proposed § 1.81(c)(2)(II)," which would require each AT Person to have certain written policies and procedures. MGEX would support eliminating this prescriptive requirement and instead

[28] *Id. a*t 85365.

support guidance for AT Persons to have a sufficient internal compliance program that is reasonably designed to reduce the risk that their electronic, including algorithmic, trading may cause market disruption.

* * * * * * * * * * * * *

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