



Commodity Markets Council  
1300 L St., N.W. Suite 1020  
Washington, D.C. 20005  
Tel 202-842-0400  
Fax 202-789-7223  
www.commoditymktcs.org

May 1, 2017

*Via Electronic Submission*

Chris Kirkpatrick  
Secretary  
U.S. Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581

Re: **Supplemental Notice of Proposed Rulemaking: Regulation Automated Trading (RIN 3038-AD52)**

Dear Mr. Kirkpatrick:

The Commodity Markets Council (“CMC”) appreciates the opportunity to submit the following comments in response to the U.S. Commodity Futures Trading Commission’s (the “CFTC” or “Commission”) Supplemental Notice of Proposed Rulemaking for Regulation Automated Trading (“Supplemental”).<sup>1</sup>

## **I. Introduction**

CMC is a trade association that brings together exchanges and their industry counterparts. Its members include commercial end-users which utilize the futures and swaps markets for agriculture, energy, metals, and soft commodities. Its industry member firms also include regular users and members of such designated contract markets (each, a “DCM”) as the Chicago Board of Trade, Chicago Mercantile Exchange, ICE Futures U.S., Minneapolis Grain Exchange, New York Mercantile Exchange, and NASDAQ Futures, Inc. They also include users of swap execution facilities (each, a “SEF”). The businesses of all CMC members depend upon the efficient and competitive functioning of the risk management products traded on DCMs, SEFs, or over-the-counter (“OTC”) markets. As a result, CMC is well positioned to provide a consensus view of commercial end-users on the impact of the Commission’s proposed regulations on derivatives markets. Its comments, however, represent the collective view of CMC’s members, including end-users, intermediaries, and exchanges.

## **II. Overview**

CMC supports the Supplemental Proposal’s stated intent to (i) reduce risk and increase transparency in algorithmic order origination and electronic trade execution in all U.S. futures

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<sup>1</sup> *Regulation Automated Trading*, Supplemental Notice of Proposed Rulemaking, 81 Fed. Reg. 85334 (Nov. 25, 2016).

exchanges; (ii) modernize the Commission's regulatory regime, (iii) promote the safety and soundness of trading on all contract markets, and (iv) seek to keep pace with evolving technologies. To assist the Commission in its attempt to accomplish its stated intent, CMC and its member firms submitted comprehensive responses to the 2013 Concept Release on Risk Controls and System Safeguards for Automated Trading Environments ("Concept Release")<sup>2</sup>, and the Notice of Proposed Rulemaking on Regulation Automated Trading ("Regulation AT")<sup>3</sup>. In addition, some of our members participated in the June 2016 Staff Roundtable on Elements of Regulation AT. Our efforts over the years were due in part because CMC believes that automated trading should be subject to *appropriate* pre- and post-trade risk and other controls. Further, CMC and its members provided feedback in an effort to help the Commission in striking the right balance between regulatory oversight and cost burdens on commercial end-users. CMC looks forward to continued dialogue with the Commission and staff to reach an outcome that will protect the integrity of our derivatives markets and be workable for commercial end-users.

As this process moves forward, CMC respectfully asks the Commission to reevaluate its original goals and purpose for this rulemaking endeavor. For example, was Regulation AT designed to address all types of automated trading? What is the purpose of floor trader registration, and the labeling of registrants and non-registrants as AT Persons? What purpose does registration serve, and is it necessary for regulatory oversight purposes? Does registration really help the Commission reduce and monitor market risks stemming from automated trading, and help enhance the safety and soundness of our derivatives markets? CMC urges the Commission to consider whether registration is indeed necessary, but also, to take a step back and reassess the original intent of this rulemaking in its entirety. It should be noted that industry best practices and regulatory technology has significantly evolved since the original 2013 CFTC Concept Release. The Commission should evaluate the extent to which current technology already addresses regulatory concerns raised in the Supplemental. For a full description of current technology and industry best practices, CMC would direct the Commission to pages 3 to 8 of the Futures Industry Association Comment Letter in Response to the Supplemental dated May 1, 2017.

The Supplemental, as proposed, is complex and overly prescriptive. The regulatory burdens it imposes are not necessary, appropriate, nor practicable to address the risks that the Commission seeks to address. In its current form, the Supplemental, still tries to accomplish too much and addresses too many issues in a single rulemaking. Moreover, the Supplemental is not consistent with the President's Executive Order, "Core Principles for Regulating the United States Financial System."<sup>4</sup> This Order outlines the principles by which the Trump Administration will regulate the financial system. One principle is to "make regulation efficient, effective, and appropriately tailored." The Supplemental, however, as proposed, runs counter to this core principle: it is neither efficient, will likely prove to be ineffective, and is not appropriately tailored.<sup>5</sup> Should the Commission move forward with a federally mandated rulemaking to regulate automated trading practices, it should adopt a principles-based rule with policies and procedures *reasonably designed* to achieve the Commission's purpose, without mandating overly prescriptive requirements as to how the underlying principles are satisfied.

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<sup>2</sup> *Concept Release on Risk Controls and System Safeguards for Automated Trading Environments*, Proposed Rule, 78 Fed. Reg. 56542 (Sept. 12, 2013).

<sup>3</sup> *Regulation Automated Trading*, Notice of Proposed Rulemaking, 80 Fed. Reg. 78824 (Dec. 17, 2015).

<sup>4</sup> Exec. Order No. 13772, 82 Fed. Reg. 9965 (Feb. 3, 2017).

<sup>5</sup> *Id.*

In order to achieve the Commission's goals and to implement the most efficient and effective regulatory regime to oversee the risks associated with automated trading, CMC encourages the Commission to take the following steps:

1. Withdraw the Supplemental.
2. Conduct a study assessing the risks accompanying automated trading, and the best method to address those risks in light of current technology and industry best practices.
3. If the study concludes that a federal rulemaking is necessary, then consider a new rulemaking that carefully analyzes the costs and benefits, and its unintended consequences.

The new rulemaking should focus on risk controls, and implement **core-principles** based on industry best practices. Additionally, the Commission should preserve its resources and better utilize the experience and expertise of self-regulatory organizations (SROs) and DCMs in addressing the risks that arise from automated trading. Meanwhile, other topics outside the scope of risk controls should be considered in separate rulemakings, only if necessary and appropriate to do so. This approach will not only best protect the markets, but will also provide the flexibility required to accommodate innovation and new technologies within the industry.

The Supplemental started out as a Concept Release in 2013, and has been controversial since its proposal. We firmly believe that there is a pressing need to take the time and effort to solicit further comments and to carefully analyze stakeholder input and the unintended consequences of any new proposal, especially given that this rule making is not mandated by the Dodd-Frank Act and is therefore not specifically required to be completed by a certain date set by Congress.

Nonetheless, if the Commission decides to move forward with the Supplemental, as written, Section III below provides an overview of the topics that are especially problematic to CMC members.

### **III. The Supplemental Notice of Proposed Rulemaking**

The Supplemental as proposed is overly prescriptive and unworkable. While CMC appreciates the Commission's efforts to address some of our concerns, the rule is flawed and still poses significant concerns to commercial end-users that utilize the derivatives markets to hedge everyday business risk. Below, CMC highlights some provisions in the Supplemental that pose the biggest challenges to our members.

#### **a. Definitions**

The Supplemental attempts to categorize market participants that would be subject to the rule's risk controls, testing, and other requirements by designating those satisfying an arbitrary volume threshold test, among other elements, as AT Persons for CFTC-registrants, or as Floor Traders (FTs) for non-registrants. CMC urges the Commission to focus on "what," (i.e. the activity), rather than the "who," in determining which parties should be subject to the rule's prescriptive standards. We believe that designation as AT Persons is unnecessary as the Commission already maintains the authority to regulate market participants' activities without imposing a registration requirement. The designation as an FT is not appropriate and is inconsistent

with the statutory history and historic function of this registration category.<sup>6</sup> CMC also opposes the requirement for AT Persons and FTs to register with a Registered Futures Association (RFA) and the additional ancillary expenses associated with registration such as CFTC Rule 1.31 and 1.35<sup>7</sup> recordkeeping requirements which would in many cases be cost prohibitive for some CMC members.

Additionally, the definition of Direct Electronic Access (DEA) is overly broad and problematic. Our members believe that the proposed definition will capture all customer orders placed through a Futures Commission Merchant (FCM), and only exclude orders that are “first received from an unaffiliated natural person by means of oral or written communications” then submitted to a DCM for or on behalf of the third party. CMC believes that the Commission intended to exclude all orders that are intermediated by an FCM or placed by a self-clearing entity subject to a DCM-approved Risk Control Framework. We believe this to be appropriate.

#### **b. Risk Control Framework**

CMC applauds the Commission’s move toward a two-tier risk control framework, recognizing the differences between an executing FCM and a clearing FCM. However, the proposed risk controls are still too prescriptive and granular (i.e. order cancellation systems, pre-trade risk controls and other risk controls, and execution throttles), and should be replaced with principles-based standards. More importantly, many of our member firms utilize basic order management functionality (i.e. excel spreadsheet, auto-spreaders, and iceberg/reserved quantity orders), and may access DCMs through software, servers, or systems owned by independent software vendors (ISVs). As such, we believe these market participants, mostly commercial end-users, should not be subject to the prescribed risk controls in any final rulemaking as they do not pose the risks that the Commission is trying to address.

#### **c. Source Code**

In the Supplemental, Algorithmic Trading Source Code (ATSC) and related records are not properly defined, and we urge the Commission to reexamine the definition. But, generally, source code is thought of by the industry as highly sensitive, proprietary information requiring the utmost protection. In addition, the Commission tried to address commenters concerns over the previous proposal’s provision that made ATSC available upon request for inspection by any representative of the Commission or the Department of Justice. The Supplemental proposes ATSC to be requested only by means of a special call authorized by the Commission or a subpoena. Nevertheless, market participants worry that the special call process does not provide the necessary safeguards to protect a firm’s valuable intellectual property. We believe the Commission should only request ATSC

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<sup>6</sup> For a full discussion of the legislative history of FT and the inapplicability of the Commission’s proposed use of that registration category in this context, *see* Comment Letter of the Commercial Energy Working Group on the Supplemental dated May 1, 2017, pages 7-8.

<sup>7</sup> *See* CFTC Rule 1.31 and 1.35.

through a valid subpoena and with additional safeguards<sup>8</sup> in place, as this is the only avenue that provides market participants with legal certainty and due process.

#### **d. Testing, Monitoring, Recordkeeping, and Reporting**

Our members are pleased by the Commission's judgment to eliminate the requirement for AT Persons and FCMs to file annual compliance reports with DCMs. Yet, we believe the requirement for FCMs and AT Persons to periodically review their compliance<sup>9</sup> with the rule, and the requirement for FCMs and AT Persons to file a certification<sup>10</sup> to the DCM are unnecessary, overly burdensome, and do not serve to enhance the safety of our markets. Instead, CMC encourages the Commission to revisit these requirements.

#### **e. Third-Party Requirements**

The Supplemental requires AT Persons using third-party systems and unable to comply with a particular development or testing requirement or a particular maintenance or production requirement for ATSC and related records to comply with the regulations by satisfying two troublesome requirements: (i) obtain a certification that the third-party is complying with the obligation; and (ii) conduct due diligence regarding the accuracy of the certification. CMC and its members believe that the certification requirement will only lead to lengthy negotiations with third-party vendors that will be very costly and time-consuming. Likewise, the due diligence requirement is costly and complex. As a result, commercial end-users fear that these requirements will disrupt and harm good working relationships with their third-party vendors, impose unnecessary cost on market participants, and provide no additional regulatory benefit. CMC, therefore, asks that the Commission refrain from any further action with regard to the Supplemental's Third-Party Requirement provision, and hold a public roundtable with interested parties to consider a different approach to address these concerns.

### **IV. Conclusion**

Thank you for the opportunity to provide comments on the Supplemental. If you have any questions or concerns regarding this letter, please do not hesitate to contact Kevin Batteh at [Kevin.Batteh@Commoditymkts.org](mailto:Kevin.Batteh@Commoditymkts.org).

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<sup>8</sup> In addition to the subpoena, the Commission could require ATSC and related records to be available for inspection only on-site at the AT Person's facilities, and/or require the ATSC and related records to be inspected in a controlled, secure environment/network.

<sup>9</sup> FCMs or AT Person must periodically review its compliance with the rule to determine whether it has effectively implemented sufficient measures reasonably designed to prevent and reduce the potential risk of an algorithmic trading event.

<sup>10</sup> FCMs or AT Persons using its own or a third-party system must certify to the DCM that they are substantially equivalent to the DCMs systems and controls.

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May 1, 2017  
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Sincerely,

A handwritten signature in blue ink that reads "Kevin K. Batteh". The signature is written in a cursive style with a long horizontal stroke at the end.

Kevin K. Batteh  
General Counsel  
Commodity Markets Council