



AMERICAN PETROLEUM INSTITUTE

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Monday, May 1, 2017

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

Re: RIN 3038-AD52: Notice of Supplemental Proposed Rulemaking on Regulation Automated Trading (“Regulation AT”), 81 Fed. Reg. 85334 (November 25, 2016)

Dear Mr. Kirkpatrick:

The American Petroleum Institute (“API”) 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 Proposal”).¹

We reiterate our support of the Commission’s goal to reduce risk in the financial markets, ensure reliable and orderly price discovery and prevent market abuses. We also support certain aspects of the Supplemental Proposal, including allowing market participants greater discretion regarding compliance with the pre-trade risk control requirements and proposing a risk control framework at two, rather than three levels. However, we believe that the Supplemental Proposal is too prescriptive and is neither necessary nor appropriate to address the risks of electronic trading.

If, however, the Commission determines that rules at the federal level are necessary, we encourage the Commission, in lieu of moving forward with the current proposal, to adopt instead principles-based rules that would require electronic trading to be subject to policies and procedures reasonably designed to achieve the purposes of the rule, and defer to the DCMs to adopt more detailed rules as appropriate for each market and market participant’s trading activity.

Direct Electronic Access

We believe that the proposed definition of Direct Electronic Access (“DEA”) is overly broad and problematic, and will capture virtually all customer orders placed through an FCM. Under our interpretation of the Supplemental Proposal, it seems that the proposed definition would exclude only those situations in which an order is first received from an unaffiliated natural person by

¹ 81 Fed. Reg. 85334 (Nov. 25, 2016).

means of oral or written communications and then submitted to a DCM for or on behalf of the third party. The definition of DEA should exclude trading through the infrastructure of an FCM. Sponsored access (i.e. through an FCM or DCM) should not be considered DEA. The DEA definition should provide a safe harbor for those trading through an FCM's infrastructure. The Commission has not explained why the Supplemental Proposal expanded the scope of DEA or why the newly captured market participants pose the type of risk that could lead to market disruptions. API believes that the Commission intended to exclude all orders that are intermediated by an FCM.

AT Person

The Supplemental Proposal 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. API urges the Commission to focus on "what," the activity, rather than the "who," in determining which parties should be subject to the rule's prescriptive standards. API opposes the use of arbitrary bright line quantitative tests and, accordingly, does not support the addition of a volume threshold test of the definition of AT person. We believe that designation as AT Persons or as FTs is unnecessary as the Commission already maintains the authority to regulate market participants' activities without imposing a registration requirement. API also opposes the requirement for AT Persons and FTs to register with a Registered Futures Association ("RFA").

Algorithmic Trading Source Code Retention and Inspection

API opposes the Commission's proposal, as set out in the Supplemental Proposal, that would make Algorithmic Trading Source Code available for inspection by any representative of the Commission or Department of Justice without a subpoena. Source code is thought of by the industry as highly sensitive, proprietary information requiring the utmost protection. The Supplemental Proposal seeks to address our member concerns by proposing that Algorithmic Trading Source Code may be requested by means of a special call authorized by the Commission ("Enhanced Special Call" or by subpoena. However, we agree with Commissioner Giancarlo that "the special call process provides the CFTC an end-run-around the subpoena process" and that although the Commission states it will "use the special call process to obtain source code in carrying out its market oversight responsibilities, there is no limit in the proposed rule on DMO staff from sharing source code with staff of the Division of Enforcement."² Although we appreciate the Commission's efforts to offer additional safeguards against unnecessary demands for disclosure of intellectual property, the Enhanced Special Call process does not provide the protections available to market participants when a subpoena is required. Consequently, it remains our view that, in the absence of a voluntary production of Algorithmic Trading Source Code from an AT Person subject to agreed restrictions, the Commission or the Department of Justice should be required to obtain such Algorithmic Trading Source Code through a validly authorized subpoena. The subpoena process provides a clear legal route for a source code owner

² Statement of Dissent by Commissioner J. Christopher Giancarlo Regarding Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading (Nov. 4, 2016) available at <http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110416>.

to challenge the production of source code or to seek and obtain legally enforceable protections (e.g., a protective order) for sensitive property.

Recordkeeping and Reporting

API supports the Commission's decision to eliminate the proposed requirement that AT Persons and FCMs file annual compliance reports with DCMs and that each DCM establish a program for effective review and evaluation of such reports. Nonetheless, we are disappointed that the Commission has chosen to impose on FCMs and swap dealers an obligation to prepare and file an annual certification in light of their obligation to already prepare and certify an annual compliance report under Commission Rule 3.3. We also question the meaning and purpose of imposing on DCMs the obligation to require such "periodic reporting" from AT Persons and FCMs "as necessary" as part of their oversight program of electronic trading on their markets.

* * *

In conclusion, API reiterates its support of the Commission's goals and objectives in enhancing the regulatory regime for automated trading. We continue to be concerned, however, that proposed Regulation AT, as revised by the Supplemental Proposal, will not achieve these goals. Proposed Regulation AT is too prescriptive and is neither necessary nor appropriate to address the risks of electronic trading.

However, if the Commission ultimately concludes that rules at the federal level are necessary, we encourage the Commission, in lieu of moving forward with the current proposal, to adopt instead principles-based rules. Principles-based requirements can evolve with the market, are appropriate to the role of the market participant, avoid unnecessary complexity, and ultimately will best serve the market. We look forward to continuing to work with the Commission and its staff as the Commission considers an efficient and effective regulatory approach to automated trading.

If you have any questions or need any additional information with respect to the matters discussed herein, please direct them to Stephen Comstock at (202) 682-8455 or comstocks@api.org.

Respectfully submitted,
/s/ Stephen Comstock
Director of Tax and Accounting Policy
American Petroleum Institute

Sincerely,

A handwritten signature in black ink, appearing to be 'J. F. K.' with a horizontal line extending to the right.