



May 1, 2017

VIA ELECTRONIC SUBMISSION

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

RE: Supplemental Notice of Proposed Rulemaking, *Regulation Automated Trading*, RIN 3038-AD52

Dear Secretary Kirkpatrick:

I. INTRODUCTION.

Freepoint Commodities LLC (“**Freepoint**”) hereby submits this comment letter in response to the Supplemental Notice of Proposed Rulemaking, *Regulation Automated Trading*,¹ issued by the Commodity Futures Trading Commission (the “**CFTC**” or “**Commission**”) on November 25, 2016.² The Supplemental NPRM addresses the Commission’s regulatory oversight of automated trading on designated contract markets (“**DCMs**”) and proposes to implement risk controls, transparency measures, and other safeguards with respect to such activity.

Freepoint is a physical commodity merchant headquartered in Stamford, CT. Founded in 2011, Freepoint has U.S. offices located in Atlanta, Houston, Kansas City, Portland, Minneapolis, and Louisville, and international offices in London, Toronto, Calgary, Beijing, Shanghai, Hong Kong, Singapore, and Zug. Freepoint engages in merchant trading in energy and agricultural commodities, as well as metals in North American, European and other global commodity markets. Freepoint’s physical marketing and logistics support is capable of managing the entire commodity chain – from the point of production to shipping and distribution to the end user. In addition to marketing and trading, Freepoint provides merchant financing and through its subsidiary, Freepoint Commodity Solutions, acts a retail energy provider in the U.S.

¹ *Regulation Automated Trading*, Supplemental Notice of Proposed Rulemaking, 81 Fed. Reg. 85,334 (Nov. 25, 2016) (“**Supplemental NPRM**”); *Regulation Automated Trading*, Notice of Proposed Rulemaking, 80 Fed. Reg. 78,824 (Dec. 17, 2015) (“**Original NPRM**”) (collectively, “**Regulation AT**”).

² The comment period for the Supplemental NPRM was extended from January 24, 2017 to May 1, 2017. See *Regulation Automated Trading*, Extension of Comment Period, 82 Fed. Reg. 8,502 (Jan. 26, 2017).



II. COMMENTS OF FREEPPOINT.

As a physical commodity merchant and active user of global commodity derivatives markets, Freepoint supports thoughtful and appropriately-tailored regulation intended to preserve fair and equitable trading in markets operated by DCMs. In this respect, Freepoint appreciates the continued effort by the Commission throughout this rulemaking to reconsider and revise its proposed framework for regulating automated trading. Notwithstanding improvements in the Supplemental NPRM, Freepoint has serious, fundamental concerns with respect to the structure, impact and overall objective of this proposed rulemaking and believes the proposed “floor trader” registration requirement is neither required nor appropriate. Given these concerns and recognizing the CFTC’s commitment to implement a workable framework for regulating automated trading, Freepoint believes that the most productive path forward is for the Commission, as part of this proceeding, to issue a re-proposal of this rule implementing a principles-based approach that eliminates any form of registration requirement and, instead, utilizes existing oversight by DCMs of automated trading in their markets.

A. The Adoption of a Regulatory Framework Tied to Floor Trader Registration Is Not Required to Achieve the Policy Goals of Regulation AT.

Freepoint supports the adoption of an appropriately-tailored approach for regulating automated trading whose sole focus is on protecting the integrity of DCM-operated commodity derivative markets. However, the regulatory framework set forth in the Supplemental NPRM, which is based on the registration of otherwise unregistered market participants who transact large volumes of DCM-listed contracts (“**Large Volume Traders**”) as “floor traders,” falls significantly short of this objective. In this respect, the proposed regulatory framework and registration regime:

- are not required to achieve the policy objectives of Regulation AT;
- will impose substantial burdens and have potentially significant unintended regulatory consequences for Freepoint and other similarly-situated commercial market participants; and
- appear to have a second, but equal, purpose of expanding the Commission’s jurisdiction under the Commodity Exchange Act (“**CEA**”) over Large Volume Traders that must register as “floor traders” that is not expressly limited to the context of regulating automated trading as contemplated in Regulation AT.

1. “Floor Trader” Registration Is Not Required to Achieve the Policy Objectives of Regulation AT.

As set forth in the Original NPRM and Supplemental NRPM, the primary policy objectives of Regulation AT are to (i) promote the safety and soundness of trading on all contract markets and (ii) keep pace with evolving technologies.³ Freepoint respectfully submits that “floor trader” registration is not necessary to protect against potential market disruption events that could result from malfunctioning or inappropriately deployed automated trading functionality, nor is it required to ensure that the development and implementation of risk controls keep pace with evolving technologies.

Many existing risk controls and best practices adopted by DCMs and utilized by market participants, including Freepoint, from order entry through order execution, are substantially similar—if not identical—to several measures that must be adopted by new “floor traders” if this rulemaking is adopted as proposed.⁴ Given this similarity, registration of new floor traders as proposed in the Supplemental NPRM will not provide any additional, material regulatory benefit or achieve the policy objectives of Regulation AT in a manner that cannot otherwise be achieved through the use of existing risk controls and best practices implemented by DCMs and market participants.

2. Costs and Burdens Imposed by “Floor Trader” Registration.

Large Volume Traders required to register as a “floor trader” for Regulation AT compliance purposes will be subject to several new prescriptive compliance obligations set forth in the Supplemental NPRM applicable to AT Persons.⁵ These compliance obligations will impose substantial costs and burdens on many commercial firms, including Freepoint, whose trades already are subject to risk and other controls imposed or administered by DCMs or other persons in the futures transaction chain, *i.e.*, intermediaries such as futures commission merchants and other clearing firms (collectively, “FCMs”).

Further, where a “floor trader” electronically accesses a DCM either (i) directly through an FCM, or (ii) through a routing system owned by (a) a DCM, such as CME Direct or WebICE,

³ See Supplemental NPRM at 85,335.

⁴ Although market-specific with respect to their operations, DCMs generally require firms that either (i) interconnect their routing systems or proprietary interface with a DCM-owned interface or (ii) electronically route orders for execution on a DCM, to implement risk and operational controls designed to protect market integrity. See CME Group, Comments on Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, RIN 3038-AD52, at 32-34 (Dec. 11, 2013) (“**CME 2013 Concept Release Comments**”); Futures Industry Association (“**FIA**”), Comments on Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, RIN 3038-AD52, at 43-45 (Dec. 11, 2013) (“**FIA 2013 Concept Release Comments**”); see also CFTC regulations 38.1-38.12, Subpart C – Compliance with Rules.

⁵ These compliance obligations include requirements to (i) implement certain pre-trade risk and other controls, (ii) adopt policies and procedures for the development, monitoring and testing of automated trading systems, (iii) keep records of algorithmic trading (“**AT**”) source code, and (iv) provide DCMs an annual certification attesting to their compliance with Regulation AT.

or (b) a non-dedicated multi-broker routing system owned by an independent software vendor (“ISV”), such as Bloomberg Tradebook Futures or Trading Technologies International, Inc., subject to FCM-administered risk controls, implementation of many of the AT Person regulatory requirements will be redundant and unnecessary given that DCMs, FCMs, and ISVs currently implement pre-trade risk and other controls. Certain other AT Person obligations will be impractical for many commercial firms falling within the “floor trader” definition to comply with since they do not own and maintain the actual AT or the routing infrastructure utilized to achieve their trading objectives.

Commercial firms becoming an AT Person by meeting the new, expanded “floor trader” definition will be subject to the requirements of an entirely new “regulator” and additional compliance requirements. Under proposed CFTC regulation 170.18, a new “floor trader” must become a “member” of a registered futures association. The only existing registered futures association in the U.S. is the National Futures Association (“NFA”).⁶ Under the Supplemental NPRM, a “floor trader” would be required to incur not only the costs and burdens associated with registering, but also the additional burdens associated with complying with substantive NFA obligations applicable to members.⁷

Finally, “floor trader” registration will have significant unintended regulatory consequences wholly unrelated to the regulation of automated trading that will undercut relief Congress and the Commission have provided to commercial firms. For example, a commercial firm that is required to register as a “floor trader” under the Supplemental NPRM (i) would become a “financial end-user” and subject to the CFTC’s and Prudential Regulator’s margin requirements⁸ and, (ii) if a “member” of a DCM or swap execution facility, would be subject to

⁶ NFA currently requires only FCMs, retail foreign exchange dealers, introducing brokers, swap dealers, major swap participants, commodity pool operators, and commodity trading advisors that direct client accounts or provide tailored investment advice to become NFA members. See <https://www.nfa.futures.org/NFA-registration/NFA-membership-and-dues.HTML>. However, under the Supplemental NPRM and distinct from current NFA rules, new “floor traders” will be required to register as a member of NFA.

⁷ Relevant requirements applicable to NFA members, include, but are not limited to: (i) maintaining business books and records supporting all aspects of the member’s commodity futures business available for inspection, (ii) maintaining policies and procedures to diligently supervise the member’s employees and agents, (iii) attesting on an annual basis that the member’s operations and procedures comply with all applicable NFA requirements, (iv) establishing a business continuity and disaster recovery plan, (v) adopting and enforcing written cybersecurity policies and procedures, (vi) implementing enhanced supervisory requirements designed to prevent abusive sales practices, (vii) undergoing periodic onsite examinations or audits by NFA, and (viii) adhering to certain standards in the member’s communication with the public, including promotional materials.

⁸ See *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, CFTC Final Rule and Interim Final Rule, 81 Fed. Reg. 636 (Jan. 6, 2016); see also Prudential Regulators Joint Final Rule, *Margin and Capital Requirements for Covered Swap Entities*, 80 Fed. Reg. 74,840 (Nov. 30, 2015), <https://www.gpo.gov/fdsys/pkg/FR-2015-11-30/pdf/2015-28671.pdf>; Prudential Regulators Joint Final Rule, *Margin and Capital Requirements for Covered Swap Entities*, 81 Fed. Reg. 50,605 (Aug. 2, 2016), <https://www.gpo.gov/fdsys/pkg/FR-2016-08-02/pdf/2016-18193.pdf>.

more stringent recordkeeping requirements under CFTC regulation 1.35 despite the Commission's efforts to reduce the regulation 1.35 burdens on an "Unregistered Member."⁹

In light of the foregoing, the proposed registration of new floor traders in the Supplemental NPRM will impose significant costs and burdens without providing any incremental regulatory benefit or achieving the policy objectives of Regulation AT. As discussed in Section II.B. below, Freepoint believes that a better and more efficient approach for achieving the policy objective of protecting market integrity would be for the Commission to issue a re-proposal in this rulemaking that recognizes and utilizes existing risk controls and best practices adopted by DCMs, intermediaries and market participants.

3. Congress Did Not Intend to Apply the Floor Trader Definition in CEA Section 1a(23) to Persons Whose Electronic Access to DCMs Is Sponsored by Intermediaries.

The Supplemental NPRM seeks to extend Commission oversight under the CEA to Large Volume Traders by subjecting them to the "floor trader" definition if they (i) transact DMC-listed contracts above a certain numeric threshold (ii) utilizing AT (iii) through "direct electronic access" ("DEA").¹⁰ As proposed in the Supplemental NPRM, the "floor trader" definition would capture Large Volume Traders meeting these criteria who place orders through, or are subject to risk controls administered by, a FCM. Freepoint submits that the proposed treatment of Large Volume Traders or any other unregistered market participant whose electronic access to DCMs is sponsored by a FCM as "floor traders" appears to be (i) beyond the scope of the statutory definition set forth in CEA Section 1a(23), and (ii) inconsistent with underlying Congressional intent which is focused on customer protection issues.¹¹

Specifically, when adopting CEA Section 1a(23), Congress intended to limit the scope and applicability of the "floor trader" definition to persons whose access to a DCM is not sponsored by a third-party intermediary. The legislative history is clear that Congress enacted this definition to capture those unregistered persons who purchased and sold futures for their own accounts on a DCM's trading floor for purposes of preventing them from aiding and abetting efforts by floor brokers to defraud their customers, *i.e.*, by acting as a conduit for floor

⁹ See *Records of Commodity Interest and Related Cash or Forward Transactions*, Final Rule, 80 Fed. Reg. 80,247 (Dec. 24, 2015); see also *Adaptation of Regulations to Incorporate Swaps – Records of Transactions*, Final Rule, 77 Fed. Reg. 75,523 (Dec. 21, 2012).

¹⁰ Under the Supplemental NPRM, DEA means, "[f]or purposes of §§ 1.3(x), 1.3(xxxx), 1.80, 1.81, 1.82, 38.255, and 40.20, . . . the electronic transmission of an order for processing on or subject to the rules of a contract market, including the electronic transmission of any modification or cancellation of such order; *provided however* that this term does not include orders, or modifications or cancellations thereof, electronically transmitted to a DCM by a FCM that such FCM first received from an unaffiliated natural person by means of oral or written communications." See proposed CFTC regulation 1.3(yyyy).

¹¹ See *Oversight Hearings With Regard to the Reauthorization of the Commodity Futures Trading Commission: Hearings Before the S. Comm. on Agric., Nutrition, and Forestry*, 101st Cong. 178 (1989) (testimony of Dr. Wendy L. Gramm, Chairman, Commodity Futures Trading Commission).

brokers to (i) trade after the close, or (ii) front-run the floor broker's customer orders.¹² Based on the foregoing, Freepoint submits that any attempt to more broadly apply the existing statutory "floor trader" definition set forth in CEA Section 1a(23) to Large Volume Traders whose electronic access to a DCM is sponsored by an intermediary, such as a FCM, would likely require a legislative amendment.

4. Regulation AT Should Not Be Used as a Vehicle for Expanding the Commission's Plenary Jurisdiction Over Otherwise Unregistered Market Participants.

The proposed "floor trader" registration regime set forth in the Supplemental NPRM appears to have a second, but equal, purpose which is to expand the Commission's plenary jurisdiction under the CEA over Large Volume Traders. Neither the proposed definition of "floor trader," nor any related text in the preamble of the Original NPRM or the Supplemental NPRM addressing "floor trader" registration generally contains language indicating intent by the Commission to expressly limit the scope of this registration requirement to automated trading as contemplated in Regulation AT.

The development of a workable regulatory framework for automated trading activity that is focused on protecting market integrity and the expansion of the Commission's plenary jurisdiction under the CEA over Large Volume Traders through implementation of a new registration regime are separate and distinct issues. Given their respective complexities, regulatory implications, and the potential for unintended consequences, Freepoint urges the Commission not use the Regulation AT rulemaking for the latter purpose. If the Commission is seriously contemplating whether it will extend its jurisdictional reach over Large Volume Traders or any other unregistered market participant, it should address this issue on its own merits and in a separately-docketed rulemaking unrelated to automated trading.

B. The Commission Should Adopt a Principles-Based Approach for Regulating Automated Trading.

In order to ensure an appropriately-tailored framework for regulating automated trading, the Commission should issue a re-proposal in this rulemaking proceeding that pursues an alternative, principles-based approach aimed at ensuring proper controls exist to mitigate potential market disruptions related to automated trading. Freepoint believes DCMs, as market operators and self-regulating organizations ("SROs"), are particularly well equipped to identify the controls needed to mitigate risks on their markets and ensure that all market participants interconnecting with a DCM or submitting orders to a DCM have adopted such controls.

¹² The Commission's final rule issued in 1993 adopting the "floor trader" registration requirements reflects Congress' intent to protect consumers from certain floor-related activities by requiring persons whose transaction activities and access to DCMs did not flow through, or were not subject to risk controls administered by, intermediaries. See *Registration of Floor Traders; Mandatory Ethics Training for Registrants; Suspension of Registrants Charged With Felonies*, Final Rule, 58 Fed. Reg. 19,575 (Apr. 15, 1993).

Under the proposed principles-based approach, DCMs should be authorized to require all market participants employing AT to adopt a minimum set of pre- and post-trade risk controls and safeguards deemed appropriate to prevent AT disruptions to their markets. Because many market participants across the futures transaction chain currently employ pre-trade risk and operational controls, such as order size limits, outbound order message rate limits, automated execution throttles, effective trade monitoring, stop logic functionality, kill switches, and cancel on disconnect functionality,¹³ DCMs can leverage and build upon these best practices and controls.

Pursuant to regulatory obligations under their existing Core Principles, DCMs have already developed and implemented appropriate risk control systems for their markets and require as a condition of participation in their markets the implementation of such controls.¹⁴ Freepoint notes that, in addition to regulatory compliance obligations imposed under their Core Principles, DCMs have a clear economic incentive to ensure their markets operate efficiently without disruption, as market participants would cease trading on their markets if marketplace integrity and protection could not be expected. This incentive is squarely aligned with commercial market participants' fundamental need to transact in fair and orderly futures markets.

Freepoint believes that the implementation of a principles-based approach to regulating automated trading in commodity markets should be guided by the following:

- Principle-based standards focused on the protection of market integrity, while leaving the actual compliance with such standards to the discretion of the different persons in the futures transaction chain.¹⁵
- Recognition of existing risk controls utilized by the different persons in the futures transaction chain, while avoiding the imposition of duplicative compliance requirements.
- Flexibility to tailor and update specific policies and procedures to address the unique sets of risks faced by each person in the futures transaction chain given their respective business operations and commercial objectives.

¹³ See FIA, Guide to the Development and Operation of Automated Trading Systems (Mar. 2015), <https://fia.org/sites/default/files/FIA%20Guide%20to%20the%20Development%20and%20Operation%20of%20Automated%20Trading%20Systems.pdf>.

¹⁴ For example, existing CFTC Regulation 38.255 (Risk Controls for Trading), which falls under DCM Core Principle No. 4, and Appendix B to Part 38 provide principles-based regulation that allows DCMs the authority and flexibility to protect their markets as they deem appropriate. Consistent with CFTC Regulation 38.255, DCMs have established many of their current risk controls and safeguards for automated trading on their markets.

¹⁵ For example, the Futures Industry Association, Principle Trader Group (“**FIA PTG**”) published a white paper setting forth proposed best practices for risk controls for trading firms, which was endorsed by the Commission Technology Advisory Committee. See FIA, Principle Traders Group, Recommendations for Risk Controls for Trading Firms (Nov. 2010), <https://fia.org/articles/fia-ptg-recommends-risk-controls-trading-firms> (“**FIA Risk Control Paper**”). The FIA Risk Control Paper provides examples of baseline risk controls that should be adopted by trading firms.



- Encouragement of proactive adaptation to changing technological developments in automated trading and industry efforts to protect markets through further innovation in risk controls and system safeguards.
- Utilization of DCMs, in their capacity as SROs, to oversee automated trading activity within their markets and, as deemed necessary and appropriate, expand the DCMs' authority under their Core Principles to facilitate such oversight.

As the Commission moves forward in considering comments filed in this proceeding, Freepoint suggests that the Commission consider hosting another public roundtable on Regulation AT.¹⁶ Such a process would help the Commission thoughtfully consider key issues associated with the implementation of a principles-based approach to regulating automated trading proposed herein, such as (i) relevant market design issues, (ii) the mechanics of DCM oversight of automated trading activity as an SRO, (iii) whether all persons in the DCM transaction chain should be under the regulatory supervision of an SRO, the Commission or both, and (iv) the relevant costs and benefits of a principles-based approach as applied to (a) the Commission in light of its limited budget, (b) DCMs in their role as SROs, and (c) other persons in the DCM transaction chain.

¹⁶ Commodity Futures Trading Commission, *Staff Roundtable on Elements of Regulation Automated Trading*, (June 10, 2016).



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III. CONCLUSION.

Freepoint appreciates the opportunity to submit comments in the instant proceeding and requests that the Commission consider them as set forth herein. Freepoint expressly reserves the right to supplement these comments, as deemed necessary and appropriate.

If you have any questions, please contact the undersigned.

Respectfully Submitted,

/s/ Martin Ramirez

Martin Ramirez
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Freepoint Commodities, LLC