

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.

On behalf of The Commercial Energy Working Group (the “**Working Group**”), Eversheds Sutherland (US) LLP hereby submits this comment letter in response to the Commodity Futures Trading Commission’s (the “**CFTC**” or “**Commission**”) Supplemental Notice of Proposed Rulemaking, *Regulation Automated Trading*,¹ which proposes risk controls, transparency measures, and other safeguards in an attempt to improve the Commission’s regulatory oversight of automated trading on designated contract markets (“**DCMs**”).

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.

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**”).

The Working Group appreciates the Commission's continued efforts to collect and consider comments from market participants so that a workable rule in this proceeding may be developed. As active participants in commodity derivatives markets, the Working Group supports regulation that is intended to preserve market integrity, including the requirement to apply proper pre-trade risk and other controls to automated trading. However, for the reasons described below in Section II.A-B, the Working Group requests that the Commission reconsider its approach to regulating automated trading and, in this docket, issue a repropose rule reflecting a principles-based approach that eliminates the registration requirement and utilizes DCMs, in their role as self-regulatory organizations ("SROs"), to provide oversight of automated trading in their markets. As noted below in Section II.C, if the Commission's objective is also to expand its jurisdiction under the Commodity Exchange Act ("CEA") to otherwise unregistered large volume traders, the Commission should propose to do so in a separate rulemaking unrelated to automated trading.

II. COMMENTS OF THE WORKING GROUP.

A. The Commission Should Reconsider Its Proposed Registration Framework for Regulating Automated Trading.

The Working Group supports appropriately-tailored regulations that protect the integrity of futures markets. However, the regulatory framework proposed in the Supplemental NPRM, which is based upon the registration of otherwise unregistered market participants who transact larger volumes of DCM-listed contracts, (1) is unnecessary to achieve the policy objectives of Regulation AT, (2) would impose substantial burdens on commercial market participants, and (3) appears to be outside the scope of, and inconsistent with Congressional intent underlying, the existing statutory definition of "floor trader," as set forth in CEA Section 1a(23). Accordingly, the Working Group urges the Commission to reject this proposed regulatory framework.

1. Registration Is Unnecessary to Effectively Regulate Automated Trading.

i. Registration Is Not Required to Achieve the Policy Objectives of Regulation AT.

Both the Original NPRM and the Supplemental NPRM propose a framework for regulating automated trading that would require an otherwise unregistered market participant to register as a "floor trader," as that term is defined in CEA Section 1a(23). The Supplemental NPRM's stated policy objectives supporting the proposed floor trader registration requirement are to (i) promote the safety and soundness of trading on all contract markets and (ii) keep pace with evolving technologies.² As stated in previous

² See Supplemental NPRM at 85,335.

comment letters,³ the Working Group believes that floor trader registration is neither necessary to mitigate potential systemic risk in futures markets resulting from malfunctioning or inappropriately deployed automated trading functionality, nor required to ensure that the development and implementation of risk controls keep pace with evolving technologies. The Working Group believes a better approach for achieving the policy objectives of Regulation AT would be to recognize and utilize existing risk controls and best practices that have been adopted by the different persons in the transaction chain from order entry through order execution on a DCM.

Many existing risk controls and best practices adopted by DCMs and utilized by market participants are substantially similar—if not identical—to several measures a new floor trader would be required to adopt under the Supplemental NPRM. For instance, while the exact requirements are specific to each market, 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 including conformance testing of any participants' software before enabling such software to access the DCM system.⁴ In addition, DCMs typically oversee trading activity in their markets through the use of unique identifiers assigned to order messages sent by market participants while keeping an audit trail of such trading activity to which the Commission has access on a daily basis.

Given these considerations, registration of new floor traders 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.

- ii. *The Commission Should Not Use Regulation AT to Expand Its Plenary Jurisdiction under the CEA over Otherwise Unregistered Market Participants.*

In addition to the foregoing, the Working Group is concerned that the proposed “floor trader” registration regime appears to have an additional purpose to expand the Commission’s plenary jurisdiction under the CEA over otherwise unregistered market participants who transact relatively large volumes of DCM-listed contracts. Specifically, neither the proposed “floor trader” definition nor the preamble guidance in the Original NPRM or the Supplemental NPRM addressing the “floor trader” definition limit the scope

³ See The Commercial Market Participants, Comments on the Public Staff Roundtable on Elements of Regulation Automated Trading, RIN 3038-AD52, at 6-7 (June 24, 2016) (“**June 24 Comments**”); The Commercial Alliance, Comments on Regulation Automated Trading, Notice of Proposed Rulemaking, RIN 3038-AD52, Section II.B.1, at 9-10 (Mar. 16, 2016) (“**March 16 Comments**”).

⁴ 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.

of the new floor trader registration requirement to those persons engaging in “algorithmic trading” (“AT”)⁵ on a DCM through “direct electronic access” (“DEA”).⁶

If it is the Commission’s intent to reconsider the scope of its jurisdiction over otherwise unregistered large volume traders of DCM-listed contracts, it should do so in a separate proceeding where the Commission could address this issue of such regulatory significance on its own merits. The development of a workable framework for regulating automated trading to protect market integrity from the risks created by automated trading is a distinct issue from the attempted expansion of the Commission’s jurisdiction over otherwise unregistered large volume traders and should be treated as such. Given the regulatory implications and potential for unintended consequences, the Working Group urges the Commission to refrain from using this rulemaking proceeding to expand its jurisdiction over large volume traders that would be subject to Regulation AT.

2. The Proposed Registration Framework Will Unnecessarily Impose Substantial Burdens upon Market Participants.

If a commercial firm is required to register as a new floor trader, it will be subject to several new prescriptive compliance obligations applicable to AT Persons, including 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 AT source code, and (iv) provide DCMs an annual certification attesting to their compliance with Regulation AT. These AT Person compliance obligations as applied to certain commercial firms falling within the new floor trader definition will impose substantial costs and burdens on such firms even though they do not

⁵ The Supplemental NPRM defines “algorithmic trading” as “[t]rading in any commodity interest as defined in [CFTC] Regulation 1.3(yy) on or subject to the rules of a [DCM], where: (1) one or more computer algorithms or systems determines whether to initiate, modify, or cancel an order, or otherwise makes determinations with respect to an order, including but not limited to: the product to be traded; the venue where the order will be placed; the timing of the order; whether to place the order; the sequencing of the order in relation to other orders; the price of the order; the quantity of the order; the partition of the order into smaller components for submission; the number of orders to be placed; or how to manage the order after submission; and (2) such order, modification or order cancellation is electronically submitted for processing on or subject to the rules of a DCM; provided, however, that Algorithmic Trading does not include an order, modification, or order cancellation whose every parameter or attribute is manually entered into a front-end system by a natural person, with no further discretion by a computer system or algorithm, prior to its electronic submission for processing on or subject to the rules of a DCM.” See proposed CFTC regulation 1.3(zzzz).

⁶ Under the Supplemental NPRM, “direct electronic access” is defined to mean, “[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).

pose the systemic risk concerns that are the focus of Regulation AT, as their trades are subject to DCM pre-trade risk and other controls.⁷

In addition, where a commercial firm 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, 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., such trades are subject to FCM-administered controls and implementation of many of the AT Person regulatory requirements would be redundant and unnecessary given DCMs, FCMs, and ISVs already would be implementing pre-trade risk and other controls. In certain cases, the Working Group submits that the AT Person obligations will be entirely unworkable for many commercial firms falling within the floor trader definition since they do not own the actual AT or the routing infrastructure utilized to achieve their trading objectives.⁸

Further, commercial firms becoming an AT Person by meeting the new, expanded “floor trader” definition will be subject to an entirely new regulatory regime that will include significant, additional compliance requirements. For example, as part of the registration process with the National Futures Association (“**NFA**”), the only existing Registered Futures Association (“**RFA**”), a market participant would incur initial costs and burdens to register with NFA, including a fingerprinting requirement, and ongoing costs to monitor personnel changes of its natural person floor traders so that it could update such registrations with the NFA.⁹

⁷ By way of example, a commercial firm could be required to register as a new floor trader if it electronically traded a daily average of 20,000 futures, options, renewable energy credits (“**RECs**”), and other DCM-traded transactions, even though it may be primarily for hedging purposes, and it executed some of these transactions using basic order management functionality, such as excel spreadsheets, “off-the-shelf” auto-spreaders, or iceberg/reserved quantity order functionality, while accessing, through a futures commission merchant or other clearing firm (collectively, an “**FCM**”) or an exchange- or independent system vendor (“**ISV**”)-owned order routing system subject to pre-trade risk and other controls, a DCM, which also imposes pre-trade risk and other control requirements on its participants.

⁸ See The Commercial Alliance, Comments on Regulation Automated Trading, Notice of Proposed Rulemaking, RIN 3038-AD52, at 11-12 (Mar. 16, 2016). While the Supplemental NPRM proposes to allow new floor traders to delegate to FCMs or ISVs some of the AT Person obligations, the delegation requirements pose substantial burdens and are unworkable as described below in Section II.C.3.iii.

⁹ Pursuant to Part 3 of the CFTC’s regulations, the Commission has delegated its registration functions to the NFA. See Original NPRM at 78,887. The Commission notes:

Non-natural person floor trader entities must register with the Commission and apply for membership in NFA via CFTC Form 7–R. Principals of non-natural person floor trader entities register via Form 8–R. Based on a review of the principals associated with registered FCMs, the Commission estimates that each non-natural person floor trader entity will have approximately 10 principals and, therefore, need to file approximately 10 Forms 8–R. In the event that a natural person meets the definition of Floor Trader in proposed § 1.3(x)(3), and is therefore required to register with the Commission and become a member of NFA, such person would only be required to complete Form 8–R.

Id.

Moreover, under proposed CFTC regulation 170.18, a new floor trader must become a “member” of NFA, even though NFA does not currently require a registered floor trader to become an NFA member.¹⁰ As an NFA member, a floor trader would be required to incur not only the costs and burdens associated with registering, but also the following additional burdens:

- Maintaining in an orderly fashion at the member’s main business books and records supporting all aspects of the member’s commodity futures business, which must be made available for inspection.
- Maintaining policies and procedures to diligently supervise the member’s employees and agents.
- Attesting on an annual basis that the member’s operations and procedures comply with all applicable NFA requirements.
- Establishing a business continuity and disaster recovery plan reasonably designed to enable the member company to continue operating, re-establish operations, or to transfer its business to other NFA members in the event of an emergency.
- Adopting and enforcing written cybersecurity policies and procedures to secure customer data and access to the member’s electronic systems.
- Implementing enhanced supervisory requirements designed to prevent sales practice abuse if the member has a sales force or principals that have been affected by questionable sales practice training or which charge high commissions and fees.
- Undergoing periodic on-site examinations or audits by NFA.
- Adhering to certain standards in the member’s communication with the public, including promotional material.¹¹

Additionally, the proposed floor trader registration will have significant unintended regulatory consequences that are wholly unrelated to the regulation of automated trading. For example, a new floor trader (i) would become a “financial end-user” and subject to the

¹⁰ 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>.

¹¹ For further explanation of these NFA member compliance burdens, see <https://www.nfa.futures.org/NFA-compliance/NFA-general-compliance-issues/index.HTML>.

CFTC's and Prudential Regulators' margin requirements¹² and, (ii) if a "member" of a DCM or swap execution facility ("SEF"), would be subject to 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."¹³

The Working Group submits that these unintended regulatory consequences undercut relief that both Congress and the Commission have determined to provide to these commercial firms. Based on the foregoing, any final rule issued in this proceeding should not adopt the proposed "floor trader" registration requirement. At a minimum, should the Commission proceed with the new floor trader registration requirement, it should expressly exempt any commercial market participant required to register as a new floor trader under Regulation AT from (i) the requirement to become a "member" of NFA or any other RFA, (ii) the CFTC's margin rules,¹⁴ and (iii) the CFTC's recordkeeping requirements under regulation 1.35, if the new floor trader is a "member" of a DCM or SEF.

3. Floor Trader Registration of Market Participants Whose Electronic Access to DCMs Is Sponsored by Intermediaries Does Not Appear to Be Supported by Law.

The Supplemental NPRM would expand the Commission's jurisdiction under the CEA over otherwise unregistered market participants by applying the Commission's "floor trader" definition to persons (i) utilizing AT (ii) through DEA, which would include orders placed through, or subject to risk controls administered by, an FCM, and (iii) transacting a certain volume of DCM-traded contracts. This is the first time that the Commission has attempted to expand the scope of the "floor trader" definition to cover unregistered persons engaged in AT activity. For the reasons provided below, this attempted expansion does not appear to be supported by the Congressional intent underlying CEA Section 1a(23).

In relevant part, CEA Section 1a(23) states that a "floor trader" includes a "person who, in or surrounding any pit, ring, post or other place provided by a contract market for the meeting of persons similarly engaged, purchases or sells solely for such person's own account" Further, the legislative history is clear that the floor trader definition was intended to capture those unregistered persons who purchased and sold futures for their own accounts on a DCM's trading floor from aiding and abetting floor brokers in

¹² 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>.

¹³ See *Records of Commodity Interest and Related Cash or Forward Transactions*, Final Rule, 80 Fed. Reg. 80,247 (Dec. 24, 2015); *Adaptation of Regulations to Incorporate Swaps – Records of Transactions*, Final Rule, 77 Fed. Reg. 75,523 (Dec. 21, 2012).

¹⁴ Commercial market participants should be granted separate, but identical, relief from the Prudential Regulators' margin rules. Such relief is, however, beyond the scope of the CFTC's jurisdiction.

defrauding their customers, for example, by acting as a conduit to trade after the close or front-run the floor broker's customer orders.¹⁵ In this respect, the legislative history reflects Congressional intent to limit the scope of this definition to persons whose access to a DCM is not subject to intermediation, *i.e.*, sponsored by a FCM (as such FCM would have the express authority to access and trade directly on the DCM or sponsor access for customers transacting on a DCM), as persons whose access is sponsored by an intermediary cannot act as a conduit or in another manner to indirectly harm third-parties transacting in futures markets.

In light of the foregoing, the legal and policy rationale underlying the definition of "floor trader" does not appear to support the proposed application of the floor trader definition to unregistered persons who engage in purchases and sales of futures and whose electronic access to a DCM is through an intermediary and its risk controls. To the extent that the Commission seeks to expand the current definition to cover such unregistered persons, it must pursue legislation by Congress that amends CEA Section 1a(23) to expand the scope of the definition of "floor trader."

B. Regulation AT Should Be Reproposed with a Framework That Adopts a Principles-Based Approach Leveraging DCM Oversight and Industry Best Practices.

Rather than proceed with the regulatory framework proposed in the Supplemental NPRM, the Working Group recommends that the Commission repropose Regulation AT with an alternative, principles-based approach aimed at ensuring proper controls exist on the DCM to mitigate potential AT disruptions. Under such reproposal, DCMs would be required to impose upon all market participants employing AT directly on the DCM requirements to adopt a minimum set of appropriate risk controls. Further, a cost-effective principles-based approach should authorize the DCMs to require the use of pre-trade risk controls and safeguards for AT that the DCMs deem appropriate to prevent AT disruptions to their markets.

DCMs are particularly well equipped to identify the controls needed to mitigate risks on their markets and ensure that all market participants interconnecting with the DCM's Application Programming Interface or submitting orders through their central limit order book have adopted such controls. Indeed, pursuant to regulatory obligations under existing DCM Core Principles, DCMs have developed appropriate risk control systems for their markets and require as a condition of participation in their markets the implementation

¹⁵ 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).

of such controls.¹⁶ In addition to their regulatory compliance obligations under the DCM Core Principles, DCMs have 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 aligned with commercial market participants' fundamental need to transact in fair and orderly futures markets.

As market operators, DCMs also are best positioned to facilitate a collaborative process involving all persons in the futures transaction chain to (i) develop and implement industry best practices for AT controls and (ii) modify them in accordance with changing technological developments in automated trading. 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,¹⁷ DCMs can leverage and build upon these best practices and controls.

In sum, rather than adopt the framework proposed in the Supplemental NPRM, the Working Group recommends that the Commission adopt a principles-based approach to regulating automated trading that should be guided, at a minimum, by the following precepts:

- A minimal set of principle-based standards should be adopted that reflect the Commission's policy objective of protecting market integrity, while leaving the actual compliance with such standards to the discretion of the different persons in the futures transaction chain.¹⁸
- Existing risk controls utilized by the different persons in the futures transaction chain should be recognized and the imposition of duplicative requirements

¹⁶ 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 existing CFTC regulation 38.255, DCMs have established many of their current risk controls and safeguards for automated trading on their markets. The Working Group supports CME Group comments stating that existing regulation 38.255 would become virtually unrecognizable as a core principle if the prescriptive requirements under the Supplemental NPRM were adopted. *See* CME Group, Comments on Notice of Proposed Rulemaking, Regulation Automated Trading, RIN 3038-AD52, at 8 (Mar. 16, 2016).

¹⁷ *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>.

¹⁸ 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.

should be avoided.

- Flexibility in tailoring and updating specific policies and procedures to address the unique sets of risks faced by different persons in the futures transaction chain should be provided.
- Proactive adaptation to changing technological developments in automated trading and industry efforts to protect markets through further innovation in risk controls and system safeguards should be encouraged.
- DCMs should be utilized to establish and oversee automated trading activity within their markets and, as deemed necessary and appropriate, the DCMs' authority under their Core Principles to facilitate such oversight of automated trading should be expanded.

Finally, recognizing the time, cost, and effort required by the Commission to issue a workable final rule addressing the regulation of automated trading, the Working Group recommends that the Commission host another public roundtable on Regulation AT.¹⁹ The Commission would benefit from an iterative discussion between Commission staff, DCMs, intermediaries, and other market participants on the key issues associated with the Working Group's recommended principles-based approach to regulating automated trading, such as (i) relevant market design issues, (ii) the mechanics of DCM oversight of automated trading activity, and (iii) the costs and benefits of a principles-based approach as applied to the Commission in light of its limited budget, DCMs in their role as SRO, and other persons in the transaction chain.

C. If the Commission Determines to Proceed with the Supplemental NPRM, Certain Modifications Should Be Adopted.

1. The Proposed Volumetric Threshold Should Be Rejected.

- i. *The Proposed Volumetric Threshold Is Overly Broad in Scope and Application.*

The Working Group believes that any quantitative test, including the Volumetric Threshold,²⁰ is an inappropriate mechanism for determining which market participants should be subject to Regulation AT. As stated by many panelists at the CFTC's 2016 Roundtable, a quantitative test cannot be applied in an appropriately limited manner to identify the universe of market participants engaged in automated trading that presents the

¹⁹ See *Public Staff Roundtable on Elements of Regulation Automated Trading*; Reopening of Comment Period, 81 Fed. Reg. 36,484 (June 7, 2010); see also Webcast of CFTC Roundtable (June 10, 2017) ("**2016 Roundtable**"), <https://www.youtube.com/watch?v=LKxRMIROkyw&feature=youtu.be>.

²⁰ The Supplemental NPRM proposes an aggregate average daily volume threshold of 20,000 contracts traded for a company's own account or customer's account over a 6-month period across all products on the electronic trading facilities of all DCMs. See proposed CFTC regulations 1.3(xxxx), 1.3(x)(1)(iii), 1.3(x)(2).

type of systemic risk that Regulation AT seeks to protect against. In contrast to the Commission's statements in the Supplemental NPRM, the proposed "Volumetric Threshold" could require the registration of a significantly larger number of unregistered market participants than the 50 new registrants estimated by the Commission, including many commercial firms and hedgers whose automated trading activity is presently subject to proper risk and other controls.²¹

In addition, the Supplemental NPRM states that all transactions traded on the electronic facilities of a DCM, except certain transactions executed outside a DCM's electronic trading platform, such as block futures and exchange for related positions transactions ("**Excluded Transactions**"), are to be counted against the Volumetric Threshold if they are executed for a market participant's "own account, the accounts of customers, or both" In other words, it appears market participants would be required to consider all executed transactions, including RECs and broker and FCM-executed trades (with the exception of the Excluded Transactions), not simply those that were executed using AT and DEA, when calculating whether they meet the Volumetric Threshold. The Working Group submits that such application of the Volumetric Threshold is overly broad, as the execution of transactions by means other than AT and DEA do not—and should not—have any bearing on whether a market participant should be subjected to the requirements of Regulation AT. Only those market participants who meet the Volumetric Threshold using AT and DEA should be subjected to Regulation AT.

Accordingly, the Working Group requests that the Commission clarify that market participants should not include in their calculation of the Volumetric Threshold any transactions that were not executed using AT and DEA.

- ii. *The Proposed Volumetric Threshold Creates Uncertainty and Will Impose Substantial Burdens on Market Participants.*

The proposed Volumetric Threshold requires contracts to be aggregated among a market participant's affiliates under common control. However, the Supplemental NPRM fails to define or provide meaningful guidance on what constitutes "control" in this context. Rather, it states that the aggregation standard for this threshold is modeled on analogous provisions in the CFTC's Final Swap Dealer Rule.²²

Under the CFTC's Final Swap Dealer Rule, for purposes of the *de minimis* exception, the Commission requires persons to aggregate positions if entered into by affiliates "controlling, controlled by or under common control." In this context, the Commission expressly declined to adopt a bright-line standard and interpreted "control" to

²¹ The Supplemental NPRM estimates there will be 120 AT Persons, and at the November 4, 2016 Open Meeting adopting the Supplemental NPRM, the Commission stated it believed 70 of these AT Persons were current registrants.

²² See *Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant" and "Eligible Contract Participant,"* Joint Final Rule, 77 Fed. Reg. 30,596 (May 23, 2012) ("**Final Swap Dealer Rule**").

mean “the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through the ownership of voting securities, by contract or otherwise,” which “is consistent with the definition of ‘control’ and ‘affiliate’ in connection with [Securities] Exchange Act rules . . .”²³

Absent further guidance from the Commission, the interpretation of “control” will require an analysis of the relevant facts and circumstances, where bright-line ownership percentages may be an important factor, but not dispositive. As such, the proposed aggregation standard likely will create regulatory uncertainty and the risk of inconsistent interpretations by both market participants and the Commission, which will unnecessarily raise exposure to enforcement risk and waste limited CFTC resources. Further, for large market participants with many affiliates under common control, the proposed Volumetric Threshold will have a disparate and unfair impact by effectively reducing the size of the threshold when applied across the corporate family.

Finally, to determine whether it meets the Volumetric Threshold, a market participant will have to adopt monitoring systems and business practices to identify the products that must be counted against this threshold, which will be costly, especially for large, international market participants with affiliates across the globe.

2. The Commission Should Adopt Appropriately Tailored DEA and AT Definitions.

Rather than applying the AT Person requirements to registrants, such requirements should apply to any person who executes futures transactions using AT and DEA, as those terms have been defined by the Working Group in other comments submitted in this proceeding and set forth below.²⁴ This approach to regulating automated trading will ensure that the policy objectives articulated by the Commission in Regulation AT are met but avoid subjecting market participants to unnecessary burdens that a registration requirement would render.

i. *Direct Electronic Access.*

In contrast to the Supplemental NPRM’s goal to reduce the scope of AT Persons, the Supplemental NPRM’s proposed DEA definition will capture even more commercial firms that do not pose systemic risk than the initially proposed DEA definition set forth in the Original NPRM. In relevant part, the Supplemental NPRM defines DEA as “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.”

²³ Swap Dealer Final Rule at 30,631 n.437.

²⁴ See March 16 Comments.

The newly proposed DEA definition no longer provides a safe harbor for those trading through an FCM's infrastructure and effectively would capture any person that is not executing Excluded Transactions, including the following persons, even though a multi-layer of risk and operational controls exist throughout the transaction chain:

- persons routing orders through an FCM without first sending it as an oral or written communication;
- persons who route their orders through the infrastructure owned and operated by DCMs (*e.g.*, exchange front-end systems like WebICE or CME Direct); and
- persons who route their orders through the infrastructure owned and operated by ISVs (*e.g.*, multi-broker ISV servers of TT or Bloomberg).

Most commercial energy firms route their orders through at least one of the methods described above and, consequently, would fall within the proposed DEA definition. Thus, an appropriately tailored definition of DEA is critical, and the Working Group restates its recommendation to revise the DEA definition as follows:

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.²⁵

ii. *Algorithmic Trading.*

Because the Supplemental NPRM does not modify the AT definition as proposed under the Original NPRM, the AT definition likely will capture basic order management functionality used by most commercial firms, including, *e.g.*, auto spreaders, iceberg/reserved quantity orders, sliced orders, timed orders, trailing limit orders, sweep orders, stop orders, and order cancels order functionality.²⁶ The Working Group submits

²⁵ Orders routed through routing systems under the administrative control of an FCM or clearing member of a derivatives clearing organization (“DCO”) are subject to pre-trade risk and operational controls applied by DCMs, FCMs, and clearing members of a DCO, including, but not limited to, (i) maximum order size limits, (ii) stop logic functionality, (iii) DCM pre-trade risk management interface with clearing firms’ proprietary risk systems, (iv) kill switch functionality, (v) order management tools with a “kill button,” (vi) cancel on disconnect functionality, (vii) maximum intra-day position limits, (viii) price limits, (ix) order monitoring using DCM order mitigation tools, and (x) credit limits. *See* CME 2013 Concept Release Comments; *see also* CME Group, Introduction to Risk Management Tools, available at <http://www.cmegroup.com/globex/trading-cme-group-products/risk-management-tools.html#cmeRiskManagement1>.

²⁶ *See* June 24 Comments, at 4-6; March 16 Comments, at 6-9 (describing “basic order management functionality”).

that basic order management functionality—wherein a natural person retains the discretion to trade and establish the parameters by which the order will be executed—can be distinguished from automated order generation systems that effectively function as independent traders through their ability to generate and execute automatically independent trading decisions and send orders to DCMs without any human intervention.

Accordingly, the Working Group recommends that the Commission reconsider its arguments previously made in this proceeding regarding the scope of the proposed definition of AT and either (i) categorically exclude basic order management functionality from the AT definition or (ii) provide a safe harbor that provides market participants with certainty that such order management functionality would not fall within the proposed AT definition.²⁷

iii. *AT Person.*

In light of the foregoing, the Commission should refrain from modifying its existing definition of floor trader and instead adopt the following definition of AT Person previously offered by the Working Group in this proceeding:

(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 Access²⁸ as defined in paragraph (yyyy) of this section, in whole or in part, to access a DCM for Algorithmic Trading.²⁹

3. **The Proposed Pre-Trade Risk and Other Controls Do Not Pass a Cost-Benefit Test.**

If the Commission determines to adopt a tiered risk control structure rather than permitting DCMs to establish the appropriate controls, the Working Group supports the proposed two-level risk control structure rather than a three-level structure given controls

²⁷ See *id.*

²⁸ The reference to “Direct Electronic Access” in this AT Person definition would reflect the Commercial Market Participants’ recommended DEA definition.

²⁹ The reference to “Algorithmic Trading” in this AT Person definition would reflect the recommendation presented in the March 16 Comments that the AT definition include only “Automated Order Generation Systems.” See March 16 Comments, Section II.A.2.

exist at the FCM and requiring AT Persons that route their orders through an FCMs to apply controls would have been duplicative and unnecessarily burdensome. However, the Working Group believes that several other requirements applicable to AT Persons are burdensome and cannot be justified by their incremental benefit, if any.

i. *Annual Certification Requirement.*

While the Working Group appreciates the Commission's proposal in the Supplemental NPRM to eliminate the annual compliance report requirement, such benefit is limited by the CFTC's proposal to require an annual certification to DCMs attesting to the AT Person's compliance with the Regulation AT requirements. Given DCMs presently have rules and policies to regulate automated trading on their markets, an additional annual certification requirement is unwarranted and will impose unnecessary costs. Importantly, DCMs and the Commission may seek information from a market participant when they suspect there could be risks related to a market participant's AT systems and trading.

ii. *Proposed Recordkeeping Requirements for Source Code.*

Given the highly confidential and sensitive proprietary nature of AT source code, the Working Group believes the CFTC should be able to obtain access to it pursuant only to a subpoena approved by the Commissioners during the course of an investigation. The Working Group supports Acting Chairman Giancarlo's proposal to protect source code through various means, such as onsite inspection and destruction of source code after a certain period.

iii. *Third-Party Delegation of Certain Compliance Obligations.*

Because FCMs and ISVs currently apply risk and other controls to their routing infrastructure and orders utilizing their infrastructure, the Working Group supports the Supplemental NPRM's proposal to permit AT Persons to delegate to them the AT Persons' compliance with Regulation AT. However, so long as the FCM and ISV represent compliance with the Regulation AT requirements, and there is no reasonable belief to suggest such representation is false or no longer accurate, the Working Group believes that the AT Person should be deemed to have satisfied any applicable due diligence requirements. In addition, the Working Group believes that AT Persons should not retain ultimate responsibility for the FCM's or ISV's compliance with Regulation AT when the AT Person has delegated its compliance requirements given the AT Person does not own the FCM's or ISV's infrastructure or software and has no control or ability to apply various risk and other controls to such.

4. The Proposed Anti-Evasion Provision Should Be Eliminated.

Proposed CFTC regulation 1.3(x)(4) prohibits any person from trading contracts or causing contracts to be traded through multiple entities for the purpose of evading the registration requirements imposed on floor traders or to avoid meeting the definition of AT Person. This anti-evasion provision creates significant regulatory uncertainty and increases

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a commercial energy firm's potential exposure to compliance and enforcement risk. For example, the proposed anti-evasion provision raises the question of what types of conduct are permissible attempts to avoid being subject to registration and regulation under Regulation AT and what conduct constitutes improper "evasion" of this proposed regulatory framework. The CFTC should not dictate the manner by which market participants pursue their business objectives in futures markets, so long as such business objectives are achieved through fair and equitable trading and not as a result of any form of manipulative or disruptive trading practices. Accordingly, the Working Group recommends that the Commission eliminate the proposed anti-evasion provision from any final rule issued in this proceeding.

III. CONCLUSION.

The Working Group requests that the Commission consider the comments set forth herein. The Working Group expressly reserves the right to supplement these comments as deemed necessary and appropriate.

If you have any questions, please contact the undersigned.

Respectfully Submitted,

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