



September 29, 2017

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

VIA ONLINE SUBMISSION

Re: CFTC Requests Public Input on Simplifying Rules (“Project KISS”) – Miscellaneous

Dear Secretary Kirkpatrick:

The Minneapolis Grain Exchange, Inc. (“MGEX”) would like to thank the Commodity Futures Trading Commission (“Commission”) for its Project KISS initiative, as set forth in a May 3, 2017 news release.¹ MGEX appreciates an opportunity to respond to the Commission’s request for public input.

Introduction

MGEX, a Designated Contract Market (“DCM”) and Subpart C Derivatives Clearing Organization is concerned that there is too much confusion regarding what conduct or practices constitute spoofing. The Commission issued an interpretative guidance and policy statement in 2013 to address this topic. MGEX, however, believes that confusion persists and that it is potentially discouraging legitimate trading. MGEX believes the Commission should issue a new interpretative guidance and policy statement on spoofing to address the concerns that are outlined in more detail below.

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

¹ <http://www.cftc.gov/PressRoom/PressReleases/pr7555-17>.

1. The Commission should issue a new interpretative guidance and policy statement on spoofing.

As background, the Dodd-Frank Wall Street Reform and Consumer Protection Act prohibited certain disruptive trading practices and specifically identified spoofing. Under section 4c(a)(5)(C), it “shall be unlawful for any person to engage in any trading practice or conduct ... that ... is, is of the character of, or is commonly known to the trade as, ‘spoofing’ (bidding or offering with the intent to cancel the bid or offer before execution).” After this provision came into effect, there were questions about what activities or practices actually constituted spoofing, and how to prove that a violation occurred. A large, uncertain factor was what intent standard (i.e., intentional, reckless, etc.) should be applied to prove a violation.

In addition, part of the confusion regarding spoofing stems from the term being broadly used to capture both legitimate and illegitimate trading. For instance, traders might configure orders – all bona fide – in a manner that creates some level of deception. Layering or iceberg orders are examples of this behavior. This is widely accepted as legitimate, in part, because such activities help protect a trader’s strategy. They also create opportunities for speculators, which is crucial for providing liquidity in a market. Unfortunately, however, many conclude that any intent to cancel a bid or order prior to execution is illegitimate, in part because CEA section 4c(a)(5)(C) ostensibly makes such activity unlawful. This view is hindering legitimate trading activity.

The Commission sought to provide clarity about spoofing by issuing an interpretative guidance and policy statement on May 28, 2013 (the “2013 Guidance”). The Commission interpreted a violation of CEA section 4c(a)(5)(C) to require that a market participant act with some degree of intent beyond recklessness. For reasons noted below, this intent standard is problematic.

In addition, the Commission noted that a violation of this section does not occur if the market participant cancelled a bid or offer prior to execution as part of a legitimate, good-faith attempt to consummate a trade. Unlike the intent standard in the 2013 Guidance, this view should be supported and incorporated into any new guidance or policy statement.

Further, and significantly, the Commission provided four non-exclusive examples where 4c(a)(5)(C) is possibly violated:

1. Submitting or cancelling bids or offers to overload the quotation system of a registered entity;
2. Submitting or cancelling bids or offers to delay another person’s execution of trades
3. Submitting or cancelling multiple bids or offers to create an appearance of false market depth
4. Submitting or cancelling bids or offers with intent to create artificial price movements upwards or downwards

The Commission also addressed whether a pattern of activity is required for a violation to occur. On one hand, the Commission notes that it “intends to evaluate the market context, the person’s pattern of trading activity (including fill characteristics), and other relevant facts and circumstances.” On the other hand, the Commission “does not interpret a CEA section 4c(a)(5)(C) violation as requiring a pattern of activity.”

While MGEX appreciates the Commission’s desire to provide clarity, the interpretative guidance has not adequately addressed the issue of intent and what activities actually constitute spoofing. As such, MGEX requests that the Commission issue a new interpretative guidance that replaces the 2013 Guidance, as set forth below. MGEX suggests that prior to issuing any new guidance, it solicit input from the industry, just as was done prior to issuing the 2013 Guidance. MGEX also notes that a DCM should be permitted to expand upon the foundation of any new guidance in their own rulebook. In other words, a DCM may need to have a more stringent rule on spoofing when compared to any new Commission guidance.

The Commission should interpret the intent standard in the parenthetical of 4c(a)(5)(C) to mean knowingly entering a non bona fide order for the purpose of misleading market participants and potentially exploiting that deception. The current standard of “some degree of intent beyond recklessness” is vague and makes it difficult for exchanges and participants to know where the boundary is between permissible and prohibited activities. A knowing or knowingly standard is more decipherable and fairer. In addition, by combining this standard with an additional condition that the actor’s purpose was to mislead a market to potentially exploit the deception, a brighter line will be established. It is important for a brighter line because vague standards make it difficult for exchanges to enforce rules and makes it more likely that there will be inconsistent outcomes, which is potentially unfair to market participants. The fear of inconsistent outcomes or an actor being found to be in violation of a rule when they believed their conduct was proper is likely discouraging legitimate trading.

Next, the Commission should remove the four non-exclusive examples of spoofing in the 2013 Guidance because they are likely doing more to confuse market participants rather than help clarify what activities are prohibited. From MGEX’s perspective, the examples are creating an impression that most disruptive practices are also spoofing. For instance, submitting or cancelling bids or offers to overload the quotation system of a registered entity, or to submit or cancel bids or offers to delay another’s execution of trades is certainly a disruptive practice, but it is not “spoofing” as it should be known.

In addition, whether a participant’s activities’ created the appearance of false market depth or artificially moved prices should not be determinative. A market participant could violate 4c(a)(5)(C) without creating false market depth or artificially moving the price of a contract. While false market depth or artificial price movements may be a fact or circumstance present in a 4c(a)(5)(C) violation, it should not in and of itself be sufficient to establish a charge of spoofing.

MGEX believes that spoofing should be limited, better defined, and distinct from other disruptive trading prohibitions. Specifically, MGEX believes that the Commission should define spoofing as knowingly entering non bona fide bids or offers with the goal of creating and then exploiting the market's reaction to such. Under this guidance, analysis into an alleged spoofing violation would be focused on (1) did the participant knowingly enter non bona fide orders and (2) if so, did they do so with the intent to mislead other market participants and create an opportunity to exploit that deception for personal benefit. This would lead to more consistent outcomes and market participants would be better able to design their operations in a manner to ensure compliance with 4c(a)(5)(C) and applicable exchange rules.

In short, MGEX believes that issuing a new interpretive guidance that establishes a clearer intent standard and removing potentially confusing examples will benefit exchanges, market participants, and the public.

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If you have any questions or concerns regarding this letter, please feel free to contact me at (612) 321-7141 or awysopal@mgex.com. Thank you for your attention to this matter.

Sincerely,



Adam Wysopal

Associate Corporate Counsel

cc: Mark G. Bagan, President & CEO, MGEX

Layne G. Carlson, Treasurer & Corporate Secretary, MGEX