



By Electronic Submission

August 24, 2020

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

Re: RIN 3038-AF04: Electronic Trading Risk Principles

Dear Mr. Kirkpatrick:

The Futures Industry Association (“FIA”)¹ and FIA Principal Traders Group (“FIA PTG”)² are pleased to submit this letter in support of the Commodity Futures Trading Commission’s (“CFTC” or “Commission”) proposed Electronic Trading Risk Principles (“the Proposal”).³ The Proposal reflects a deliberate, reasoned approach from the Commission that builds on the industry’s efforts over the years to mitigate the risks of electronic trading.

For more than a decade, FIA member firms have taken a leadership role in identifying risks and strengthening safeguards related to electronic trading in the futures markets globally. Since April 2010, FIA has published six papers proposing industry best practices and guidelines related to these important topics. In addition, FIA has submitted comprehensive responses to numerous CFTC discussions and rulemaking initiatives, including: (i) the Commission’s 2013 Concept

¹ FIA is the leading global trade organization for the futures, options, and centrally cleared derivatives markets, with offices in London, Brussels, Singapore and Washington DC. FIA’s mission is to support open, transparent and competitive markets; protect and enhance the integrity of the financial system; and promote high standards of professional conduct. FIA’s membership includes clearing firms, exchanges, clearinghouses, trading firms and commodities specialists from more than 48 countries, as well as technology vendors, lawyers and other professionals serving the industry. FIA’s core constituency consists of firms that operate as clearing members in global derivatives markets, including firms registered with the Commodity Futures Trading Commission as futures commission merchants (“FCMs”).

² FIA PTG is an association of firms who trade their own capital on exchanges in futures, options and equities markets worldwide. FIA PTG members engage in manual, automated and hybrid methods of trading, and they are active in a wide variety of asset classes, including equities, fixed income, foreign exchange and commodities. FIA PTG member firms serve as a critical source of liquidity, allowing those who use the markets, including individual investors, to manage their risks and invest effectively. The presence of competitive professional traders contributing to price discovery and the provision of liquidity is a hallmark of well-functioning markets. FIA PTG advocates for open access to markets, transparency and data-driven policy. Throughout this letter, references to “FIA” and “FIA member firms” should be read to include FIA PTG member firms.

³ Electronic Trading Risk Principles, 85 Fed. Reg. 42,761 (July 15, 2020).

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Release on Risk Controls and System Safeguards for Automated Trading Environments; (ii) the Commission's Notice of Proposed Rulemaking on Regulation AT; (iii) the Staff Roundtable on Elements of Regulation Automated Trading; and (iv) the Supplemental Proposed Rule on Automated Trading. See the Appendix for links to these papers and submissions.

Through the years, we have consistently advocated for principles-based regulation for electronic trading. For that reason, and as further set forth below, we strongly support the current Proposal and urge the Commission to prioritize its approval.

The Proposal recognizes the critical role of technology in moving futures markets forward and builds on the industry's efforts to reduce the risks inherent with electronic trading. FIA appreciates the Commission acknowledging and codifying the extensive work of the industry in developing and implementing the current risk control framework for electronic trading. We believe the Commission's Proposal supplements and enhances prevailing designated contract market ("DCM") practices that address electronic trading risks.

Today's electronic futures markets are more efficient, open, and transparent than they have ever been. Market quality metrics have improved across the board: trading costs are lower; markets are deeper and more liquid; discrepancies in prices across related markets are reduced; and prices better reflect information about the value of the commodities underlying futures contracts.

However, electronification of futures markets also has introduced new types of risk as market participants have become more dependent on complex hardware and software integration. Electronification also has accelerated the trading process, making it critical to build stronger pre-trade risk controls and move closer to real-time risk management. Erroneous trades are not new, but the technology of trading has changed. The challenge we all face is understanding how to implement appropriate pre-trade risk controls that work in the electronic environment.

As markets have transitioned from open outcry to electronic, the industry has worked together to better understand these risks and adapt risk control systems through the use of new technological tools and safety procedures. Initially the industry developed basic "fat finger" controls to prevent traders from accidentally inputting orders at the wrong size or the wrong price. Later the industry developed more sophisticated tools such as dynamic price collars, kill switches, cancel-on-disconnect, drop copy feeds, and self-match prevention. More recently, sophisticated, granular pre-trade controls to manage limits within a product group were added to the growing list of available system safeguards. This has been an evolving, iterative process, with market participants, FCMs, technology vendors and DCMs working together to build the safeguards needed to protect our markets. After all, it is in everyone's interest to have efficient, reliable markets.

In some respects, the evolution of the electronic trading marketplace is similar to that of the automobile industry. Modern cars are much safer than older cars, not because people have become better drivers or because the police are issuing more tickets. Rather, it is because car manufacturers have created and installed many more safety controls. Some of those controls were

mandated, such as seat belts and air bags. But the majority have been developed by the industry, using innovations such as automated emergency braking, child car seats, blind-spot monitors, and forward collision warnings.

As in the car industry, the role of technology has been critical to the development of risk controls in the listed derivatives markets. For this reason, FIA has continually emphasized the importance of taking a flexible approach with principles-based rules, rather than hamstringing the industry with overly prescriptive standards or rules that impose one-size-fits-all requirements. In our 2017 response to the Supplemental Proposed Rule on Automated Trading, we suggested “that all electronic trading be subject to policies and procedures ‘reasonably designed’ to achieve the purposes of [Regulation AT], and defer to the DCMs to adopt more detailed rules as appropriate for each market and market participant’s trading activity.” In contrast to Regulation AT, we noted that such an objective, principles-based approach “would provide the flexibility necessary to accommodate new technologies and practices in this dynamic and evolving marketplace.”⁴ We are pleased to see that the Commission is proposing to codify principles-based rules in the current Proposal rather than the prescriptive, rigid requirements previously proposed in Regulation AT.

Evolution from voluntary practices to mandatory principles will ensure all trading venues operate with objectively reasonable safeguards. FIA’s recommendations for risk controls have been adopted by many market participants, but they are not mandatory, and neither FIA nor FIA PTG has the power to enforce compliance. For that reason, FIA and FIA PTG support the evolution of pre-trade risk controls from voluntary practices to mandatory principles. The current proposal will codify into CFTC regulations an “objectively reasonable” set of principles that will be enforced across the marketplace.

DCMs are the gatekeeper and overseer of electronic trading platforms. Thus, while all market participants have a responsibility to implement pre-trade risk controls, DCMs are uniquely positioned to apply pre-trade controls uniformly to all participants and trading in their markets. DCMs have invested in surveillance tools that have the ability to scan hundreds of millions of order messages per day and quickly detect unusual patterns of trading activity that may be caused by software malfunctions or erroneous trades.

Well before the CFTC began to develop rules in this area, the leading DCMs developed their own systems for protecting the market from disruptions caused by electronic trading systems. We are confident that the leading U.S. DCM operators, such as CME Group and Intercontinental Exchange, will continue to meet both the letter and spirit of the principles-based rules in the current proposal, given their long track record and extensive experience in this area. We expect that the forces of innovation and competition will lead to the establishment of new types of trading facilities in the coming years, and it is imperative that these new venues be held to the same high standards for risk controls. By finalizing the current Proposal, the Commission will be better positioned to ensure the right framework for responsible innovation.

⁴ See Letter from Walt Lukken, President and Chief Executive Officer, FIA, to Christopher J. Kirkpatrick, Secretary, CFTC, at 2 (May 1, 2017), available at https://live-fia-d8.pantheonsite.io/sites/default/files/2020-02/2017-05-01_CFTC_RegAT_0.pdf.

The Proposal's principles-based approach will protect markets while allowing controls to continue to develop and benefit from innovation. The Proposal's flexible framework will allow DCM practices to continue to adapt to evolving technology and markets. Historically, FIA has cautioned the Commission against adopting prescriptive risk control requirements that fail to account for the unique characteristics of diverse market participants and the ever-changing nature of markets, technologies, and trading strategies. Such prescriptive requirements, as proposed in Regulation AT, may increase, rather than decrease, electronic trading risks. The current Proposal's flexible framework, by contrast, will allow DCM practices to continue to adapt to evolving technologies and markets and provide innovative risk control mechanisms and system safeguards.

All market participants that trade electronically have the potential to disrupt markets. For this reason, FIA has consistently advanced the view that all electronic trading should be subject to pre-trade risk controls and other measures to help minimize the likelihood of a market disruption and has worked with the industry to implement appropriate controls. We commend the Commission for proposing principles that would address the risks that arise from all electronic trading.

The Proposal also balances the need for DCM-level rules governing electronic orders and the importance of market participants preventing and mitigating market disruptions and system anomalies. We support the Commission's determination that DCMs, in their capacity as market operators, should have discretion to identify market disruptions and system anomalies as they relate to the DCM's markets and trading activity. Given DCM's central role in the electronic trading infrastructure, as well as their status as self-regulators, application of the proposed principles to DCMs will ultimately guide the implementation of safeguards at market participants and FCMs as well.

All market participants have a shared interest in strengthening risk controls. The interconnectedness of the listed derivatives markets means that all market participants are vulnerable when risk controls fail. It is no surprise, then, that the industry has worked diligently to enhance and extend risk controls over the years. The Proposal will complement these industry-led initiatives and help ensure that electronic markets are safe and reliable for years to come.

We strongly encourage the agency to prioritize the Proposal in its rulemaking agenda. Approval of this rule will support the reliability and vitality of markets by ensuring that all electronic trading is subject to objectively reasonable principles-based pre-trade risk controls. The principles will guard against disruptions while providing flexibility to encourage continued innovation and improvement. They will also provide regulatory certainty to market participants. We urge the Commission to codify the principles-based rules as soon as possible.

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While we believe the current infrastructure underlying the futures marketplace is very strong, FIA and its members will continue to work to further strengthen that infrastructure through the ongoing development of risk controls and system safeguards. This Proposal will aid those efforts.

Thank you for your consideration of these comments. If the Commission or the staff have any questions regarding the matters discussed herein, please contact Allison Lurton, FIA's Chief Legal Officer and General Counsel, at 202.466.5460 or alurton@fia.org.

Respectfully submitted,

A handwritten signature in cursive script that reads "Walt L. Lukken".

Walt L. Lukken
President and Chief Executive Officer

cc: Honorable Heath P. Tarbert, Chairman
Honorable Brian Quintenz, Commissioner
Honorable Rostin Benham, Commissioner
Honorable Dan Berkovitz, Commissioner

Dorothy D. DeWitt, Director, Division of Market Oversight

Appendix

- ❖ Comments on the Supplemental Proposed Rule on Automated Trading, May 2017
- ❖ Joint Industry Comments to the CFTC on Proposed Rule on Automated Trading, June 2016
- ❖ Comments on CFTC's Proposed Rule on Automated Trading, March 2016
- ❖ Guide to the Development and Operation of Automated Trading Systems, March 2015
- ❖ Response to the CFTC Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, December 2013
- ❖ Drop Copy Recommendations, September 2013
- ❖ Order Handling Risk Management Recommendations for Executing Brokers, March 2012
- ❖ Software Development and Change Management Recommendations, March 2012
- ❖ Recommendations for Risk Controls at Trading Firms, November 2010
- ❖ Market Access Risk Management Recommendations, April 2010