



December 11, 2013

Via Electronic Mail

Melissa D. Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Concept Release on Risk Controls and System Safeguards for Automated Trading Environments; RIN 3038-AD52

Dear Ms. Jurgens:

Managed Funds Association¹ (“**MFA**”) is pleased to have the opportunity to submit comments to the Commodity Futures Trading Commission (“**CFTC**” or “**Commission**”) on its “Concept Release on Risk Controls and System Safeguards for Automated Trading Environments” (“**Concept Release**”).² MFA appreciates the Commission’s commitment to the safety and soundness of the U.S. derivatives markets and its evaluation of the need for additional measures.

MFA generally believes the Commission has implemented a robust derivatives market regulatory framework that rigorously addresses risk controls and system safeguards for automated trading environments as further discussed below. The Concept Release provides a useful discussion of the technological and regulatory developments in the derivatives markets and requests comment on additional risk controls or system safeguards. In this letter, we provide recommendations for fine-tuning some of the pre-trade risk controls already in place; recommendations for adopting post-trade reporting measures; and support for more robust and routine testing of trading software, among other views and recommendations. In particular, we believe that:

¹ Managed Funds Association (MFA) represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry’s contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, the Americas, Australia and many other regions where MFA members are market participants.

² 78 Fed. Reg. 56542 (Sept. 12, 2013) (hereinafter “**Concept Release**”), available at: <http://www.gpo.gov/fdsys/pkg/FR-2013-09-12/pdf/2013-22185.pdf>.

- High frequency trading (“**HFT**”) is not a strategy, but the use of technology to deploy certain trading strategies. The Commission should monitor the markets for abusive trading rather than the means of transaction delivery; as such, it is not necessary, nor particularly effective for the Commission to define HFT.
- To protect market integrity and prevent market disruptions, the Commission should address risk controls and system safeguards with respect to all electronic trading and not just automated trading or so-called HFT.
- Operational, infrastructure and security risks should be addressed by centralizing risk controls at the trading platform and clearing member levels. Risk controls and system safeguards at such entities will protect market participants and the markets by acting as gateways that monitor activity for market participants and block inappropriate or erroneous orders from the markets.
- In considering proposed rulemaking, the Commission should take a principles-based approach that encourages effective self-regulation through trading platforms, futures commission merchants (“**FCMs**”), swap dealers (“**SDs**”) and major swap participants (“**MSPs**”).
- Maximum order size and credit risk controls should be available and apply to all market participants regardless of a customer’s trading method or strategy.
- Trading platforms, FCMs and derivatives clearing organizations (“**DCOs**”) should provide real-time post-trade reports to market participants and their clearing firms.
- Trade cancellation and adjustment policies should be clear, objective and predictable.
- We support more robust and more routine testing of trading software at the trading platform-level. In addition to individual testing, trading platforms should offer integrated or holistic testing where a firm’s software interacts with others.

I. Introduction

As a result of technological developments, the modern world has and continues to transition from manual processes to electronic or automated processes. The derivatives markets are no different. MFA believes that advancements in technology have empowered customers—commercial, institutional and retail end-users—with more sophisticated and efficient methods to access the derivatives markets and execute their investment strategies. Hedgers have also benefited from the same technologies by both being able to deploy their hedging strategies through use of automated trading systems (“**ATSS**”) and from the increased liquidity of the U.S. derivatives markets.

Advancements in technology have vastly improved analytical, trading and execution tools; and led to significant strides in market efficiencies through competition and lower transaction costs. Trading platforms compete on the range of products, trading technology and tools that they offer members and their customers. Advanced trading technology has become broadly accessible to users. Technology is and has been a tool for market participants to implement their trading strategies with lower overall transaction costs. We agree as concluded in the research paper of Professors Gomber, Arndt, Lutat and Uhle (“**Gomber**”), HFT “describes the usage of sophisticated technology that implements traditional trading strategies;” and as such, it is the individual trading strategies that need to be assessed rather than the means of transaction delivery.³

In this respect, technology has not created new classes of market participants; and in response to the Concept Release, we do not believe it is necessary, nor should the Commission define HFT or create a new registration category.⁴ The Commission has access to trade data and information on market participants through designated contract markets (“**DCMs**”), DCOs, FCMs, SDs, MSPs, swap data repositories, and, soon, swap execution facilities (“**SEFs**”) (DCMs and SEFs, together referred to herein as “trading platforms”). In addition, our members are registered with the Commission as commodity trading advisors (“**CTAs**”) and/or commodity pool operators (“**CPOs**”), and already provide extensive information on a quarterly basis on their businesses and positions. As such, to the extent that certain CTAs/CPOs engage in automated trading or HFT, we do not believe it is necessary to add another registration designation.

We are concerned, however, that regulators, including the Commission and the Securities and Exchange Commission (“**SEC**”), and foreign policy makers, are using or defining the term “HFT” differently.⁵ Our members operate global firms and the different HFT definitions increase regulatory risk and confusion for firms, their investors and the public. We raise this point as another reason in respectfully urging the Commission to refrain from adopting a definition or registration category for HFT.

We recognize that in changing the nature of derivatives trading from floor-based to electronic, the use of technology has changed the risks market entities and participants face. We believe that in order to deter and prevent market disruptions and to protect market participants, it is necessary to address risk controls and system safeguards with respect to all electronic trading and not just automated trading or so-called HFT. For example, a manually-entered “fat-finger”

³ See, e.g., Peter Gomber et. al., High Frequency Trading, Goethe Universitat, Frankfurt Am Main, [hereinafter, “Gomber”] at p. 30, available at: <http://ssrn.com/abstract=1858626>. The research paper concludes, among others, that HFT is a technical means to implement established trading strategies; it applies the latest technological advances in market access, market data access and order routing to maximize the returns of established trading strategies. See also World Federation of Exchanges, “Understanding High Frequency Trading (HFT),” April 4, 2013.

⁴ See Concept Release at p. 56545.

⁵ Compare, the CFTC Technology Advisory Committee’s definition of HFT, Concept Release at p. 56545, with SEC Form PF, question 21 of section 1c, and the definition of HFT in the European Union’s Markets in Financial Instruments Directive II legislation.

error for an electronic order can have just as calamitous an impact on markets and market participants as a software malfunction in an ATS.

II. General Comments

MFA believes that with the evolution and automation of the U.S. derivatives markets, it is important to ensure that appropriate risk controls and system safeguards are in place to address operational, infrastructure and security risks (referred to herein as “**Marketplace Risks**”). MFA generally believes that the Commission has implemented a robust derivatives market framework and supports recently adopted rules that:

- Require FCMs, SDs and MSPs that are clearing members to establish risk-based limits based on position size, order size, margin requirements, or similar factors; and requiring those entities to use automated means to screen orders for compliance with the risk limits when such orders are subject to automated execution;⁶
- Require DCMs to establish and maintain risk control mechanisms to prevent and reduce the potential for price distortions and market disruptions;⁷ and
- Require SEFs to establish and maintain risk control mechanisms to prevent and reduce the potential for market disruptions.⁸

These rules (together, the “**CFTC Risk Control Rules**”)⁹ establish a positive framework for addressing risk controls and system safeguards, in a manner, pursuant to the CEA, which foster a system of effective self-regulation.¹⁰ The CFTC Risk Control Rules embody the CEA goals of deterring and preventing disruptions to market integrity; ensuring financial integrity of transactions and the avoidance of systemic risk; and promoting responsible innovation and fair competition.¹¹

In general, MFA believes that Marketplace Risks should be addressed in two ways: (1) by requiring that trading platforms have appropriate risk control mechanisms, and policies and procedures to ensure that they operate as intended; and (2) by requiring FCMs, SDs and MSPs that are clearing members, as the gateways to the markets, to have financial and regulatory risk management controls to reduce risks associated with market access. We strongly believe that such a framework, which requires risk controls at both the trading platform and intermediary-levels, optimizes customer protection, market integrity and the promotion of responsible innovation and fair competition. We also believe, from a practical and regulatory standpoint, that

⁶ 17 C.F.R. §§ 1.73, 23.609.

⁷ 17 C.F.R. § 38.255.

⁸ 17 C.F.R. § 38.607.

⁹ See *supra* n. 6-8.

¹⁰ See, e.g., Section 3(b) of the Commodity Exchange Act (“CEA”).

¹¹ See *id.*

such a framework would be both consistent with the Commission's prior rulemaking and more manageable to implement and enforce. In considering proposed rulemaking, the Commission should take a principles-based approach that encourages effective self-regulation through trading platforms, FCMs, SDs and MSPs.¹² Risk controls and system safeguards by such entities will act as gateways to block inappropriate or erroneous orders by market participants.

Below, we provide views on risk controls raised in the Concept Release.

III. Pre-Trade Risk Controls

The Commission seeks public comment on a range of pre-trade risk controls to determine the effectiveness and need for any additional measures.¹³ MFA believes that the CFTC Risk Control Rules together with current market practices require entities to have sufficient and effective pre-trade risk controls. We believe the CFTC Risk Control Rules serve as a primary defense against operational and technological risk. In addition, from our experience since the May 6, 2010 "Flash Crash," we believe trading platform/marketplace controls such as, price collars and trading pauses are highly effective risk tools.¹⁴ Such controls serve to prevent or minimize market disruptions during times of market stress, help restore confidence in the markets and limit harm to customers. Because risk controls need to be fine-tuned to markets and able to adapt and evolve with market practices in order to prevent from being disruptive to orderly markets, it is important for these types of controls to be managed and implemented by trading platforms.¹⁵ In addition, we agree with the Futures Industry Association's Market

¹² For example, in some jurisdictions, such as Hong Kong, exchanges and/or intermediaries have the responsibility of monitoring electronic trading by customers and request customers to complete electronic trading due diligence questionnaires.

¹³ Concept Release at p. 56552.

¹⁴ See, e.g., letter from Stuart J. Kaswell, Executive Vice President & Managing Director, MFA, to Members of the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues, dated September 12, 2010 on comments on proposals responding to the events of the Flash Crash, available at: <https://www.managedfunds.org/wp-content/uploads/2010/09/MFA-Ltr-on-May-6th-events-9.12.10.pdf>; letter from Stuart J. Kaswell, Executive Vice President & Managing Director, MFA, to Elizabeth M. Murphy, Secretary, SEC, dated June 9, 2010, on stock-by-stock circuit breakers, available at: <https://www.managedfunds.org/wp-content/uploads/2010/06/MFA-Comments-on-Stock-by-Stock-Circuit-Breakers.pdf>; letter from Stuart J. Kaswell, Executive Vice President & Managing Director, MFA to Elizabeth M. Murphy, Secretary, SEC, dated June 21, 2011, on a Joint Industry "Limit Up-Limit Down" Proposal, available at: <http://www.managedfunds.org/wp-content/uploads/2011/06/MFA-Final-limit-up-limit-down.6.21.11.pdf>; and letter from Stuart J. Kaswell, Executive Vice President & Managing Director, MFA to Elizabeth M. Murphy, Secretary, SEC, dated October 25, 2011, on Self-Regulatory Organization Proposals to Implement Market-Wide Circuit Breakers, available at: http://www.managedfunds.org/wp-content/uploads/2011/10/MFA.letter.on_market-wide.circuit.breakers1.pdf.

¹⁵ See, e.g., CME Group Market Integrity Controls (including messaging controls, limits and banding, stop logic, velocity logic and market and instrument states), available at: <http://www.cmegroup.com/confluence/display/EPICSANDBOX/Market+Integrity+Controls>.

Access Working Group that certain risk controls should reside at the exchange-level and be required for all trading to ensure a level playing field.¹⁶

Market participants already have legal and regulatory obligations with respect to disruptive practices¹⁷ and exchange trading rules.¹⁸ Sections 5 of the CEA sets forth as Core Principles for a contract market that a DCM shall have rules and the capacity and responsibility to prevent abusive trading practices, manipulation, price distortion and disruptions to delivery or settlement.¹⁹ Section 5h of the CEA sets forth as Core Principles for a SEF that a SEF shall monitor and prevent manipulation, price distortion and disruption to delivery or settlement.²⁰ The Commission also has rules requiring DCMs and SEFs to comply with Core Principles;²¹ these rules allow for effective self-regulation.²²

We do not believe it is necessary to prescribe regulations on the manner in which market participants must comply or meet their existing legal and regulatory obligations. In fact, we believe such regulations could detract or undermine the existing framework by implementing a one-size-fits-all solution on a broadly diverse universe of market participants. Market participants who operate or engage in the use of ATSs already program various risk metrics and trading parameters congruent with their trading/investment strategy into their systems. Indeed, market participants have a strong self-interest in ensuring that they have robust risk controls; and one of the reasons that market participants use ATSs is to minimize operational risks. Where issues arise is when a market participant's risk controls fail or it experiences a software malfunction. We strongly believe that the most effective way to reduce systems risk and safeguard market integrity is to require external real-time risk controls at the FCM/SD/MSP-level and at the trading platform level.

¹⁶ Concept Release at p. 56552.

¹⁷ Section 4c(5) of the CEA.

¹⁸ See, e.g., Chapter 4 of the CME Rulebook, Enforcement of Rules, available at: <http://www.cmegroup.com/rulebook/CME/1/4/4.pdf>; and Section 4 of the ICE Futures U.S. Rulebook, General Trading Rules, available at: https://www.theice.com/publicdocs/rulebooks/futures_us/4_Trading.pdf. See also, Chicago Mercantile Exchange Notice of Disciplinary Action No. 12-8783-BC, Kohl Trading, LLC, November 27, 2013 (citing the member for failure to diligently supervise its employees and agents because it did not use an alert system to notify it that its pre-trade controls were inadvertently disabled); and Chicago Board of Trade Notice of Disciplinary Action No. 12-8969-BC, Chopper Trading, LLC, November 27, 2013 (citing the member for committing an act which is detrimental to the interest or welfare of the Exchange and for failure to diligently supervise its employees and agents because even though the member tested its ATS in more liquid Exchange products, it failed to perform specific testing in the back month E-mini Dow market).

¹⁹ Section 5(d) of the CEA, Designation of Boards of Trade as Contract Markets. 7 U.S.C. § 7(d).

²⁰ Section 5h(f) of the CEA, Swap Execution Facilities. 7 U.S.C. § 7b-3(f).

²¹ 17 C.F.R. Parts 37 and 38.

²² Section 3(b) of the CEA. 7 U.S.C. § 5(b).

A. Message and Execution Throttles

The Commission seeks comment regarding the potential benefits and existing use of maximum message rate and execution rate throttles.²³ Many exchanges already implement message rate quotas where market participants will incur fees once they surpass certain messaging thresholds. We understand these quotas have been effective at encouraging market participants to refine their software programming and become more efficient with their use of messaging. As messaging rates are linked to market news and events, for the maintenance of fair and orderly markets, it is important that trading platforms have flexibility with respect to setting and enforcing rates. We believe it would be most efficient for trading platforms to use maximum messaging rates as a tool to discourage excessive messaging. With respect to setting maximum execution rates, however, we are concerned that such a control could increase risk in certain instances by blocking orders that could be sent to off-set risk at times of heavy volume or market distress.

B. Volatility Awareness Alerts

The Commission seeks comment on the effectiveness of volatility awareness alerts.²⁴ Market participants employing ATSS use many internal alerts, including volatility awareness alerts. It would not be effective, however, for the Commission to prescribe a volatility alert; and could, in fact, create or exacerbate a liquidity crisis during times of market volatility or stress if all ATSS paused for a second while human traders assessed markets after a volatility alert. Market participants each have different volatility tolerance levels; therefore, a prescribed parameter would not be appropriate for all strategies.

Generally, an automated trading strategy is programmed based on specific parameters; and once the thresholds or parameters are exceeded, the program will cease trading. For example, one of the likely reasons for the loss in liquidity during the May 6, 2010 Flash Crash was that automated traders did not have or were not receiving adequate or accurate market information and data and, thus, ceased trading.²⁵

We believe it is best for market participants employing ATSS to determine which of many alerts are most appropriate for their ATS, rather than for the Commission to require a few, or even a comprehensive list, of alerts. The issue with the Commission requiring one or two specific alerts is that the alerts may not be the most appropriate ones for a market participant's ATS, and as such, would add little measurable value in controlling for risk or safeguarding systems. The issue with the Commission requiring a comprehensive list of alerts is that with too many alerts, the alerts could quickly lose their effectiveness. The most effective alerts are those

²³ Concept Release at p. 56552.

²⁴ Concept Release at p. 56553.

²⁵ Report of the Staffs of the CFTC and SEC to the Joint Advisory Committee on Emerging Regulatory Issues, Findings Regarding the Market Events of May 6, 2010, (Sept. 30, 2010) at section II, *available at*: <http://www.sec.gov/news/studies/2010/marketevents-report.pdf>.

that are tailored to a specific ATS trading strategy. We believe market participants are in the best position to make these determinations.

C. Self-Trades

The Commission seeks comment on the use of self-trade controls by market participants to prevent matching opposing orders between a firm or a single or commonly owned account.²⁶ As noted by the Commission, both the CME Group and ICE Futures U.S. offer software functionality to prevent self-matches.²⁷ We believe that such functionality is helpful to our members and others working to address marketplace challenges in connection with inadvertent self-matches; but that further development of such functionality is needed. MFA supports efforts to prevent inadvertent self-matches and notes that such a result economically disadvantages market participants because of the associated execution fees.²⁸

We strongly support further development of anti-self-matching software; and believe it is most cost-effective for exchanges to offer such software rather than for each market participant to develop its own software. We are concerned that current anti-self-matching software includes limitations that are incompatible with the trading needs of some market participants. For example, the current CME Group Self-Match Prevention (“SMP”) functionality offers only “cancel oldest” technology, which cancels the resting order and replaces it with the incoming order. As a result, an inadvertent order on the other side of the market will cause a market participant to lose its resting orders, even if they have been working in the queue. Moreover, the market participant will lose the entire resting order because the SMP functionality does not currently offer “decrement” technology, which would decrease the larger order by the size of the smaller order and cancel the smaller order.²⁹ In addition, we believe anti-self-matching software should be extended to accommodate orders executed through multiple brokers.

D. Price Collars

The Commission seeks comment about price collars for both orders and executions.³⁰ We support the use of price collars and believe they are an important risk control that is effective in addressing extreme market volatility with fewer unintended consequences than trading pauses. In our experience, price collars in the futures markets have been effective in supporting the

²⁶ Concept Release at p. 56553.

²⁷ *Id.*

²⁸ See letter from Stuart J. Kaswell, Executive Vice President & Managing Director, MFA, to Melissa Jurgens, Secretary, CFTC, dated August 14, 2013, on CME Group Market Regulation Advisory Notice on Wash Trades Prohibited, available at: https://www.managedfunds.org/wp-content/uploads/2013/08/MFA_CME_Wash_Trade_Rule_Comments-final-8-14-13-2.pdf.

²⁹ Some exchanges currently offer greater configurability including “cancel newest” and “decrement” technology. See, e.g., NYSE Euronext, Client Notice, Four New Self-Trade Prevention Modifiers (June 24, 2009) available at www.nyse.com/pdfs/STP_Modifier.pdf.

³⁰ Concept Release at p. 56554.

maintenance of fair and orderly markets. After the Flash Crash, the benefits of price collars became especially apparent and we supported the Joint CFTC-SEC Advisory Committee on Emerging Regulatory Issues recommendation in response to the market events of May 6, 2010 to the SEC and other self-regulatory organizations to implement a “limit up/limit down” process. With respect to linked equity products, equity market and derivative market price collars should be coordinated.³¹

E. Maximum Order Size

The Commission seeks comment on the use of maximum order size controls that protect against execution of orders for a quantity larger than a predetermined “fat finger” limit.³² We believe that maximum order size controls should be implemented at the FCM and/or exchange-level; and that such functionality should apply to all market participants—whether manual traders or those trading through ATSS.

In fact, manual or electronic traders are more prone to “fat finger” errors, whereas with respect to an ATS, the size of an order is a parameter that is already programmed. Interestingly, Gregg Berman, Associate Director in the Office of Analytics and Research, SEC, reported earlier this year that from the SEC staff’s review of sudden price spikes, or so-called “mini-flash crashes,” it found that these types of events “tend to be triggered by old-fashioned human mistakes.”³³

Some FCMs already offer their customers fat finger limit controls, which allow customers to customize and set their preferred default levels, including: order limits that apply to each individual direct market access order; order limits that apply to each individual algorithmic order; net sell and buy order limits; and aggregate or total contract limits. We believe all FCMs should offer such order size functionality to customers at the trader-level.

Accordingly, while we believe that CFTC regulation 1.73, which requires an FCM that is a clearing member to have pre-trade risk controls in place that would set limits on order size, is a sufficient control, to the extent the Commission believes further measures are necessary, we submit that all FCMs should offer order limit controls to their customers, regardless of a customer’s trading method or strategy.

³¹ See Report of the Presidential Task Force on Market Mechanisms, January 1988. The Presidential Task Force on Market Mechanisms (“Task Force”) was created to investigate the October 19, 1987 market crash. The Task Force recommended, among others, that across the stock, futures and options markets there should be coordinated circuit breaker mechanisms, such as price limits and trading halts.

³² Concept Release at p. 56554.

³³ Transformational Technologies, Market Structure, and the SEC, speech by Gregg E. Berman, Associate Director, SEC, at SIFMA TECH Conference, New York, NY, June 18, 2013, *available at*: <http://www.sec.gov/News/Speech/Detail/Speech/1365171575716#.UpKv8dqA1aQ>.

F. Trading Pauses

The Commission seeks comment on trading pauses.³⁴ We believe the current exchange-implemented trading pauses work well. After the Flash Crash, the equities markets implemented circuit breakers as well. To prevent confusion or create greater uncertainty, we believe that when a particular security is undergoing a trading pause, CFTC or trading platform rules should address whether a related exchange-traded derivative product should also be paused or halted from trading.³⁵ In this respect, the Commission or trading platforms may want to consider establishing a threshold number of issuers or a weighting percentage as it pertains to underlying securities of an index that must be paused before the related index is also paused.

G. Credit Risk Limits

The Commission seeks comment on the use of credit limits as a mechanism for limiting the disruptive activity of a malfunctioning ATS.³⁶ We support the use of credit risk limits as a pre-execution filter. Market participants employing ATSS build credit risk limits into their models. Nevertheless, like maximum order limit controls, we believe FCMs and/or trading platforms should offer credit risk limit controls and work with customers/members in agreeing to a maximum credit limit. Such a control would help in mitigating a customer/member ATS software malfunction.

IV. Post-Trade Reports and Other Post-Trade Measures

A. Order Reports, Trade Reports & Position Reports

The Commission seeks comment about the potential advantages of increased standardization of real-time order, trade, and position reports for use by clearing firms and market participants.³⁷ We strongly support having trading platforms and/or DCOs provide, in real-time, post-order receipts or “drop copies,” post-trade drop copies, and post-clearing or “position” reports (post-order, post-trade and position reports, together referred to as “Post-Trade Reports”) to customers. Such reports would allow customers to independently confirm orders and trades sent to their FCMs, and their overall positions; as well as assist with a clearing firm’s ability to assess customer risk. We agree with the Concept Release that Post-Trade Reports have

³⁴ Concept Release at p. 56554.

³⁵ As the Commission mentions in the Concept Release, we note that the CME Group has taken action to ensure that the thresholds that trigger circuit breakers for U.S. equity index futures are consistent with the thresholds for exchange-listed securities in the U.S. markets. *See* Concept Release at p. 56547; *and* CME Group, “Changes to CME and CBOT Equity Index Price Limits: Frequently Asked Questions,” *available at*: <http://www.cmegroup.com/education/files/faq-eg-hours-and-limits.pdf>. *See also supra* n. 30.

³⁶ Concept Release at p. 56555.

³⁷ *Id.*

the potential to mitigate the impact of malfunctioning pre-trade risk controls or algorithms, particularly if the post-trade reports are made available and utilized on a low-latency basis.³⁸

With the evolution of low latency trading technology, we believe real-time Post-Trade Reports would help strengthen the robustness of the trading framework by allowing market participants to independently confirm their orders, trades and positions; and assisting clearing firms with their risk assessments. CFTC Regulation 1.33 requires an FCM to provide a customer with a written confirmation of a commodity interest transaction by the next business day.³⁹ In this day and age, where e-commerce customers receive real-time electronic receipts for online purchases, we believe trading commodity interests should be no different. We recommend that the Commission amend and broaden its regulations to require trading platforms, FCMs and/or DCOs to provide real-time Post-Trade Reports to market participants and their clearing firms.

B. Trade Cancellation and Adjustment Policies

The Commission seeks comment on developing uniform trade cancellation and adjustment policies, including specified timeframes for when a trader must notify an exchange of an error.⁴⁰ We strongly support the development by trading platforms of objective trade cancellation and adjustment policies. We believe the uncertainty around marketplace trade cancellation and adjustment policies may have contributed to market participants' confusion during the May 6, 2010 Flash Crash. Clear and objective rules would decrease uncertainty among market participants, especially during times of market distress.⁴¹ We recognize, however, that there may be legitimate reasons for trade cancellation and adjustment policies to differ depending on the product and trading venue. Such policies should always apply consistently across market participants though—manual and automated traders alike.

The most important aspect of trade cancellation and adjustment policies is predictability. As such, policies need to be clear and objective with limited administrative discretion. In promoting market integrity, policies should also instill a reasonable level of accountability on market participants—market participants should be disallowed from completely externalizing costs from trade errors.

³⁸ *Id.*

³⁹ 17 C.F.R. § 1.33.

⁴⁰ Concept Release at p. 56556.

⁴¹ See, e.g., SEC Rel. No. 34-62885, SR-FINRA-2010-032, Sept. 10, 2010, available at: <http://www.sec.gov/rules/sro/finra/2010/34-62885.pdf> (SEC Order granting approval of the Financial Industry Regulatory Authority's ("FINRA") proposed rule change relating to clearly erroneous transactions). To address concerns raised during the Flash Crash, FINRA and other U.S. equities and options exchanges filed similar proposed rule changes with respect to breaking erroneous trades and the SEC granted approval of such changes. Subsequently, FINRA and other self-regulatory organizations have proposed additional amendments relating to rules on breaking erroneous trades.

With respect to a timeframe for which trade errors must be reported, we believe trading platforms should require market participants to report trade errors as soon as they are identified. The Concept Release suggests that market participants must report trade errors within five minutes after execution. We believe that five minutes may not be adequate time for a market participant to identify and report an erroneous trade.

We recommend that trading platforms adopt clear and objective trade cancellation and adjustment policies that limit administrative discretion and instill accountability; and require that market participants report trade errors as soon as they are identified.

V. System Safeguards

A. Controls Over Order Placement

1. Order Cancellation Capabilities

The Commission seeks comment on various standards related to order cancellation capabilities, including “auto-cancel on disconnect requirements” and “selective working order cancellation.”⁴² We support the ability of trading platforms to implement a flexible system that allows a user to determine whether its orders should be left in the market upon disconnection, provided that a clearing firm’s risk manager has the ability to cancel working orders for the trader if the trading system is disconnected. We also believe exchanges should establish policies on whether their default settings are to maintain or cancel working orders of market participants whose trading systems disconnect.

In addition, we support exchanges monitoring the responsiveness of a given algorithm; and developing the capacity to selectively cancel working orders at the level of individual algorithms, individual accounts or individual firms in an emergency situation.

The Commission also seeks comment on “kill switch” abilities—the ability to immediately cancel all working orders.⁴³ We believe all market participants that operate ATSS should have the ability to disconnect their ATSS in the event a software glitch makes it necessary. With respect to a trading platform having a kill switch to cancel working orders from an individual market participant or clearing firm, we believe such authority is necessary for the safety and soundness of the overall market but should be used only in emergency situations and as a last resort. Trading platforms should have clear, objective policies and procedures detailing circumstances that warrant use of a kill switch to cancel orders from an individual market participant or clearing firm. Even still, we believe trading platforms should have some flexibility in its use of judgment on use of a kill switch based on its experience with the trading style or strategies of a market participant; clearing firm; or instruction by the market participant at issue. Moreover, if a trading platform is aware of a critical ATSS systems issue, it should have a

⁴² Concept Release at p. 56557.

⁴³ *Id.*

responsibility to disconnect it to protect market participants, market integrity, the markets and the public in general.

2. Repeated Automated Execution Throttle

The Commission seeks comment on the potential use of a “repeated automated execution throttle” as a risk control for ATSS.⁴⁴ Such a control would disable a trading system after a configurable number of repeated executions until a human re-enables the system. While a repeated automated execution throttle can be effective as a risk control, we believe for the reasons discussed *supra* in the section on Volatility Awareness Alerts, that it is best for market participants employing ATSS to determine which of many alerts are most appropriate for their ATS. We strongly advise against the required use of a repeated automated execution throttle.

B. Policies and Procedures for the Design, Testing, and Supervision of ATSS

The Commission seeks comment on the need for standards with respect to ATS design, testing and supervision.⁴⁵ As the Commission contemplates this issue, we emphasize that an important distinction needs to be made among market utilities, such as DCMs, DCOs and SEFs; service providers, such as FCMs, SDs and MSPs; and market participants or customers. Policies and procedures that may be feasible for market utilities or even service providers may not be as effective or efficient when applied to each customer who has an algorithmic or quantitative component to their trading/investing. While certainly all market entities operating or engaging in the use of an ATS should have appropriate risk controls in place and conduct internal back testing, we caution against overly prescriptive requirements as applied to market participants. Moreover, we believe the Commission’s CFTC Risk Control Rules address appropriately risks from customer orders; and that the Commission, National Futures Association (“NFA”) and exchanges have adequate regulatory tools to address disruptive trading from market participants or customers.⁴⁶

We believe that rules or industry practice should encourage more robust and more routine testing of trading software at the trading platform-level. We understand that many, if not all, exchanges provide market participants a test facility to test trading software and algorithms, as well as offer test symbols to trade. In addition to individual testing, trading platforms should offer integrated or holistic testing where a firm’s software interacts with others. We believe it is important for testing of critical software to become more routine practice, especially testing the process for the suspension of a particular algorithm or trading software in the event an issue arises in a live environment. DCMs, DCOs, FCMs, SDs, MSPs and other market participants

⁴⁴ Concept Release at p. 56557.

⁴⁵ Concept Release at p. 56557.

⁴⁶ See, e.g., Section 4c(5) of the CEA; NFA Rule 2-9 on Supervision; Chapter 4 of the CME Rulebook, Enforcement of Rules, available at: <http://www.cmegroup.com/rulebook/CME/I/4/4.pdf>; and Section 4 of the ICE Futures U.S. Rulebook, General Trading Rules, available at: https://www.theice.com/publicdocs/rulebooks/futures_us/4_Trading.pdf.

should conduct more routine testing of trading software to review for anomalies and interdependencies as markets evolve. In particular, we believe that such integrated testing in many instances may be preferable to testing exclusively within a firm.⁴⁷

With respect to supervision, MFA believes there should be at least one designated principal who is available and authorized at all times to suspend all or part of the firm's trading program in the event of a trading or software malfunction. Such a person should be "on duty" anytime the firm is trading and should have sufficient information flow to ensure appropriate action. MFA believes that it is important that market sponsors including FCMs have "plan-of-action" protocols including scenarios that include timely trading suspension based on specific software malfunctions or general disaster recovery events. Firm principals should have the ability through a kill-switch to turn off the trading program. Firms should also periodically test their kill-switch functionality.

The Commission also seeks comment on measures to improve the identification of ATSs or their underlying algorithms.⁴⁸ Specifically, the Commission believes that identification of ATSs or underlying algorithms could: (1) help both firms and trading platforms to more quickly identify malfunctioning systems that could disrupt markets; and that (2) help improve Commission oversight, including the *ex post* analysis of disruptive events.⁴⁹ Beyond the logistical cost of creating such a tagging system, we do not believe such a system would provide that much added value to the Commission. As we understand, exchanges and firms are able to identify malfunctioning systems fairly quickly. The issue is not so much "who" is behind the ATS or algorithm, but what to do once a malfunctioning system is identified. We also understand that exchanges already receive fairly detailed market data and have the capability to analyze and investigate market events and their participants.

As the Commission reviews its regulatory framework with ATSs in mind, we want to respectfully remind the Commission that market participants invest significant research, time and resources into developing proprietary investment strategies and ATSs. Such investment strategies are trade secrets, protected by law. The CEA, like other statutes,⁵⁰ recognizes the legitimate commercial need to protect the confidentiality of such secrets. We also believe that as a matter of financial stability, it is important for regulators to maintain the confidentiality of market participants' trade data and investment strategies; and prevent it from misused, stolen, or

⁴⁷ See, e.g., letter from Stuart J. Kaswell, Executive Vice President & Managing Director, MFA, to the Hon. Mary L. Schapiro, Chairman, SEC, dated August 14, 2012, on Computer Trading & Risk Management Issues, *available at*: <https://www.managedfunds.org/wp-content/uploads/2012/08/Risk-Management-8-14-12-final.pdf>.

⁴⁸ Concept Release at p. 56559.

⁴⁹ *Id.*

⁵⁰ See e.g., Section 8(a) of the CEA; and Freedom of Information Act, 5 USC §552 (b)(4) (hereinafter "FOIA") (exception for "trade secrets and commercial or financial information obtained from a person and privileged or confidential....").

reverse-engineered.⁵¹ We are concerned that if regulators are not able to protect sensitive or proprietary information relating to an investment firm's portfolio or investment, recipients could use such information to trade against the investment firm and cause, especially during times of market stress or financial stress for the investment firm, further market or financial stress, and even the potential liquidation of such firm's fund or positions. Accordingly, we believe the Commission in requesting for more detailed information from firms or in considering requiring that firms provide sensitive information to exchanges/trading platforms, needs to consider how to ensure that the confidentiality of such information is protected.⁵²

Finally, we want to emphasize that as a separate component to risk controls, but an important aspect to safeguarding marketplaces, trading platforms need to ensure that adequate investment is made into their infrastructure yearly, including their data bandwidth to prevent time delays of accurate market data; their ability to handle peak volumes; and their ability to protect against security infringements.

C. Other

The Commission seeks comment on whether exchanges should impose a minimum time period for which orders must remain on the order book before they can be withdrawn.⁵³ Imposing a minimum resting period would allow other market participants to pick off orders on an order book that become stale when the market moves and trade against the relevant positions. A minimum resting period would therefore reduce market participants' ability to react to changing market conditions and leave them exposed to market movements. By creating more risk for market participants to place an order, a minimum resting period would incentivize market participants to place fewer orders and of smaller size which could ultimately lead to a widening of spreads and decreased market liquidity. Accordingly, we are strongly opposed to a minimum resting period for orders.

VI. Conclusion

MFA appreciates the Commission's vigilance in thoughtfully reviewing the regulatory framework and infrastructure of the U.S. derivatives markets and whether additional risk controls

⁵¹ For example, we were extremely troubled and alarmed by press reports from earlier this year alleging that CFTC staff and outside researchers used sensitive and proprietary information and published independent research papers based on that information that was not sanctioned by the CFTC. We were especially concerned that the individuals at issue may have reverse-engineered certain trading strategies from the sensitive and proprietary trade information which they had access to or obtained. *See, e.g.,* Adam Clark-Joseph, *Exploratory Trading*, January 13, 2013. *See also,* Andrei Kirilenko et al., *The Flash Crash: The Impact of High Frequency Trading on an Electronic Market*, May 26, 2011; and Jaksa Cvitanic and Andrei Kirilenko, *High Frequency Traders and Asset Prices*, March 11, 2010.

⁵² *See, e.g.,* Recommendations for FSOC Members/Regulators On the Protection of Non-Public, Sensitive, and Proprietary Information, MFA, May 2013, available at: <https://www.managedfunds.org/wp-content/uploads/2013/05/MFA-Data-Confidentiality-paper-final-5-22-13.pdf>.

⁵³ Concept Release at p. 56568.

or system safeguards are needed. We believe the Commission has established a robust derivatives market framework and CFTC Risk Control Rules significantly address Marketplace Risks. We believe, as discussed herein, that the Commission and/or the industry could take some additional measures with respect to pre- and post-trade controls and systems testing to further enhance protections against Marketplace Risk.

MFA members have a strong interest in liquid and deep markets that operate efficiently and with integrity. MFA stands committed to work with the Commission and its staff on efforts to maintain the safety and soundness of the U.S. derivatives markets. We welcome the opportunity to discuss our comments in greater detail. Please do not hesitate to contact the undersigned or Jennifer Han, Associate General Counsel, at (202) 730-2600.

Respectfully submitted,

/s/ Stuart J. Kaswell

Stuart J. Kaswell
Executive Vice President & Managing Director,
General Counsel

CC: The Hon. Gary Gensler, Chairman
The Hon. Bart Chilton, Commissioner
The Hon. Scott D. O'Malia, Commissioner
The Hon. Mark P. Wetjen, Commissioner