



## CFTC OPEN MEETING

### • OVERVIEW

For questions on the note below, please contact [Kwon Park](#) at (202) 547-3035.

Today, the CFTC held an [open meeting](#) to consider a proposed rulemaking on automated trading systems (ATS).

Please click below for additional information:

[Fact Sheet: Regulation AT](#)

[Question and Answer: Regulation AT](#)

### Key Takeaways

- The Commissioners voted unanimously (3 – 0) to adopt the notice of proposed rulemaking on Regulation AT as a regulatory response to the evolution of automated trading on U.S. designated contract markets (DCMs).
- Chairman Massad stated that firms, regardless of size, could impact the market, and solicited feedback on whether all firms trading through electronic markets should be required to register even if they are not engaged in electronic trading.
- Commissioner Bowen questioned whether the Commission should go further in its prohibition on market maker programs, and broaden the definition of algorithmic trading.
- Commissioner Giancarlo raised concerns regarding the CFTC's newly proposed authority to inspect, collect, and protect a trading firm's proprietary source code information.
- The comment period will be open for 90 days after the proposal is published in the Federal Register.

### • SUMMARY

#### Opening Statements

##### [Chairman Timothy Massad](#)

- Automated trading has brought many benefits to market participants (i.e., efficient execution, lower spreads, and greater transparency), but its extensive use raises important policy and supervisory concerns.
- Today's proposal focuses on minimizing the potential for disruptions and other operational problems that may arise from automation of order origination, transmission, or execution.
- On the proposal:

- Largely reflects industry best practices to minimize the risk of disruptions in a principles-based way.
- Applies regardless of whether the automated trading is high- or low-frequency, but does not define high-frequency trading (HFT).
- Requires registration of proprietary traders who engage in algorithmic trading on regulated exchanges via “direct electronic access.”
- Adopts standards applicable regardless of size or similar attributes of a trading firm.
- Proposed risk controls for futures commission merchants (FCMs) with respect to their customers engaged in algorithmic trading.
- Commenters should consider whether:
  - All firms trading through electronic markets should be required to register even if they are not engaged in electronic trading.
  - Standards should vary in any way depending on firm size or activity level.
  - Any aspects of required controls may pose burdens on FCMs.

#### Commissioner Sharon Bowen

- Lack of comprehensive, precise data on algorithmic trades does not mean regulators should wait for the data to act, as problems may emerge in the interim.
- This rule should not substantially change how many firms utilize algorithms and will not create significant new burdens for that firm.
- The public should comment on whether:
  - The definition of algorithmic trading should be expanded to include trades “manually entered into a front-end system by a natural person.”
  - Regulation 1.31’s annual report requirement should be expanded to ask registrants for more information.
  - The prohibition on DCMs from paying market maker incentive program benefits for trades between accounts under common ownership should go further.

#### Commissioner Chris Giancarlo

- Three main concerns:
  - Does this proposal benefit the safety and soundness of America’s futures markets so as to outweigh its additional costs and burdens.
  - Costs and burdens on small market participants and its requirement that registrants hold their proprietary source code in data repositories available for inspection by the Commission or the Department of Justice (DOJ) at any time for any reason.
  - Regulatory inconsistencies regarding market participants that must comply with this proposal.

#### ● **Proposed Rulemaking on Automated Trading Systems**

**Sebaastian Pujol, DMO**

- Four elements:
  1. Registration of persons engaged in proprietary algorithmic trading in the floor trader category.
    - “AT Person” means any person registered or required to be registered as an FCM, floor broker, swap dealer, major swap participant, commodity pool operator, commodity trading advisor, or introducing broker that engages in “Algorithmic Trading” on or subject to the rules of a DCM; or registered as a floor trader as amended by this proposal.
  2. Definition of algorithmic trading.
  3. Pre-trade and other risk controls at firm (including “AT Person”), FCM, and DCM levels.
  4. Enhanced transparency (i.e. prohibitions on certain types of market maker and incentive fee compensation, self-match prevention requirement).

- **Question and Answer**

*Giancarlo:* Is proprietary source code information currently subject to inspection and collection by the Commission via a special call type authority? Should source code, commonly considered intellectual property of a trading firm, be subject to a higher standard for review (i.e. subpoena)? *Vince McGonagle, Director of DMO:* The CFTC has investigative rights under regulation 1.31 (requirement to keep books and records for inspection).

*Giancarlo:* Is source code information equivalent to books and records of past activity as required by regulation 1.31 and subject to the same standards for examination by the CFTC and DOJ? *McGonagle:* Commenters should provide feedback on the nature and scope of regulation 1.31. Currently, regulation 1.31 as amended by proposed Regulation AT would include source code information, giving the Commission the right to collect and inspect source codes.

*Giancarlo:* Does the SEC or any other regulator have the authority to inspect and collect proprietary source code information similar to the standard laid out in this proposal? Does the FDA have the authority to ask Coca-Cola for their secret formula? *McGonagle:* Unclear what other authorities are doing and would need to be studied.

*Giancarlo:* Hypothetically, if we had special call authority to examine source code, does the CFTC have the capability to do anything with that information? *McGonagle:* Source code would be reviewed and inspected in an as needed basis as requested by staff. Inspections may be done at the firm’s facilities and does not necessarily have to be transferred to the Commission; *Massad:* CFTC staff have the ability to analyze algos. The enforcement division has already engaged in many cases with algorithms and have built the expertise to analyze and study this type of information.

*Giancarlo:* How can the government provide the public assurance that their proprietary source code information is safe (i.e. cyber attacks, hacking) if transferred to the Commission? *McGonagle:* The CFTC handles confidential information regularly and is vigilant in maintaining security and confidentiality; *Massad:* The CFTC receives many types of confidential and highly sensitive information that can impact our markets. Source code would be treated just as carefully.