drums along the potomac

Take my jurisdiction, please. Last time, we filed the following piece under the "Are You Kidding Me" federal rule category. Don't get us wrong, the CFTC gets a lot of stuff right. But when it gets something wrong, it's not usually small. Same with FERC, for that matter. This time, FERC is in the right. Of course, we're talking about the recent CFTC proposal that would allow private rights of action under Section 22 of the CEA, in relation to certain electricity transactions by FERC-regulated ISOs and RTOs. This week the FERC came out in very strong terms against the CFTC move. Noting that RTOs and ISOs are "pervasively regulated" by FERC, and that the Federal Power Act bars private actions under FERC's anti-manipulation rule, the FERC staff opposed the "introduction to FERC-jurisdictional markets of a private right of action under the CEA." It argued that such a private right of action to these markets would conflict with Congress' intention to rely on public enforcement by a specialized agency, and also would create jurisdictional conflicts between the CFTC and FERC. FERC stated that the proposal would conflict with Congress' directive that the CFTC and FERC establish cooperative procedures for avoiding conflicts where the agencies' jurisdictions may overlap. FERC staff further asked the CFTC to clarify that it does not have exclusive jurisdiction over transactions covered by the RTO-ISO order if the CFTC chooses to go ahead with the proposal. A separate comment letter issued by ISO/RTO counsel emphasized that "permitting private claims is likely to have a number of additional unintended consequences that do not serve the public interest, and that create the same uncertainty that the ISO-RTO order was designed to avoid." This week, Cadwalader's Bob Zwirb wrote a brief commentary on this situation. We hope we can coerce him to file a lengthier piece in the future. In his formal statement on the CFTC proposal, agency Chairman Tim Massad said that "private actions serve the public interest by allowing harmed parties to seek damages in instances where the CFTC lacks the resources to do so on their behalf, and secondly that Congress has determined that the public benefit of such rights of action outweigh any potential costs that may be incurred … "

"As a general matter," Zwirb says, "both propositions are true." However, neither seems appropriate in the present context, he adds, since both points involve a complex, regulated wholesale electricity market in which market participants are "highly sophisticated entities such as generators and utilities," as the FERC letter indicates. "Suffice to say that a lot can go wrong, both legally and economically, in such a carefully regulated structure if the floodgates open to private litigation across various jurisdictions. More to the point, consumers are protected already. Both the CFTC and FERC have the robust enforcement authority to address any manipulation that may occur, and the CFTC also has the authority to seek restitution to compensate customers for any harm caused by wrongful conduct," Zwirb says. We must agree. Given the earlier trajectory of the CFTC draft proposal or at least the known (or assumed) CFTC thinking on the matter prior to its recent release, it's believed that this proposal was somewhat of an 11th hour creation. Only, nobody is quite sure why. This was a staff effort, for sure, though an issue that a couple commissioners gave public lip service to in the past – only not in the same form that it ultimately emerged. Here's one the chief should have maybe dug a bit deeper into. Fortunately, he can still "fix" it with the stroke of his pen, one regulatory attorney tells us. It's not a battle worth going to the mat for, so why do it at all?

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Source code sans subpoena. A very interesting debate has emerged about record keeping, algorithmic strategy source code, what it is, what it is not and who can access it (and for what reasons). Following a recent staff roundtable on the subject, Regulation AT is now officially under the microscope, and source code access is a leading-edge topic. CFTC commissioners have made the rounds recently at industry events laying out their positions. Chairman Massad seems adamant about code access, for example. Though access by subpoena or not? Well, he has hinted at both, to Congress and at industry functions. His mind may not be made up yet. GOP Commissioner Chris Giancarlo is equally adamant, only, on the other end of the spectrum. He thinks the commission should only gain access to algo source code via subpoena. He further asserted that although the broader (AT) proposal is a "well-meaning attempt by the agency to catch up to the digital revolution in US futures markets," Regulation AT has a "seemingly broad scope, hazy objectives and several significant inconsistencies." He described the proposal's requirement that proprietary source code be accessible to the CFTC and the Justice Department as "notorious" and stated that it "should come as no surprise that law abiding businesses are very concerned with the prospect of handing over highly valuable, proprietary business source code to the CFTC." He noted at last week's DC Bar Association meeting (he was the featured speaker) that Regulation AT is seemingly a "20th century solution for a 21st century issue." He may be right. Commissioner Sharon Bowen seems open to discussion on all of it, and keen to listen, though we reckon she will ultimately give the nod to more burdensome requirements for algo traders, including full access to code, registration, expansive recordkeeping and so on. Bowen seems broadly leery of algo trading in some markets, and she is hardly alone. At a past event we recall her (seemingly) roll her eyes after hearing the common refrain on the importance of AT and algo trading, "because it brings liquidity to the market … " The look we saw from Bowen spoke volumes: "I've heard it

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all before, so come up with a better one." On the source code matter, from what we hear inside the commission, staff seems a little divided too. There are those who recognize the importance of trade secrets and keeping them safe and secure. There are others who believe that the commission should not look at such things just because they are curious. There are still others who firmly believe that investigators should have full access to everything, including the source code, whether they have the resources to scrutinize it or not. Records are records, they tell us. And given that there is a certain smoking gun element to algo source code, arguments against keeping and storing source code and all associated market data seem to fall flat in our humble view. We've heard many arguments over the past week on this stuff and now view source code as any other transaction record that the rules dictate must be held or stored, in an easily accessible manner, for three or five years. Just because they might be trade secrets, should regulators be denied access? Of course not. Regulators should, however, treat such data carefully and securely. It's our guess that the CFTC, SEC and FERC have handled trade secrets in a secure manner in the past, and source code for algo strategies is no different. Should a trade data vault exist for storing such proprietary data? Sure, why not. The feds don't need to own or operate it, just be able to access it. Maybe a bank can do it, or an exchange. Come to think if it, SDRs aren't doing much in this sector at the moment, despite all the vast investment, time and resources commercial entities expended to serve this regulatory whim, er, Dodd-Frank swap market design. Maybe this is a fair use for SDRs – a trade data vault for source code.

We don't see the fuzziness on this one. Algo source code is in fact a record, we believe, of your intent to trade. If the algo commands it, intent is inherent. And so, records must be kept.

We read a piece in DealBreaker/NYC the other day that seemed to argue that the agency is "overreaching in its quest for market safety and soundness," by demanding access to source code without a subpoena. "Record retention is a worthy goal, but it is unclear whether the strapped regulator can protect such intellectual property. Worse, it may open the door for other officials to ask for the same unusual gateway … "

Strapped regulator? Unusual gateway? We think such arguments deflect from the core matter. If source code records are needed to nail bad guys, what's the question? "There is reason to wonder whether the agency could protect the source codes it might obtain," the DealBreaker commentary continues. "Like the Securities and Exchange Commission, it is perennially underfunded. Every year, lawmakers either cut its expense requests or leave its budget flat. Even government entities with fewer resource problems, like the White House, are vulnerable to hacking … " By this reasoning, we guess agencies shouldn't play with any important data if it's vulnerable to hacking. This week it was reported that the DNC was hacked by the Russian government and opposition re-

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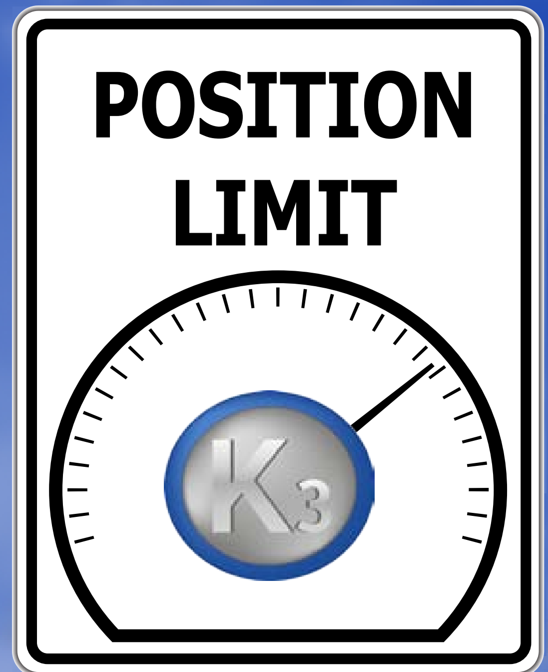
WITHOUT A
SPEEDOMETER



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search files were compromised. This topic has indeed stirred a hornet's nest among some algo traders, which many view as suspicious. We think the push-back is pegged directly to the smoking gun analogy. But if the big issue is data security and integrity, it's our opinion that some smart company will create such a secure retention solution, like the guys who already created the secure SDRs. The political leverage of the AT/algo sector is growing, but admittedly a bit scattered. End-users and commercial operators in this sector are not known to be great fans of AT trading operations, and they have not significantly weighed in (yet) on the matter of Regulation AT. However, end-users certainly have the ear of lawmakers and by extension, Chairman Massad. If end-users and commercial operations, utilities, E&P companies and the like start to press for greater restrictions and requirements for AT/algo operations, it could change the outcome significantly. And, possibly put some of the commissioners in a very delicate position.

The good folks at Cadwalader summarized and reviewed the recent CFTC staff roundtable discussion of Regulation AT and it is now available at *https://www.findknowdo.com/news/06/13/2016/cadwalader-attorneys-review-concerns-voiced-during-regulation-roundtable*. Submit comments on Regulation AT, at the CFTC website at *http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1705*.

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Comments please. Sure, as a "hedger" (nod, nod, wink, wink) in the energy sector, you thought the whole position limits quandary was finally resolved earlier this month at the CFTC, right? Not so fast smart guy. Along with the proposed supplemental rule, comes a comment period. A Cadwalader Cabinet summary notes that the CFTC requested comments on this recent supplement to its December 2013 position limits proposal (yes, it's really been three years), which (1.) modifies the procedures for seeking exemptions from speculative position limits for nonenumerated bona fide hedging, and (2.) defines procedures for recognizing certain anticipatory bona fide hedge positions. "The proposed supplement provides a new way for exchanges and swap execution facilities (SEFs) to recognize certain positions in commodity derivative contracts as nonenumerated bona fide hedges or enumerated anticipatory bona fide hedges. The procedures in the supplement exempt certain spread positions from federal position limits, subject to CFTC review. Additionally, the proposal clarifies the general definition of "bona fide hedging position" for physical commodities under the standards set forth in CEA Section 4a(c). Comments on the proposed supplement, which must be read in conjunction with the notice of proposed rulemaking that was issued in December 2013, must be submitted by July 13, 2016. To submit or view current comments, go to *http://comments.cftc.gov/PublicComments/CommentList.aspx?id=1708*.

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The CFTC's Market Risk Advisory Committee (MRAC) will hold a public meeting on Monday, June 27, 2016, from 10 to 1:30 at the CFTC's HQ on 1155 21st Street, NW in Washington, DC. Commissioner Sharon Bowen is the sponsor of this advisory committee. The MRAC will discuss: (1.) the CCP Risk Management Subcommittee's draft recommendations on how central counterparties (CCPs) can better coordinate their efforts in preparing for the default of a significant clearing member, and (2.) the role of the Federal Deposit Insurance Corporation (FDIC) and CFTC in the resolution of both banks and CCPs.

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