

## CFTC Approves Supplemental Proposal for Proposed Regulation AT

On November 4, 2016, the Commodity Futures Trading Commission (“CFTC” or the “Commission”) approved, by a 2 – 1 vote, a supplemental proposal (“Reg AT Supplemental Proposal”) that amends a 2015 proposed rule related to automated trading (“Proposed Reg AT”).<sup>1</sup> The Reg AT Supplemental Proposal includes a 60-day comment period that commences upon publication in the Federal Register. Unless addressed in the Reg AT Supplemental Proposal, Proposed Reg AT remains the same. Below is a summary of the key aspects of the Reg AT Supplemental Proposal based upon the discussion at the CFTC’s open meeting along with the fact sheet and Q&A document posted to the CFTC website.<sup>2</sup>

### I. Quantitative Test for Registration as AT Person

Under Proposed Reg AT, Commission registrants that engage in algorithmic trading are subject to Commission rules related to the registrant’s algorithmic trading (“AT Persons”). Proposed Reg AT also would expand the scope of floor traders required to register with the Commission to include algorithmic traders that trade on a designated contract market (“DCM”) via direct electronic access.

The Reg AT Supplemental Proposal generally retains this framework. However, it proposes a new quantitative threshold to determine whether a person must register under the new category of floor trader, and whether a Commission registrant is an AT Person. The proposed volume threshold is 20,000 contracts on average, per day, over a six-month period. As a result, if a market participant trades on a DCM via direct electronic access, the participant must register as a floor trader if the participant exceeds the volume threshold. Furthermore, if an existing Commission registrant engages in algorithmic trading, the registrant is an AT Person if the registrant exceeds the volume threshold. With the proposed volume threshold, the CFTC estimates that 120 persons will fall into the definition of an AT Person, of which, 50 would be newly registered floor traders and 70 would be current registrants.

### II. Confidentiality Structure for Source Code

Proposed Reg AT required that AT Persons maintain records of their source code and make the source code available to Commission Staff, upon request. As initially proposed, CFTC Staff did not need to seek Commission approval in order to request and obtain the source code. However, under the Reg AT Supplemental Proposal, the Staff only would be able to obtain the source code through issuance of a subpoena or special call, either of which must be approved by a Commission vote.

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<sup>1</sup> Regulation Automated Trading, 80 Fed. Reg. 78824 (Dec. 17, 2015) (proposed rule).

<sup>2</sup> The CFTC fact sheet is [available here](#). The CFTC Q&A document is [available here](#).

The open meeting revealed significant differences of opinion among the Commission about the effectiveness of the new provisions related to obtaining source code information. Commissioner Giancarlo, who dissented, compared the process for obtaining source code through the special call procedure under the Reg AT Supplemental Proposal as an unconstitutional taking without due process of law. In contrast, Chairman Massad viewed the special call procedure as providing the CFTC with the same tools it already has with respect to non-algorithmic traders. Notwithstanding these differences, the Chairman and Commissioner Giancarlo appeared to agree that the Reg AT Supplemental Proposal could be improved by narrowly tailoring the manner in which CFTC Staff access source code, for example, by building in safeguards that limit the location of the review and the duration of the CFTC's access to the information.

### **III. Elimination of Annual Reports**

The Reg AT Supplemental Proposal removes the requirement for futures commission merchants ("FCMs") and AT Persons to file annual reports with a DCM regarding their risk control framework. In lieu of the annual report, the Reg AT Supplemental Proposal would establish an annual certification process for AT Persons to certify compliance with Regulation AT to a DCM. The Reg AT Supplemental Proposal also obligates DCMs to establish a program for periodic review of AT Persons' compliance with Regulation AT.

### **IV. Risk Controls: Two-Tier Framework in Lieu of Three-Tier Framework**

Proposed Reg AT includes various pre-trade risk controls that DCMs, FCMs, and AT Persons must design and implement. The Reg AT Supplemental Proposal shifts the three-tier structure for pre-trade risk controls in Proposed Reg AT to a two-tier structure. Specifically, both the applicable DCM, as well as either the AT Person or its FCM, must adopt pre-trade risk controls. The Reg AT Supplemental Proposal also shifts the FCM pre-trade risk controls from the clearing FCM to the executing FCM. In deciding who should implement the pre-trade controls, an AT Person may delegate pre-trade risk controls to its executing FCM, but that FCM is not obligated to accept the delegation.

Finally, the Reg AT Supplemental Proposal would expand the scope of pre-trade risk controls to require controls for all electronic trading, as opposed to Proposed Reg AT, which would have limited the pre-trade risk controls to the algorithmic trading of AT Persons. Under this proposed regulatory framework, FCMs would need to develop pre-trade risk controls for electronic trading of non-AT Persons.

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