

[Securities Regulation Daily Wrap Up, TOP STORY—CFTC proposes rules on automated trading, \(Nov. 24, 2015\)](#)

Securities Regulation Daily Wrap Up

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The Commodity Futures Trading Commission voted unanimously to release for public comment a proposal to implement a series of risk controls, transparency measures, and other safeguards to enhance the regulation of algorithmic order origination and electronic trade execution. The proposed rules, collectively known as Regulation AT, focus on minimizing the potential for problems that may arise from the automation of order origination, transmission or execution due to malfunctioning algorithms, inadequate testing of algorithms, or other errors.

The Commission [proposed](#) risk control and other requirements for market participants using algorithmic trading systems (AT persons). It also proposed risk controls for clearing member futures commission merchants (FCMs) with respect to their AT person customers, and designated contract markets (DCMs) executing AT person orders. The Commission noted in a [press release](#) that the proposed rules would require the implementation of risk controls such as maximum order message and maximum order size parameters, and the establishment of standards for the development, testing and monitoring of algorithmic trading systems.

The CFTC clarified in an accompanying [fact sheet](#) that AT persons subject to the new rules would be required to submit annual compliance reports to DCMs regarding their risk controls as well as copies of policies developed to comply with testing and other requirements. Clearing member FCMs would have to submit annual compliance reports to DCMs describing their program for establishing and maintaining the required pre-trade risk controls for their AT person customers.

Trader registration. Regulation AT would require the registration of certain proprietary traders that, while responsible for significant trading volumes in key futures products, are not currently registered with the CFTC. The proposed registration requirement would be applicable specifically to proprietary traders engaged in algorithmic trading through direct electronic access to a DCM.

Sebastian Pujol of the CFTC's Division of Market Oversight said that the staff estimates an upper limit of 100 firms, representing 35 percent of all contracts traded across futures markets, that will be subject to the new registration requirements. The advantage to having these firms register, he noted, is that they will be subject to direct Commission oversight and existing rules can then be applied to them.

Self-trade prevention. The proposed rules would also require the use of self-trade prevention tools by market participants on DCMs, while permitting trades originating from accounts with independent decision makers. The proposed rules are designed to increase transparency around DCM electronic trade matching platforms by requiring DCMs to publish a description of rules or known attributes of the trade matching platform that materially affect factors such as the time, price or quantity of execution of market participant orders.

Source code repository. One potentially controversial aspect of Regulation AT is the requirement that AT persons maintain a source code repository. Commissioner J. Christopher Giancarlo [said](#) that he considers source code to be intellectual property and he is not aware of any other federal agency that it allowed to obtain the intellectual property of a firm without a subpoena. He questioned whether the CFTC would be able to provide assurances that source code will be kept confidential.

Chairman Timothy Massad [said](#) that confidentiality of information is always a key requirement of law, and he does not see the difference between algorithmic source code and all of the other sensitive information the Commission receives that it is required to keep confidential.

Pujol said that the CFTC will treat source code as a business record, which means the Commission will have the right to inspect it like any other business record. He added, however, that the source code repository requirement is not designed to create an ongoing review of this sensitive information. A likely scenario in which it will be inspected is when there is market trouble and the Commission needs to see if the algorithm coding contributed to it, he said.

Association membership. To help ensure that Regulation AT remains current as markets and trading technologies evolve, the CFTC also proposed to require that all AT Persons become members of a registered futures association (RFA), and that RFAs consider membership rules addressing algorithmic trading for each category of member in the RFA. These provisions are designed to allow RFAs to supplement elements of Regulation AT in response to future industry developments.

The proposed rules are derived from comments the CFTC received on a September 2013 concept release. Massad said that he believes the proposals largely reflect industry best practice to minimize the risk of disruptions and similar problems. The Commission has tried to be principles-based in its approach, setting forth requirements for certain controls, but avoiding prescribing the parameters or levels at which they should be set, he concluded.

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