Commodity Futures Trading Commission
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Fact Sheet - Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading

On December 17, 2015, the U.S. Commodity Futures Trading Commission (Commission) published a notice of proposed rulemaking (NPRM) proposing a series of risk controls, transparency measures, and other safeguards to enhance the safety and soundness of automated trading on all designated contract markets (DCMs) (collectively, Regulation Automated Trading).[1] The Commission's proposed rules in Regulation AT reflect a comprehensive effort to reduce risk and increase transparency in algorithmic order origination and electronic trade execution on all U.S. futures exchanges.

The supplemental notice of proposed rulemaking for Regulation AT (Supplemental) amends and streamlines certain requirements of the NPRM. Notably, the Supplemental revises the NPRM's proposed risk control framework to concentrate pre-trade risk controls at a minimum of two levels rather than three. In addition, the Supplemental establishes a threshold of existing and new Commission registrants that are considered "AT Persons" under Regulation AT by adding a minimum trading volume test to the criteria for determining who is an AT Person.

The Supplemental addresses algorithmic trading source code through new provisions regarding recordkeeping and access. Specifically, the Supplemental proposes that access to source code by the Division of Market Oversight be limited to special calls issued by the Commission itself.

The Supplemental also proposes additional amendments to the NPRM, as described below. The Commission notes, however, that the proposed rules in the NPRM remain under active consideration unless specifically amended in the Supplemental. The Supplemental will be published in the Federal Register and open for a 60-day public comment period.

Proposed Risk Control Framework.

The NPRM for Regulation AT proposed placing risk controls at three levels: the AT Person, the FCM and the DCM. In the Supplemental, the Commission is proposing to replace the three-level risk control structure with a two-level structure. Risk controls would be set at the levels of (1) the AT Person or its FCM;[2] and (2) the DCM. Pursuant to the Supplemental two-level structure, an AT Person would have the option of delegating compliance with pre-trade risk control requirements to its FCM(s), with the agreement of such FCM(s).

In the NPRM, the Commission also proposed requiring risk controls only with respect to the Algorithmic Trading of AT Persons. Recognizing comments, the Supplemental NPRM expands risk control requirements to also encompass Electronic Trading,[3] including Electronic Trading at the FCM and DCM levels.[4]

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[1] Regulation Automated Trading, Proposed Rule, 80 FR 78824 (Dec. 17, 2015).
[2] The NPRM's risk control requirements applied to "clearing member" FCMs. The Supplemental NPRM revises such requirements to apply to "executing" FCMs.
[3] "Electronic Trading" is defined in Supplemental proposed § 1.3(aaaaa). The Commission notes that Electronic Trading was not defined in the NPRM.
[4] Pursuant to the Supplemental NPRM's proposed rules, AT Persons' risk control obligations would be expanded to include not only Algorithmic Trading, but also Electronic Trading.

The NPRM also proposed requiring that pre-trade risk controls be set at the level of each AT Person or market participant, or other more granular levels as the AT Person, FCM or DCM determined appropriate. The Supplemental revises the risk control provisions to provide AT Persons, FCMs and DCMs greater flexibility regarding the level at which pre-trade controls must be set.

Registration of certain market participants not already registered with the Commission as "AT Persons".

Regulation AT would require registration of certain market participants. Such market participants would be required register as "floor traders," as defined in Supplemental proposed § 1.3(x)(1)(iii) ("New Floor Traders"), and consistent with other requirements, would also be required to become members of a registered futures association ("RFA"). Together with certain existing registrants, New Floor Traders would be considered AT Persons and be subject to all associated requirements of Regulation AT.

Pursuant to the NPRM, the proposed registration criteria for New Floor Traders were that such persons be engaged in (1) proprietary, (2) Algorithmic Trading (3) through Direct Electronic Access ("DEA") on a DCM. The Supplemental retains these requirements but also incorporates a volume-based quantitative test for registration as a New Floor Trader. The Commission also proposes to apply this same volume-based quantitative test to existing registrants and persons otherwise required to register with the Commission to determine whether they are AT Persons.

Algorithmic Trading Source Code.

Regulation AT requires that algorithmic trading source code be preserved and made available to the Commission when necessary. The NPRM required that AT Persons make source code available for inspection in accordance with the Commission's general recordkeeping requirements.

The Supplemental acknowledges concerns regarding algorithmic trading source code[5] and revises these provisions extensively. Algorithmic Trading Source Code and related records are required to be preserved, but preservation and access obligations would be set forth in provisions separate from the Commission's general recordkeeping rules. Notably, the Supplemental NPRM provides that the Commission would have access to Algorithmic Trading Source Code only via a subpoena or a special call approved by the Commission itself. In addition, the Supplemental provides that the Commission would also have access, via a subpoena or special call approved by the Commission, to (a) records that track changes to an AT Person's Algorithmic Trading Source Code; and (b) log files that record the activity of an AT Person's Algorithmic Trading system.

Other AT Person and FCM Records; DCMs' Review of Compliance with Regulation AT.

In the NPRM, the Commission proposed requiring that each AT Person provide the DCMs on which they operate with annual reports containing information on the AT Person's compliance with requirements concerning risk controls. The NPRM further would have required DCMs to establish a program for effective review and evaluation of such reports. The Supplemental eliminates DCMs' obligation to review annual compliance reports. In place of such obligation, the Supplemental requires that each DCM establish a program for effective periodic review of AT Persons' compliance with Regulation AT. The Supplemental also provides that DCMs must require AT Persons to provide the DCMs with an annual certification attesting that the AT Person complies with Regulation AT.

Similarly, the Supplemental eliminates the obligation proposed in the NPRM that DCMs review annual compliance reports provided by FCMs. The Supplemental replaces such obligation with a requirement that that each DCM also establish a program for effective periodic review of FCMs' compliance with Regulation AT. Pursuant to the Supplemental NPRM, each DCM must also require FCMs to provide the DCM with an annual certification attesting that the FCM complies with Regulation AT.

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[5] "Algorithmic Trading Source Code" is defined in Supplemental proposed § 1.3(ccccc). The Commission notes that source code was not defined in the NPRM.

AT Persons' Use of Third-Party Systems, and Other Regulation AT Provisions.

The Supplemental provides AT Persons who use third-party systems as part of their Algorithmic Trading with options to facilitate their compliance with elements of Regulation AT. Finally, the Supplemental also discusses a number of changes to certain defined terms proposed in the NPRM, as well as other provisions that the Commission is considering in response to comments from market participants. These include limiting the scope of "Algorithmic Trading Compliance Issue," "Algorithmic Trading Disruption," and "Algorithmic Trading Event."