



Contacts

Mark D. Young
Washington, D.C.
202.371.7680
mark.d.young@skadden.com

Maureen A. Donley
Washington, D.C.
202.371.7570
maureen.donley@skadden.com

Elizabeth A. Mastrogiacomo
Washington, D.C.
202.371.7312
elizabeth.mastrogiacomo@skadden.com

Daniel B. O’Connell
Washington, D.C.
202.371.7003
daniel.oconnell@skadden.com

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1440 New York Avenue, N.W.
Washington, D.C. 20005
202.371.7000

Four Times Square
New York, NY 10036
212.735.3000

CFTC Revises the Regulation AT Proposal for Automated Trading

The Commodity Futures Trading Commission (CFTC or Commission) recently issued a supplemental proposal (the Supplemental)¹ that amends and replaces components of the Regulation Automated Trading framework the CFTC originally proposed in December 2015 for automated trading on U.S. derivatives exchanges (Reg AT).² The changes proposed in the Supplemental mostly focus on:

- Revising the definition of “AT Person,” including by adding a volume threshold test;
- Replacing the originally proposed three layers of risk controls with two layers of risk controls;
- Subjecting all Electronic Trading,³ rather than just Algorithmic Trading,⁴ to two layers of risk controls;
- Replacing the annual compliance report requirement for AT Persons and futures commission merchants (FCMs) with an annual certification requirement, subject to effective periodic review by designated contract markets (DCMs); and
- Allowing the Commission to access an AT Person’s Algorithmic Trading Source Code and related records through a special call.

The Supplemental is not a replacement or withdrawal of the rules the CFTC proposed in December 2015 (Initial Proposal). Accordingly, all regulatory text in the Initial Proposal remains under Commission consideration as proposed unless specifically amended in the Supplemental. Appendix A to this alert is a redline indicating how the Supplemental modifies the text of the Initial Proposal. Comments are due by January 24, 2017.

In the aftermath of the presidential election and the expected change in leadership at the CFTC, the fate of Reg AT is uncertain. Therefore, addressing the issues raised by the Supplemental during the public comment process will be even more important than normal.

¹ Regulation Automated Trading, 81 Fed. Reg. 85,334 (proposed Nov. 25, 2016) (to be codified at 17 C.F.R. pts. 1, 38, 40 & 170).

² Regulation Automated Trading, 80 Fed. Reg. 78,824 (proposed Dec. 17, 2015) (to be codified at 17 C.F.R. pts. 1, 38, 40 & 170). For more information about the originally proposed Regulation Automated Trading, see Skadden’s January 20, 2016 [client alert](#).

³ The Supplemental defines Electronic Trading as trading in any commodity interest on an electronic trading facility where the order, order modification, or order cancellation is electronically submitted for processing on or subject to the rules of a DCM. See Proposed CFTC Rule 1.3(ddddd).

⁴ The Supplemental does not change the originally proposed definition of Algorithmic Trading.

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AT Person Definition

Under the Supplemental, an AT Person would be:

- An existing CFTC registrant⁵ that engages in Algorithmic Trading on or subject to the rules of a DCM and exceeds the volume threshold;
- A “New Floor Trader”; or
- Someone who elects to become an AT Person.⁶

Like the Initial Proposal, the Supplemental would further expand the Commission’s existing “Floor Trader” definition and require those New Floor Traders to register as AT Persons. A New Floor Trader would be any person who:

- Is not otherwise registered with the Commission;
- In or surrounding any other place provided by a contract market, purchases or sells for its own account any futures contract, security futures product, swap or commodity option;
- Uses Direct Electronic Access; and
- Exceeds the volume threshold.⁷

In response to comments, the Commission has modified the originally proposed definition of Direct Electronic Access to mean “the electronic transmission of an order for processing on or subject to the rules of a contract market, including the electronic transmission of any modification or cancellation of such order ...”⁸ Direct Electronic Access would not include orders, or order modifications or cancellations, electronically transmitted to a DCM by an FCM that the FCM first received orally or in writing from an unaffiliated natural person.⁹ Written communications would include communications written on paper, email, text messages or instant messaging chat tools; the common denominator is that such communications are specifically written by a natural person.¹⁰

The Commission has proposed a volume threshold that it expects to narrow the universe of AT Persons. To be an AT Person, existing CFTC registrants and New Floor Traders must exceed an aggregate average daily volume of 20,000 contracts for the person’s own account, the accounts of customers, or both.¹¹ The

⁵ An existing registrant includes a FCM, floor broker, swap dealer, major swap participant, commodity pool operator, commodity trading advisor or introducing broker.

⁶ See Proposed CFTC Rule 1.3(xxxx).

⁷ See Proposed CFTC Rule 1.3(x)(1)(iii).

⁸ Proposed CFTC Rule 1.3(yyyy).

⁹ See *id.*

¹⁰ See 81 Fed. Reg. at 85,345 n.63, 85,346 n.85.

¹¹ See Proposed CFTC Rule 1.3(x)(2).

AT Person would need to calculate biannually the aggregate average daily volume across all products and on the electronic trading facilities of all DCMs.¹² For purposes of this calculation, the AT Person would need to aggregate its own trading volume with that of any other persons controlling, controlled by or under common control with the person.¹³ The Supplemental adds an anti-evasion provision, which would prohibit a person from trading contracts through multiple entities to evade meeting the definitions of New Floor Trader or AT Person.¹⁴ The Commission estimates that the volume-based criteria would lead to approximately 120 AT Persons, some of whom are already registered with the Commission in some capacity.¹⁵

Risk Controls

The Supplemental proposes a two-tiered risk control framework as opposed to the Initial Proposal’s three-tiered framework. Those two layers of risk controls would apply to all Electronic Trading rather than just Algorithmic Trading. The Supplemental states that under the revised proposal, the Commission is providing AT Persons, FCMs and DCMs with greater flexibility regarding the level of granularity at which risk controls are set.¹⁶

Under the Supplemental, all AT Order Messages¹⁷ would be subject to risk controls at the DCM level and at either the executing FCM or AT Person level.¹⁸ An AT Person would be allowed to delegate compliance to its executing FCM if technologically feasible and accepted by executing FCM.¹⁹

Similarly, all Electronic Trading Order Messages²⁰ originating with an AT Person would be subject to risk controls at the DCM

¹² See *id.* The AT Person would be required to perform this calculation for each January 1 through June 30 and July 1 through December 31.

¹³ See *id.*

¹⁴ See Proposed CFTC Rule 1.3(x)(4).

¹⁵ See 81 Fed. Reg. at 85,336.

¹⁶ See *id.*

¹⁷ An AT Order Message is defined as “each new order submitted through Algorithmic Trading by an AT Person and each modification or cancellation submitted through Algorithmic Trading by an AT Person with respect to such an order.” See Proposed CFTC Rule 1.3(www).

¹⁸ See Proposed CFTC Rule 40.20 (requiring a DCM to implement pretrade and other risk controls designed to prevent and reduce the potential risk of a disruption associated with Electronic Trading, including Algorithmic Trading Disruption); Proposed CFTC Rule 1.80 (requiring an AT Person to implement pretrade risk controls and other measures reasonably designed to prevent and reduce the potential risk of an Algorithmic Trading Event).

¹⁹ See Proposed CFTC Rule 1.80(d).

²⁰ An Electronic Trading Order Message is defined as “each new order submitted by Electronic Trading and each modification or cancellation submitted by Electronic Trading with respect to such an order.” See Proposed CFTC Rule 1.3(bbbbb).

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level and at either the executing FCM or AT Person level.²¹ An AT Person would be allowed to delegate compliance to its executing FCM if technologically feasible and accepted by the executing FCM.²²

All Electronic Trading Order Messages not originating with an AT Person would be subject to risk controls at the DCM level and at the executing FCM level.²³ Thus, all Electronic Trading on DCMs,²⁴ including the Electronic Trading of someone who does not meet the AT Person volume threshold, would be subject to two layers of risk controls.

Annual Certification in Lieu of Annual Compliance Report

The Supplemental eliminates the requirement that AT Persons and clearing member FCMs provide annual reports to any DCMs on which they operate. In response to comments that the requirement was overly burdensome with little benefit, the Commission has instead proposed requiring that AT Persons and executing FCMs provide DCMs with an annual certification attesting that the AT Person or FCM complies with applicable Reg AT requirements.²⁵ DCMs would be required to establish a program for periodic review and evaluation of AT Persons' compliance with Proposed CFTC Rules 1.80 and 1.81 and executing FCMs' compliance with Proposed CFTC Rule 1.82.²⁶

Requirements to Store and Provide Algorithmic Trading Source Code

The Supplemental's requirements regarding Algorithmic Trading Source Code are expected to be the most controversial element of Reg AT. Notably, the Supplemental broadly defines Algorithmic Trading Source Code as "computer commands written in a computer programming language that is readable by natural persons," including "computer code, logic embedded in

electronic circuits, scripts, parameters input into an Algorithmic Trading system, formulas, and configuration files."²⁷

The Supplemental would require AT Persons to retain source code, records that track changes to the source code and log files that record the activity of the AT Person's algorithmic trading system, for five years.²⁸ Additionally, the CFTC would be able to use a "special call," a type of nonsubpoena, regulatory information demand authorized by the Commission, to obtain source code and related records.²⁹ Currently, the CFTC can only use the subpoena process to obtain source code.³⁰ The proposed rules would not alter the CFTC's ability to seek access to source code with a subpoena, making the subpoena process one of two options that would be available to the CFTC for accessing source code.³¹

Under the Supplemental, if the Commission approved a special call for source code or related records, the Commission could authorize the director of the Division of Market Oversight to execute the special call and specify the form and manner in which the records must be produced.³² The proposed rules also would require AT Persons to maintain source code and related records in a form and manner that ensures the authenticity and reliability of the information they contain, and AT Persons also would need to maintain systems to promptly retrieve and display those records.³³ The Commission noted that the two methods of accessing source code are intended to distinguish investigatory proceedings from market surveillance activities, and that the different methods of access to source code would depend on whether the Commission staff is formally investigating potential violations of law (which would likely use the subpoena process) or engaging in market oversight (which would likely use the special call process).³⁴

In approving the Supplemental, Chairman Timothy G. Massad said that updating the Commission's regulations requires "the preservation of source code and other records — the equivalent of the records that those trading at human speed have preserved for years."³⁵ Massad described requiring Commission approval for source code special calls as a "significant departure" from the Commission's "standard practice" of allowing staff to seek information that registrants are required to retain without a subpoena

²¹ See Proposed CFTC Rule 40.20 (requiring a DCM to implement pretrade and other risk controls designed to prevent and reduce the potential risk of a disruption associated with Electronic Trading); Proposed CFTC Rule 1.80(g) (requiring an AT Person to implement pretrade risk controls and other measures to its Electronic Trading Order Messages that do not arise from Algorithmic Trading).

²² See Proposed CFTC Rule 1.80(g)(2)–(3).

²³ See Proposed CFTC Rule 40.20 (requiring a DCM to implement pretrade and other risk controls designed to prevent and reduce the potential risk of a disruption associated with Electronic Trading); Proposed CFTC Rule 1.82 (requiring an executing FCM to use pretrade risk controls reasonably designed to prevent and reduce the potential risk of a disruption associated with Electronic Trading — including an Algorithmic Trading Disruption — for all Electronic Trading Order Messages not originating with an AT Person).

²⁴ Algorithmic Trading would be a subset of Electronic Trading. See 81 Fed. Reg. at 85,357 n.227.

²⁵ See Proposed CFTC Rule 40.22(d).

²⁶ See Proposed CFTC Rule 40.22(a). Proposed CFTC Rules 1.80 and 1.81 address pretrade risk controls for AT Persons and standards for the development, monitoring and compliance of Algorithmic Trading systems. Proposed CFTC Rule 1.82 addresses executing FCM risk management.

²⁷ See Proposed CFTC Rule 1.3(ccccc).

²⁸ See Proposed CFTC Rule 1.84(a)(1)–(3).

²⁹ See Proposed CFTC Rule 1.84(b).

³⁰ See Dissenting Statement of CFTC Commissioner J. Christopher Giancarlo; 81 Fed. Reg. at 85,397.

³¹ See Proposed CFTC Rule 1.84(c).

³² See Proposed CFTC Rule 1.84(b)(1).

³³ See Proposed CFTC Rule 1.84(b)(2)(i)–(ii).

³⁴ See 81 Fed. Reg. at 85,347.

³⁵ See Statement of CFTC Chairman Timothy G. Massad; 81 Fed. Reg. at 85,395.

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or specific Commission authorization, and emphasized that the special call process “will require the same level of Commission review that comes with the issuance of a subpoena.”³⁶

However, Commissioner J. Christopher Giancarlo, currently the CFTC’s only Republican commissioner, argued that the Supplemental’s special call process provides the CFTC with an “end-run” around the subpoena process, removing the “opportunity to challenge the scope, timing and manner of discovery and whether any legal privileges apply to the process of surrendering property to the government”³⁷ that is fundamental to the subpoena process. Giancarlo described the source code provisions as “dubiously constitutional,” suggesting that they may violate constitutional guarantees of due process and protections against unreasonable searches and seizures.³⁸ Because the proposed source code provisions allow the CFTC to forego the subpoena process, Giancarlo warned that if the CFTC adopts the source code provisions, it would likely have to litigate constitutional challenges to them, consuming the agency’s “limited resources and its credibility.”³⁹

³⁶ See *id.* at 85,395–96.

³⁷ See Statement of Commissioner Giancarlo; 81 Fed. Reg. at 85,397.

³⁸ See *id.* at 85,398.

³⁹ See *id.*

Giancarlo also questioned the information security that proprietary source code handed over to the CFTC would receive, citing input from commenters to the Initial Proposal as well as specific instances of data breaches at the Federal Deposit Insurance Corporation, Federal Reserve, Office of the Comptroller of the Currency and Office of Personnel Management.⁴⁰ As a result of these concerns, Commissioner Giancarlo voted against publishing the Supplemental for public comment.⁴¹

Postponed Consideration of Certain DCM Regulations

The Supplemental states that the Commission is considering deferring further consideration of some of the proposed regulations focused specifically on DCMs to a second phase of Regulation AT that would be finalized at a later date.⁴² These regulations, proposed in the Initial Proposal, address topics including self-trade prevention tools and transparency regarding DCMs’ electronic trade matching platforms.

⁴⁰ See *id.* at 85,397–98.

⁴¹ Commissioner Giancarlo stated that it is his normal practice to vote in favor of publishing proposed rules for public comment as part of the administrative process. See Statement of Commissioner Giancarlo. However, due to the source code provisions in the Supplemental, Commissioner Giancarlo voted against even publishing the Supplemental for notice and comment. See *id.* at 85,399.

⁴² See 81 Fed. Reg. at 85,337, 85,366.

PART 1—GENERAL REGULATIONS UNDER THE COMMODITY EXCHANGE ACT

1. The authority citation for part 1 continues to read as follows: Authority: 7 U.S.C. 1a, 2, 5, 6, 6a, 6b, 6c, 6d, 6e, 6f, 6g, 6h, 6i, 6k, 6l, 6m, 6n, 6o, 6p, 6r, 6s, 7, 7a-1, 7a-2, 7b, 7b-3, 8, 9, 10a, 12, 12a, 12c, 13a, 13a-1, 16, 16a, 19, 21, 23, and 24 (2012).

2. ~~In Amend~~ § 1.3, ~~add paragraphs (x)(3), (ttt), (uuuu), (vvvv), (wwww), (xxxx), (yyyy), and (zzzz) to read~~ as follows:

- (a) Revise paragraph (x);
- (b) Reserve paragraphs (ttt)–(vvvv);
- (c) Add paragraphs (wwww), (xxxx), and (yyyy);
- (d) Reserve paragraphs (zzzz) and (aaaa); and
- (e) Add paragraphs (bbbbb), (ccccc), and (dddd).

§ 1.3 Definitions.

* * * * *

(x) ~~* * *~~ Floor trader. (1) In general. This term means any person:

~~(3)~~(i) Who, in or surrounding any pit, ring, post or other place provided by a contract market for the meeting of persons similarly engaged, purchases, or sells solely for such person's own account—

(A) Any commodity for future delivery, security futures product, or swap; or

(B) Any commodity option authorized under section 4c of the Act; ~~and~~or

(ii) Who is registered with the Commission as a floor trader; or

(iii)(A) Who, in or surrounding any other place provided by a contract market for the meeting of persons similarly engaged, purchases or sells solely for such person's own account—

(1) Any commodity for future delivery, security futures product, or swap; or

(2) Any commodity option authorized under section 4c of the Act;

~~(B)~~ Who uses Direct Electronic Access as defined in paragraph (yyy) of this section, in whole or in part, to access such other place for Algorithmic Trading; ~~and~~

~~(C)~~ Who is not registered with the Commission as a futures commission merchant, floor broker, swap dealer, major swap participant, commodity pool operator, commodity trading advisor, or introducing broker; ~~and~~

(D) Who, with respect to purchases or sales on any designated contract market of any commodity for future delivery, security futures product, or swap, or any commodity option authorized under section 4c of the Act, satisfies the volume threshold test set forth in (x)(2) of this section.

(2) Volume threshold test. A person satisfies the volume threshold test for purposes of (x)(1)(iii)(D) of this section if such person trades an aggregate average daily volume of at least 20,000 contracts for such person's own account, the accounts of customers, or both where;

(i) Such person shall calculate the aggregate average daily volume across all products and on the electronic trading facilities of all designated contract markets where such person trades;

(ii) Such person shall calculate the aggregate average daily volume for each January 1 through June 30 and July 1 through December 31 period, based on all trading days in the respective period; and

(iii) For purposes of calculating the aggregate average daily volume, such person shall aggregate its own trading volume and that of any other persons controlling, controlled by or under common control with such person.

(3) Registration period. (i) Unregistered persons who satisfy (x)(1)(iii)(A)–(C) of this section, and who satisfy the volume threshold test set forth in (x)(2) of this section in any January 1 through June 30 or July 1 through December 31 period, shall register as a floor trader within 30 days after the end of such period and shall comply with all requirements of AT Persons pursuant to Commission regulations within 90 days after the end of such period.

(ii) For any group consisting of a person and any other persons controlling, controlled by or under common control with such person, if such group of persons in the aggregate satisfies the volume threshold test set forth in (x)(2) of this section, then one or more persons in such group shall register as floor traders under (x)(3)(i) of this section, so that the aggregate average daily volume of the unregistered persons in the group trade an aggregate average daily volume below the volume threshold test set forth in (x)(2) of this section.

(4) Anti-Evasion. (i) No person shall trade contracts or cause contracts to be traded through multiple entities for the purpose of evading the registration requirements imposed on floor traders under (x)(3) of this section, or to avoid meeting the definition of AT Person under (xxxx) of this section.

(ii) Contracts that any person trades or causes to be traded through multiple entities for the purpose of evading the registration requirements imposed on floor traders under (x)(3) of this section, or to avoid meeting the definition of AT Person under (xxxx) of this section, shall be attributed to such person for purposes of the volume threshold test calculation contained in (x)(2) of this section.

* * * * *

(ttt) *Algorithmic Trading Compliance Issue.* This term means an event at an AT Person that has caused any Algorithmic Trading of such entity to operate in a manner that does not comply with the Commodity Exchange Act or the rules and regulations thereunder, the rules of any designated contract market to which such AT Person submits orders through Algorithmic Trading, the rules of any registered futures association of which such AT Person is a member, the AT Person's own internal requirements, or the requirements of the AT Person's clearing member, in each case as applicable.

(uuuu) *Algorithmic Trading Disruption*. This term means an event originating with an AT Person that disrupts, or materially degrades—

- (1) The Algorithmic Trading of such AT Person,
- (2) The operation of the designated contract market on which such AT Person is trading, or
- (3) The ability of other market participants to trade on the designated contract market on which such AT Person is trading.

(vvvv) *Algorithmic Trading Event*. This term means an event at an AT Person that constitutes—

- (1) An Algorithmic Trading Compliance Issue; or
- (2) An Algorithmic Trading Disruption.

(www) *AT Order Message*. This term means each new order ~~or quote submitted through Algorithmic Trading to a designated contract market by an AT Person and each change or deletion~~ submitted through Algorithmic Trading by an AT Person and each modification or cancellation submitted through Algorithmic Trading by an AT Person with respect to such an order ~~or quote~~.

(xxxx) *AT Person*. (1) This term means any person registered or required to be registered as a—

- ~~(1)~~ Futures commission merchant, 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~~

(A) Engages in Algorithmic Trading on or subject to the rules of a designated contract market; ~~or~~ and

(B) With respect to purchases or sales of any commodity for future delivery, security futures product, or swap, or any commodity option authorized under section 4c of the Act, satisfies, or has satisfied, the volume threshold test set forth in (x)(2) of this section; provided, however, that if an AT Person does not satisfy such volume threshold test for two consecutive semi-annual periods, as outlined in (x)(2) of this section, then such person shall no longer be considered an AT Person; or

- ~~(2)~~ (ii) Floor trader as defined in ~~paragraph (x)(31)(iii)~~ of this section.

(2) (i) A person who does not satisfy the conditions of (xxxx)(1) of this section may elect to become an AT Person, provided that such person:

(A) Registers as a floor trader as defined in (x)(1)(ii) of this section; and

(B) Submits an application for membership in at least one registered futures association pursuant to § 170.18 of this chapter.

(ii) A person that elects to become an AT Person pursuant to (xxxx)(2)(i) of this section shall comply with all requirements of AT Persons pursuant to Commission regulations in this chapter.

(yyyy) *Direct Electronic Access*. ~~This~~ For purposes of §§ 1.3(x), 1.3(xxxx), 1.80, 1.81, and 1.82, and §§ 38.255, and 40.20 of this chapter, this term means ~~an arrangement where a person~~ the ~~electronically~~ transmission of an order for processing on or subject

to the rules of a contract market, including the electronic transmission of any modification or cancellation of such order; provided however that this term does not include orders, or modifications or cancellations thereof, electronically transmitted to a designated contract market, ~~without the order first being routed through a separate person who is a member of a derivatives clearing organization to which the designated contract market submits transactions for clearing,~~ by a futures commission merchant that such futures commission merchant first received from an unaffiliated natural person by means of oral or written communications.

(zzzz) *Algorithmic Trading*. This term means trading in any commodity interest as defined in paragraph (yy) of this section on or subject to the rules of a designated contract market, where:

(1) One or more computer algorithms or systems determines whether to initiate, modify, or cancel an order, or otherwise makes determinations with respect to an order, including but not limited to: The product to be traded; the venue where the order will be placed; the type of order to be placed; the timing of the order; whether to place the order; the sequencing of the order in relation to other orders; the price of the order; the quantity of the order; the partition of the order into smaller components for submission; the number of orders to be placed; or how to manage the order after submission; and

(2) Such order, modification or order cancellation is electronically submitted for processing on or subject to the rules of a designated contract market; provided, however, that Algorithmic Trading does not include an order, modification, or order cancellation whose every parameter or attribute is manually entered into a front-end system by a natural person, with no further discretion by any computer system or algorithm, prior to its electronic submission for processing on or subject to the rules of a designated contract market.

(aaaaa) [Reserved]

(bbbb) *Electronic Trading Order Message*. This term means each new order submitted by Electronic Trading and each modification or cancellation submitted by Electronic Trading with respect to such an order.

(cccc) *Algorithmic Trading Source Code*. Algorithmic Trading Source Code generally means computer commands written in a computer programming language that is readable by natural persons. For purposes of §§ 1.81 and 1.84, Algorithmic Trading Source Code shall include at minimum computer code, logic embedded in electronic circuits, scripts, parameters input into an Algorithmic Trading system, formulas, and configuration files.

(dddd) *Electronic Trading*. For purposes of §§ 1.80, 1.82, and 1.83, and §§ 38.255, 40.20, and 40.22 of this chapter, this term means trading in any commodity interest as defined in paragraph (yy) of this section on an electronic trading facility as such term is defined by section 1a(16) of the Act, where the order, order modification or order cancellation is electronically submitted for processing on or subject to the rules of a designated contract market.

3. Add subpart A to read as follows:

Subpart A—Requirements for Algorithmic Trading

Sec.

1.80 Pre-trade risk controls for AT Persons.

1.81 Standards for the development, monitoring, and compliance of Algorithmic Trading systems.

1.82 ~~Clearing~~Executing futures commission merchant risk management.

1.83 AT Person and ~~clearing member~~executing futures commission merchant ~~reports and~~ recordkeeping.

1.84 Maintenance of Algorithmic Trading Source Code and related records.

1.85 Use of third-party Algorithmic Trading systems or components.

Subpart A—Requirements for Algorithmic Trading

§ 1.80 Pre-trade risk controls for AT Persons.

For all AT Order Messages, an AT Person shall implement pre-trade risk controls and other measures reasonably designed to prevent and reduce the potential risk of an Algorithmic Trading Event, including but not limited to:

(a) *Pre-Trade Risk Controls.* (1) The pre-trade risk controls shall include, at a minimum, the following:

(i) Maximum AT Order Message frequency per unit time and maximum execution frequency per unit time; and

(ii) Order price parameters and maximum order size limits.

(2) Pre-trade risk controls shall be set at a level or levels of granularity that shall include as appropriate the level of each AT Person, ~~or such~~

~~other more granular level as the AT Person may determine, including but not limited to, by~~ product, account number or designation, or one or more identifiers of the natural persons or the order strategy or Algorithmic Trading system associated with an AT Order Message.

~~(3) Natural person monitors at the AT Person shall be promptly alerted when pre-trade risk control parameters established pursuant to this section are breached.~~

(b) *Order Cancellation Systems.* (1) Systems that have the ability to:

(i) Immediately disengage Algorithmic Trading;

(ii) Cancel selected or up to all resting orders when system or market conditions require it; and

(iii) Prevent submission of new AT Order Messages.

(2) Prior to an AT Person's initial use of Algorithmic Trading to submit a message or order to a designated contract market's trading platform, such AT Person must notify the designated contract market on which it conducts Algorithmic Trading whether all of its resting orders should be cancelled or suspended in the event that the AT Person's Algorithmic Trading system disconnects with the trading platform.

(c) *System Connectivity.* AT Persons with Direct Electronic Access as defined in § 1.3(yyyy) shall implement systems to indicate on an ongoing basis whether they have

proper connectivity with the trading platform and any systems used by a designated contract market to provide the AT Person with market data.

~~(d) *Notification of Algorithmic Trading.* Prior to an AT Person's initial use of Algorithmic Trading to submit a message or order to a designated contract market's trading platform, such AT Person shall notify its clearing member and the designated contract market on which it will be trading that it will engage in Algorithmic Trading.~~

(d) *Delegation.* (1) An AT Person may choose to comply with paragraph (a) of this section by implementing required pre-trade risk controls, or it may instead delegate compliance with such obligations to its executing futures commission merchant(s).

(2) An AT Person may only delegate such functions when—

(i) It is technologically feasible for each relevant futures commission merchant to comply with paragraph (a) of this section with a level of effectiveness reasonably designed to prevent and reduce the potential risk of an Algorithmic Trading Event; and

(ii) Each relevant futures commission merchant notifies the AT Person in writing that the futures commission merchant has accepted the AT Person's delegation and that it will comply with paragraph (a) of this section on behalf of the AT Person.

(e) *Self-Trade Prevention Tools.* To the extent that implementation of a designated contract market's self-trade prevention tools requires calibration or other action by an AT Person, such AT Person shall calibrate or take such other action as is necessary to apply such tools.

(f) *Periodic Review for Sufficiency and Effectiveness.* Each AT Person shall periodically review its compliance with this section to determine whether it has effectively implemented sufficient measures reasonably designed to prevent and reduce the potential risk of an Algorithmic Trading Event. Each AT Person that has delegated its pre-trade risk controls to a futures commission merchant pursuant to paragraph (d) paragraph (g)(2)–(3) of this section shall periodically review such futures commission merchant's compliance with the requirements of paragraph (a) of this section on behalf of the AT Person. Each AT Person shall take prompt action to remedy any deficiencies it identifies in its own measures or in those of a futures commission merchant to which it has delegated.

(g) *AT Persons' pre-trade risk controls for electronic trading.* (1) An AT Person shall also apply the risk control mechanisms described in paragraphs (a), (b), and (c) of this section to its Electronic Trading Order Messages that do not arise from Algorithmic Trading, after making appropriate adjustments in the risk control mechanisms to accommodate the application of such mechanisms to Electronic Trading Order Messages.

(2) An AT Person may choose to comply with paragraph (g)(1) of this section as to the risk controls in paragraph (a) of this section by implementing required pre-trade risk controls, or it may instead delegate compliance with such obligations to its executing futures commission merchant(s).

(3) An AT Person may only delegate such functions when (i) it is technologically feasible for each relevant futures commission merchant to comply with paragraph (g)(1) of this section as to risk control mechanisms required by paragraph (a) of this section with a level of effectiveness reasonably

designed to prevent and reduce the potential risk of a disruption associated with Electronic Trading; and (ii) Each relevant futures commission merchant notifies the AT Person in writing that the futures commission merchant has accepted the AT Person's delegation and that it will comply with paragraph (a) of this section on behalf of the AT Person.

§ 1.81 Standards for the development, monitoring, and compliance of Algorithmic Trading systems.

(a) *Development and testing of Algorithmic Trading Systems.* (1) Each AT Person shall implement written policies and procedures for the development and testing of its Algorithmic Trading systems. Such policies and procedures shall at a minimum include the following:

(i) Maintaining a development environment that is adequately isolated from the production trading environment. The development environment may include computers, networks, and databases, and should be used by software engineers while developing, modifying, and testing source code.

(ii) ~~Testing of all Algorithmic Trading code and related systems,~~ including Algorithmic Trading Source Code, and any changes to such code and systems or code, prior to their implementation, including. Such testing ~~to~~ shall be reasonably designed to effectively identify circumstances that may contribute to future Algorithmic Trading Events. ~~Such testing must be conducted both internally within the AT Person and on each designated contract market on which Algorithmic Trading will occur.~~

(iii) Regular back-testing of Algorithmic Trading using historical transaction, order, and message data to identify circumstances that may contribute to future Algorithmic Trading Events.

(iv) Regular stress tests of Algorithmic Trading systems to verify their ability to operate in the manner intended under a variety of market conditions.

~~(v) Procedures for documenting the strategy and design of proprietary Algorithmic Trading software used by an AT Person, as well as any changes to such software if such changes are implemented in a production environment.~~

~~(vi) Maintaining a source code repository to manage source code access, persistence, copies of all code used in the production environment, and changes to such code. Such source code repository must include an audit trail of material changes to source code that would allow the AT Person to determine, for each such material change: who made it; when they made it; and the coding purpose of the change. Each AT Person shall keep such source code repository, and make it available for inspection, in accordance with § 1.31.~~

(2) Each AT Person shall periodically review the effectiveness of the policies and procedures required by this paragraph (a), and take prompt action to document and remedy deficiencies in such policies and procedures.

(b) *Monitoring of Algorithmic Trading Systems.* (1) Each AT Person shall implement written policies and procedures reasonably designed to ensure that each of its Algorithmic Trading systems is subject to continuous real-time monitoring by knowledgeable and qualified staff while such Algorithmic Trading system is engaged in trading. Such policies and procedures shall at a minimum include the following:

(i) Continuous real-time monitoring of Algorithmic Trading to identify potential Algorithmic Trading Events.

(ii) Automated alerts when an Algorithmic Trading system's AT Order Message behavior breaches design parameters, upon loss of network connectivity or data feeds, or when market conditions approach the boundaries within which the Algorithmic Trading system is intended to operate, to the extent applicable.

(iii) Monitoring staff of the AT Person shall have the ability and authority to disengage an Algorithmic Trading system and to cancel resting orders when system or market conditions require it, including the ability to contact staff of the applicable designated contract market and clearing firm, as applicable, to seek information and cancel orders. Such monitoring staff must also have dashboards and control panels to monitor and interact with the Algorithmic Trading systems for which they are responsible.

(iv) Procedures that will enable AT Persons to track which monitoring staff is responsible for an Algorithmic Trading system during trading hours.

(2) Each AT Person shall periodically review the effectiveness of the policies and procedures required by this paragraph (b), and take prompt action to document and remedy deficiencies in such policies and procedures.

(c) *Compliance of Algorithmic Trading Systems.* (1) Each AT Person shall implement written policies and procedures reasonably designed to ensure that each of its Algorithmic Trading systems operates in a manner that complies with the Commodity Exchange Act and the rules and regulations thereunder.

(2) Each AT Person shall implement written policies and procedures requiring:

(i) Staff of the AT Person to review Algorithmic Trading systems in order to detect potential Algorithmic Trading Compliance Issues. Procedures shall indicate that such staff shall include staff of the AT Person familiar with the Commodity Exchange Act and the rules and regulations thereunder, the rules of any designated contract market to which such AT Person submits AT Order Messages, the rules of any registered futures association of which such AT Person is a member, the AT Person's own internal requirements, and the requirements of the AT Person's clearing member, in each case as applicable.

(ii) A plan of internal coordination and communication between compliance staff of the AT Person and staff of the AT Person responsible for Algorithmic Trading regarding Algorithmic Trading

design, changes, testing, and controls, which plan should be designed to detect and prevent Algorithmic Trading Compliance Issues.

(3) Each AT Person shall periodically review the effectiveness of the policies and procedures required by this paragraph (c), and take prompt action to document and remedy deficiencies in such policies and procedures.

(d) *Designation and training of Algorithmic Trading staff.* (1) Each AT Person shall implement written policies and procedures to designate and train its staff responsible for Algorithmic Trading. Such policies and procedures shall at a minimum include the following:

(i) Procedures for designating and training all staff involved in designing, testing and monitoring Algorithmic Trading, and documenting training events. Training must, at a minimum, cover design and testing standards, Algorithmic Trading Event communication procedures, and requirements for notifying staff of the applicable designated contract market when Algorithmic Trading Events occur.

(ii) Training policies reasonably designed to ensure that natural person monitors are adequately trained for each Algorithmic Trading system or strategy (or material change to such system or strategy) for which such monitors are responsible. Training must include, at a minimum, the trading strategy for the Algorithmic Trading as well as the automated and non-automated risk controls that are applicable to the Algorithmic Trading.

(iii) Escalation procedures to inform senior staff of the AT Person as soon as Algorithmic Trading Events are identified.

(2) Each AT Person shall periodically review the effectiveness of the policies and procedures required by this paragraph (d), and take prompt action to document and remedy deficiencies in such policies and procedures.

§ 1.82 ~~Clearing member~~ Executing futures commission merchant risk management.

(a) ~~For all AT~~ Electronic Trading Order Messages not originating with an AT Person; ~~the. Each executing~~ futures commission merchant ~~that is the clearing member for such AT Person~~ shall comply with the following requirements for all Electronic Trading Order Messages not originating with an AT Person:

(1) Make use of pre-trade risk controls reasonably designed to prevent ~~or mitigate~~ and reduce the potential risk of a disruption associated with Electronic Trading (including an Algorithmic Trading Disruption), including at a minimum, ~~those pre-trade risk controls described in § 1.80(a)(1);~~

(i) Maximum Electronic Trading Order Message frequency per unit time and maximum execution frequency per unit time; and

(ii) Order price parameters and maximum order size limits.

(2) Pre-trade risk controls must be set at ~~the level of each AT Person, or such other more granular level as the clearing futures commission merchant may determine, including but not limited to,~~ by a level or levels of granularity that will prevent and reduce the potential risk of an Electronic Trading disruption,

which shall include as appropriate the level of each customer, product, account number or designation, or one or more identifiers of the natural persons or the order strategy or Algorithmic Trading system associated with an Electronic Trading AT Order Message.

(3) The futures commission merchant shall have policies and procedures reasonably designed to ensure that natural person monitors at the ~~clearing~~ futures commission merchant are promptly alerted when pre-trade risk control parameters established pursuant to this section are breached.

(4) Make use of ~~the~~ order cancellation systems ~~described in § 1.80(b)(1)~~ that have the ability to:

(i) Immediately disengage Electronic Trading;

(ii) Cancel selected or up to all resting orders when system or market conditions require it; and

(iii) Prevent submission of new Electronic Trading Order Messages.

(b) *Direct Electronic Access orders.* For all ~~AT~~Electronic Trading Order Messages not originating with an AT Person and that are submitted to a trading platform through Direct Electronic Access as defined in § 1.3(yyy), the futures commission merchant ~~that is the clearing member for the AT Person shall~~may comply with the requirements of paragraphs (a)(1), (2), and (4) of this section by implementing the pre-trade risk controls and order cancellation systems provided by designated contract markets pursuant to § 38.255(b) and (c) of this chapter.

(c) *Non-Direct Electronic Access orders.* For all ~~AT~~Electronic Trading Order Messages not originating with an AT Person and that are not submitted to a trading platform through Direct Electronic Access as defined in § 1.3(yyy), the futures commission merchant ~~that is the clearing member for the AT Person~~ shall comply with the requirements of paragraphs (a)(1), (2), and (4) of this section by —

(i) itself establishing and maintaining the pre-trade risk controls and order cancellation systems described therein; or

(ii) implementing the pre-trade risk controls and order cancellation systems provided by designated contract markets pursuant to § 38.255(b) and (c) of this chapter.

§ 1.83 AT Person and ~~clearing member~~executing futures commission merchant ~~reports and~~ recordkeeping.

~~(a) AT Person Reports. Each AT Person shall annually prepare a report and submit such report by June 30 to each designated contract market on which such AT Person engaged in Algorithmic Trading. Together with the annual report, each AT Person shall submit copies of the written policies and procedures developed to comply with § 1.81(a) and (c). Such report shall cover the time period from May 1 of the previous year to April 30 of the year such report is submitted. The report shall include the following:~~

~~(1) A description of the pre-trade risk controls required by § 1.80(a), including a description of each item enumerated in § 1.80(a) and a description of all parameters and the specific quantitative settings used by the AT Person for such pre-trade risk controls; and~~

~~(2) A certification by the chief executive officer or chief compliance officer of the AT Person that, to the best of his or her knowledge and reasonable belief, the information contained in the report is accurate and complete.~~

~~(b) Clearing member futures commission merchant reports. Each futures commission merchant that is a clearing member for one or more AT Person(s) shall annually prepare and submit a report by June 30 to each designated contract market on which such AT Person(s) engaged in Algorithmic Trading. Such report shall cover the time period from May 1 of the previous year to April 30 of the year such report is submitted. The report shall include the following:~~

~~(1) A description of the clearing member futures commission merchant's program for establishing and maintaining the pre-trade risk controls required by § 1.82(a)(1) for its AT Persons at the designated contract market; and~~

~~(2) A certification by the chief executive officer or chief compliance officer of the futures commission merchant that, to the best of his or her knowledge and reasonable belief, the information contained in the report is accurate and complete.~~

~~(ea) AT Person recordkeeping. Each AT Person shall keep, and provide upon request to each designated contract market on which such AT Person engages in Algorithmic Trading, books and records regarding such AT Person's compliance with all requirements pursuant to §§ 1.80 and 1.81.~~

~~(db) Clearing member Executing futures commission merchant recordkeeping. Each executing futures commission merchant that is a clearing member for an AT Person shall keep, and provide upon request to each designated contract market on which such AT Person's customers engages in Algorithmic Electronic Trading, books and records regarding such clearing member futures commission merchant's compliance with all requirements pursuant to § 1.82.~~

§ 1.84 Maintenance of Algorithmic Trading Source Code and related records.

(a) Records required to be maintained. Each AT Person shall retain the following records, in their native format, for a period of five years:

(1) Any Algorithmic Trading Source Code used by the AT Person.

(2) Any records generated by the AT Person in the ordinary course of business that track material changes to the Algorithmic Trading Source Code, including, if generated by the AT Person in the ordinary course of business, a record of when and by whom such changes were made.

(3) Any logs or log files generated by the AT Person in the ordinary course of business that record the activity of the AT Person's Algorithmic Trading system, including a chronological record of such system's actions.

(b) Commission access to required records pursuant to special call. AT Persons shall produce records required to be maintained pursuant to § 1.84(a) as requested pursuant to special call of the Commission.

(1) Form and manner. Such special call by the Commission may authorize the Director of the Division of Market Oversight to execute the special call and to specify the form and manner in which records shall be produced.

(2) Accessibility and production of records of Algorithmic Trading activity.

(i) The records required to be kept pursuant to § 1.84(a) shall be maintained in a form and manner that ensures the authenticity and reliability of the information contained in such records.

(ii) AT Persons shall have available at all times systems to promptly retrieve and display the records required to be maintained pursuant to § 1.84(a) and the information contained in such records. Such systems shall, at a minimum, be equivalent to the systems used by the AT Persons when accessing records required to be maintained pursuant to § 1.84(a) in the ordinary course of its business.

(iii) Each AT Person must, at its own expense, produce promptly upon demand, such records as may be set forth in the Commission's special call or as specified by the Director of the Division of Market Oversight pursuant to special call by the Commission.

(3) Confidentiality of records of required to be maintained. Records required to be maintained pursuant to § 1.84(a) are subject to section 8(a) of the Act when produced to the Commission pursuant to § 1.84(b). Except as specifically authorized in the Act or the Commission's regulations, the Commission shall not disclose any record provided pursuant to § 1.84(b), including data and information that would separately disclose the market positions, business transactions, trade secrets, or names of customers of any person.

(c) Subpoenas. The special call procedure set forth in paragraph (b) of this section in no way limits the ability of the Commission, any member of the Commission, or Commission staff to obtain records required to be maintained pursuant to paragraph (a) of this section via the subpoena procedure set forth in part 11 of this chapter.

§ 1.85 Use of third-party Algorithmic Trading systems or components.

(a) Use of third-party Algorithmic Trading systems or components. With respect to Algorithmic Trading systems or components, AT Persons who are otherwise unable to comply with an obligation set forth in the following provisions: §§ 1.81(a)(1)(i), 1.81(a)(1)(ii), 1.81(a)(1)(iii), 1.81(a)(1)(iv), 1.81(a)(2), or 1.84, due solely to their use of third-party systems or components may comply with such obligation by obtaining a certification from the third party that the relevant system or component meets applicable regulatory requirements.

(b) AT Persons shall obtain a new certification described in paragraph (a) of this section each time there is a material change to such third-party provided systems or components.

(c) Each AT Person shall conduct due diligence to reasonably determine the accuracy and sufficiency of a certification provided by a third party.

(d) Notwithstanding the provisions of paragraphs (a)–(c) of this section, each AT Person shall remain responsible for compliance with the obligations set forth in § 1.84. Each AT Person shall retain records pursuant to § 1.84(a), or shall cause such records to be maintained. Each AT Person shall also produce records pursuant to § 1.84(b), or cause such records to be produced, when requested by the Commission.

4. The authority citation for part 38 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 6, 6a, 6c, 6d, 6e, 6f, 6g, 6i, 6j, 6k, 6l, 6m, 6n, 7, 7a-2, 7b, 7b-1, 7b-3, 8, 9, 15, and 21, as amended by the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376.

5. Revise § 38.255 to read as follows:

§ 38.255 Risk controls for trading.

(a) The designated contract market must establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions, including, but not limited to, market restrictions that pause or halt trading in market conditions prescribed by the designated contract market.

(b) For all ~~AT~~Electronic Trading Order Messages ~~originating with an AT Person~~ that are submitted to a designated contract market through Direct Electronic Access as defined in § 1.3(yyy) of this chapter, the designated contract market shall make available to the ~~clearing member~~executing futures commission merchants ~~for such AT Person~~ effective systems and controls, reasonably designed to facilitate the items enumerated below:

(1) The ~~clearing member~~ futures commission merchant's management of the risks, pursuant to § 1.82(a)(1) and ~~(a)~~(2) of this chapter, that may arise from such ~~AT Person's Algorithmic~~Electronic Trading ~~using Direct Electronic Access~~.

(i) Such systems and controls shall include, at a minimum, the pre-trade risk controls described in § 1.802(a)(1) of this chapter.

(ii) Such systems shall, at a minimum, enable the ~~clearing member~~ futures commission merchant to set the pre-trade risk controls at a level or levels of granularity that will prevent and reduce the potential risk of an Electronic Trading disruption, which shall include as appropriate the level of each ~~such AT Person~~customer, product, account number or designation, and one or more identifiers of the natural persons or the order strategy or Algorithmic Trading system associated with an ~~AT~~Electronic Trading Order Message. ~~Designated contract market rules should permit clearing member futures commission merchants to choose the level at which they place control, so long as clearing member futures commission merchants use at least one of the levels.~~

(2) The ~~clearing member~~ future commission merchant's ability, ~~pursuant to~~ to make use of the order cancellation systems required by § 1.82(a)(4) of this chapter, ~~to make use of the order cancellation systems described in § 1.80(b)(1) of this chapter~~. The designated contract market shall enable the ~~clearing member~~ future commission merchant to apply such order cancellation systems to orders ~~from each such AT Person~~ at a level or levels of granularity that will prevent and reduce the potential risk of an Electronic Trading disruption, which shall include as appropriate orders from each customer, product, account number or designation, or one or more identifiers of the natural persons or the order strategy or Algorithmic Trading system associated with an ~~AT~~Electronic Trading Order Message.

(c) A designated contract market that permits Direct Electronic Access as defined in § 1.3(yyyy) of this chapter shall also require ~~clearing member~~ futures commission merchants to use the systems and controls described in paragraph (b) of this section, or substantially equivalent systems and controls developed by the futures commission merchant itself or provided by a third party, with respect to all ~~AT~~Electronic Trading Order Messages not originating with an AT Person that are submitted through Direct Electronic Access. Prior to a futures commission merchants' use of its own or a third party's systems and controls, the futures commission merchant must certify to the designated contract market that such systems and controls are substantially equivalent to the systems and controls that the designated contract market makes available pursuant to paragraph (b) of this section.

6. Amend § 38.401 as follows:

- a. Revise paragraph (a)(1)(iii);
- b. Add paragraph (a)(1)(iv);
- c. Revise paragraph (a)(2); and
- d. Add paragraph (c)(3).

The revisions and additions read as follows:

§ 38.401 General requirements.

(a) * * *

(1) * * *

(iii) Rules and specifications pertaining to the operation of the electronic matching platform or trade execution facility, including but not limited to those pertaining to the operation of its electronic matching platform that materially affect the time, priority, price, or quantity of execution, or the ability to cancel, modify, or limit display of market participant orders.

(iv) Any known attributes of the electronic matching platform, other than those already disclosed in rules or specifications under paragraph (a)(1)(iii) of this section, that materially affect the time, priority, price, or quantity of execution of market participant orders, the ability to cancel, modify, or limit display of market participant orders, or the dissemination of real-time market data to market participants, including but not limited to latencies or other variability in the electronic matching platform and the transmission of message acknowledgements, order confirmations, or trade confirmations, or dissemination of market data.

(2) Through the procedures, arrangements and resources required in paragraph (a) of this section, the designated contract market must ensure public dissemination of information pertaining to new product listings, new rules, rule amendments, rules pertaining to the operation of the electronic matching platform or trade execution facility, known attributes of its electronic trading platform under paragraph (a)(1)(iv) of this section, or other changes to previously-disclosed information, in accordance with the timeline provided in paragraph (c) of this section.

* * * * *

(c) * * *

(3) A designated contract market, in making available on its Web site information pursuant to paragraphs (a)(1)(iii) and (iv) of this section, shall place such information and submissions on its Web site within a reasonable time, but no later than 10 business days, following the identification of or changes to such attributes. Such information shall be disclosed prominently and clearly in plain English.

* * * * *

7. In Appendix B to part 38, in the paragraph with the subject heading Core Principle 4 of section 5(d) of the Act: PREVENTION OF MARKET DISRUPTION, revise paragraph (b)(5) to read as follows:

Appendix B to Part 38 -- Guidance on, and Acceptable Practices in, Compliance With Core Principles

* * * * *

Core Principle 4 of section 5(d) of the Act:
PREVENTION OF MARKET DISRUPTION

* * * * *

(b) * * *

(5) *Risk controls for trading.* An acceptable program for preventing market disruptions must demonstrate appropriate trade risk controls, in addition to pauses and halts. Such controls must be adapted to the unique characteristics of the markets to which they apply and must be designed to avoid market disruptions without unduly interfering with that market's price discovery function. The designated contract market must employ the pre-trade risk controls specified in the Commission's regulations (including applicable regulations contained in part 40 of this chapter), and may employ additional controls that the designated contract market believes are appropriate to its market. Within the specific array of controls that are selected, the designated contract market also must set the parameters for those controls, so long as the types of controls and their specific parameters are reasonably likely to serve the purpose of preventing market disruptions and price distortions, or as they are otherwise required to be designed pursuant to Commission regulation. If a contract is linked to, or is a substitute for, other contracts, either listed on its market or on other trading venues, the designated contract market must, to the extent practicable, coordinate its risk controls with any similar controls placed on those other contracts. If a contract is based on the price of an equity security or the level of an equity index, such risk controls must, to the extent

practicable, be coordinated with any similar controls placed on national security exchanges.

* * * * *

PART 40—PROVISIONS COMMON TO REGISTERED ENTITIES

8. The authority citation for part 40 continues to read as follows:

Authority: 7 U.S.C. 1a, 2, 5, 6, 7, 7a, 8 and 12, as amended by Titles VII and VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. 111-203, 124 Stat. 1376 (2010).

9. Revise § 40.1(i) to read as follows:

§ 40.1 Definitions.

* * * * *

(i) *Rule* means any constitutional provision, article of incorporation, bylaw, rule, regulation, resolution, interpretation, stated policy, advisory, terms and conditions, market maker or trading incentive program, trading protocol (including but not limited to any operation of an electronic matching platform that materially affects the time, priority, price, or quantity of execution of market participant orders, the ability to cancel, modify, or limit display of market participant orders, or the dissemination of real-time market data to market participants), agreement or instrument corresponding thereto, including those that authorize a response or establish standards for responding to a specific emergency, and any amendment or addition thereto or repeal thereof, made or issued by a registered entity or by the governing board thereof or any committee thereof, in whatever form adopted.

* * * * *

§§ 40.13 through 40.19 [Reserved]

10. Add reserved §§ 40.13 through 40.19.

11. Add § 40.20 ~~through 40.23~~ to read as follows:

§ 40.20 Risk controls for trading.

A designated contract market shall implement pre-trade and other risk controls reasonably designed to prevent and reduce the potential risk of a disruption associated with Electronic Trading (including an Algorithmic Trading Disruption ~~(or, pursuant to paragraph (d) of this section, similar disruption resulting from orders that originate from manual order entry or other non-Algorithmic Trading) or an Algorithmic Trading Compliance Issue~~, including at a minimum all of the following:

(a) *Pre-trade risk controls*. Pre-trade risk controls reasonably designed to address the risks from ~~Algorithmic~~Electronic Trading on a designated contract market.

(1) The pre-trade risk controls to be established and used by a designated contract market shall include, ~~at a minimum, those described in § 1.80(a)(1) of this chapter.:~~

(i) Maximum Electronic Trading Order Message frequency per unit time and maximum execution frequency per unit time; and

(ii) Order price parameters and maximum order size limits.

~~(2) At a minimum, the pre-trade risk controls established and used pursuant to this section shall be set at the level of each AT Person.~~ Designated contract markets must ~~also evaluate whether to establish~~set the pre-trade risk controls at a ~~more granular level, including at a minimum~~level or levels of granularity that will prevent and reduce the potential risk of an Electronic Trading disruption, which shall include as appropriate the level of each trading firm, by product or one or more identifiers of the natural persons or the order strategy or Algorithmic Trading system associated with an ~~AT~~Electronic Trading Order Message. ~~Where deemed appropriate by the designated contract market, pre-trade risk controls should be set at such more granular levels.~~

~~(3) A designated contract market shall have policies and procedures reasonably designed to ensure that natural person monitors at such designated contract market are promptly alerted when pre-trade risk control parameters established pursuant to this section are breached.~~[Reserved]

(b) *Order cancellation systems.* (1) Order cancellation systems that have the ability to:

~~(i) Perform the actions described in § 1.80(b)(1) of this chapter with respect to orders from AT Persons; and~~

(i) Immediately disengage Electronic Trading;

(ii) Cancel selected or up to all resting orders when system or market conditions require it;

(iii) Prevent submission of new Electronic Trading Order Messages; and

~~(iv)~~ Cancel or suspend all resting orders from AT Persons in the event of disconnect with the trading platform.

(2) [Reserved]

(c) *System connectivity.* (1) Systems that enable the systems of an AT Person with Direct Electronic Access as defined in § 1.3(yyyy) of this chapter to indicate to the AT Person on an ongoing basis whether the AT Person has proper connectivity with

(i) The designated contract market's trading platform, and

(ii) Any systems used by the designated contract market to provide the AT Person with market data.

(2) [Reserved]

~~(d) Risk control mechanisms for manual order entry and other non-Algorithmic Trading. (1) A designated contract market shall implement the risk control mechanisms described in paragraphs (a) and (b)(1)(i) of this section for orders that do not originate from Algorithmic Trading, after making any adjustments to the mechanisms that the designated contract market determines are appropriate for such orders.~~

~~(2) [Reserved]~~

12. Add reserved § 40.21.

§ 40.21 DCM test environments.

(a) A designated contract market shall provide a test environment that will enable AT Persons to simulate production trading. Such test environment shall provide access to historical transaction, order and message data and shall also enable AT Persons to

conduct conformance testing of their Algorithmic Trading systems to verify compliance with the requirements of §§ 1.80(a) through (c) and 1.81(a)(1)(ii) through (iv) and (c)(1) of this chapter.

(b) [Reserved]

13. Add reserved § 40.22 to read as follows:

§ 40.22 DCM ~~review of compliance reports; maintenance of books and records~~requirements for AT Persons and executing FCMs; DCM review program.

A designated contract market shall comply with the following:

~~(a) *Review of reports.* Implement rules that require each AT Person that trades on the designated contract market, and each futures commission merchant that is a clearing member of a derivatives clearing organization for such AT Person, to submit the reports described in § 1.83(a) and (b), respectively, of this chapter;~~

~~(b) *Submission date.* Require the submission of such reports by June 30th of each year;~~

~~(e) *Review* Compliance program. Establish a program for effective periodic review and evaluation of ~~reports described in paragraph (a) of this section, and of the measures described therein~~AT Persons' compliance with §§ 1.80 and 1.81 of this chapter and executing futures commission merchant compliance with § 1.82 of this chapter. An~~

effective program shall include measures by the designated contract market reasonably designed to identify and remediate any insufficient mechanisms, policies and procedures ~~described in such reports~~, including identification and remediation of any inadequate quantitative settings or calibrations of pre-trade risk controls required of AT Persons pursuant to § 1.80(a) of this chapter;

~~(d) *Maintenance of books and records.* Implement rules that require each AT Person to keep and provide to the designated contract market books and records regarding such AT Person's compliance with all requirements pursuant to §§ 1.80 and 1.81 of this chapter, and require each ~~clearing member~~executing futures commission merchant to keep and provide to the designated contract market books and records regarding such ~~clearing member~~executing futures commission merchant's compliance with all requirements pursuant to § 1.82 of this chapter; and~~

~~(e) *Review and evaluate, as necessary, books and records required to be kept pursuant to paragraph (d) of this section, and the measures described therein. An appropriate review shall include measures by the designated contract market reasonably designed to identify and remediate any insufficient mechanisms, policies, and procedures described in such books and records.*~~

(c) *Reporting.* Require such periodic reporting from AT Persons and executing futures commission merchants as is necessary to fulfill the designated contract market's obligations pursuant to paragraph (a) of this section.

(d) *Annual Certification.* Require by rule that AT Persons and executing futures commission merchants provide the designated contract market with an annual certification attesting the AT Person or executing futures commission merchant complies with the requirements of §§ 1.80, 1.81, and 1.82 of this chapter, as applicable. Such annual certification shall be made by the chief compliance officer or chief executive officer of the AT Person or the executing futures commission

merchant, and shall state that, to the best of his or her knowledge and reasonable belief, the information contained in the certification is accurate and complete.

14. Add reserved §§ 40.23 through 40.28.

§ 40.23 Self-trade prevention tools.

(a) A designated contract market shall implement rules reasonably designed to prevent self-trading by market participants, except as specified in paragraph (b) of this section. “Self-trading” is defined for purposes of this section as the matching of orders for accounts that have common beneficial ownership or are under common control. A designated contract market shall either apply, or provide and require the use of, self-trade prevention tools that are reasonably designed to prevent self-trading and are applicable to all orders on its electronic trade matching platform. For purposes of complying with this requirement, a designated contract market may either determine for itself which accounts should be prohibited from trading with each other, or require market participants to identify to the designated contract market which accounts should be prohibited from trading with each other.

(b) Notwithstanding the foregoing, a designated contract market may, in its discretion, implement rules that permit self-trading described in paragraphs (b)(1) or (b)(2) of this section to occur, in each case subject to the requirements of paragraph (c) of this section:

(1) A self-trade resulting from the matching of orders for accounts with common beneficial ownership where such orders are initiated by independent decision makers. A designated contract market may through its rules further define for its market participants “independent decision makers.”

(2) A self-trade resulting from the matching of orders for accounts under common control where such orders comply with the designated contract market’s cross-trade, minimum exposure requirements or similar rules, and are for accounts that are not under common beneficial ownership.

(c) A designated contract market may permit self-trading described in paragraph (b) of this section only if the designated contract market:

(1) Requires market participants to request approval from the designated contract market that self-trade prevention tools not be applied with respect to specific accounts under common beneficial ownership or control, on the basis that they meet the criteria of paragraph (b) of this section. The designated contract market must require that such approval request be provided to it by a compliance officer or senior officer of the market participant; and

(2) Requires market participants to withdraw or amend an approval request if any change occurs that would cause the information provided in such approval request to be no longer accurate or complete.

(d) For each product and expiration month traded on a designated contract market in the previous quarter, the designated contract market must prominently display on its website the following information:

(1) The percentage of trades in such product including all expiration months that represent self-trading approved (pursuant to paragraph (c) of this section)

by the designated contract market, expressed as a percentage of all trades in such product and expiration month;

(2) The percentage of volume of trading in such product including all expiration months that represents self-trading approved (pursuant to paragraph (c) of this section) by the designated contract market, expressed as a percentage of all volume in such product and expiration month; and

(3) The ratio of orders in such product and expiration month whose matching was prevented by the self-trade prevention tools described in paragraph (a) of this section, expressed as a ratio of all trades in such product and expiration month.

~~12. Add reserved § 40.24.~~

§ 40.24 [Reserved]

~~13. Add §§ 40.25 through 40.28 to read as follows:~~

§ 40.25 Additional public information required for market maker and trading incentive programs.

(a) When submitting a Rule regarding a market maker or trading incentive program pursuant to § 40.5 or § 40.6, a designated contract market shall, in addition to information required by such sections, include the following information in its public Rule filing:

(1) The name of the market maker program or trading incentive program, the date on which it is scheduled to begin, and the date on which it is scheduled to terminate (if applicable);

(2) An explanation of the specific purpose for the market maker or trading incentive program;

(3) A list of all products or services to which the market maker or trading incentive program applies;

(4) A description of any eligibility criteria or categories of market participants defining who may participate in the market maker or trading incentive program;

(5) For any market maker or trading incentive program that is not open to all market participants, an explanation of why such program is limited to the chosen eligibility criteria or categories of market participants, and an explanation of how such limitation complies with the impartial access and comparable fee structure requirements of § 38.151(b) of this chapter for designated contract markets;

(6) An explanation of how persons eligible for the market maker or trading incentive program may apply to participate, and how eligibility will be evaluated by the designated contract market;

(7) A description of any payments, incentives, discounts, considerations, inducements or other benefits that market maker or trading incentive program participants may receive, including any non-financial incentives; and

(8) A description of the obligations, benchmarks, or other measures that a participant in a market maker or trading incentive program must meet to receive the benefits described in paragraph (a)(7) of this section.

(9) A description of any legal affiliation between the designated contract market and any entity acting as a market maker or participating in a market maker program.

(b) In addition to any public notice required pursuant to this part (including without limitation the requirements of §§ 40.5(a)(6) and 40.6(a)(2)) of this chapter a designated contract market shall ensure that the information required by paragraphs (a)(1) through (a)(8) of this section is easily located on its public website from the time that such designated contract market begins accepting participants in the market maker or trading incentive program through the time that it ceases operation of the market maker or trading incentive program.

(c) A designated contract market shall notify the Commission upon the termination of a market maker or trading incentive program prior to the termination date previously notified to the Commission; any extension or renewal of a market maker or trading incentive program beyond its original termination date shall require a new Rule filing pursuant to this part.

§ 40.26 Information requests from the Commission or the Director of the Division of Market Oversight.

(a) Upon request by the Commission or the Director of the Division of Market Oversight, a designated contract market shall provide such information and data as may be requested regarding participation in market maker or trading incentive programs offered by the designated contract market, including but not limited to, individual program agreements, names of program participants, benchmarks achieved by program participants, and payments or other benefits conferred upon program participants.

(b) [Reserved]

§ 40.27 Payment for trades with no change in ownership prohibited.

(a) A designated contract market shall implement policies and procedures reasonably designed to prevent the payment of market maker or trading incentive program benefits, including but not limited to payments, discounts, or other considerations, for trades between accounts that are:

- (1) Identified to such designated contract market as under common beneficial ownership pursuant to the approval process described in § 40.23(c); or
- (2) Otherwise known to the designated contract market as under common ownership.

(b) [Reserved]

§ 40.28 Surveillance of market maker and trading incentive programs.

(a) A designated contract market, consistent with its obligations pursuant to subpart C of part 38 of this chapter, shall review all benefits accorded to participants in market maker and trading incentive programs, including but not limited to payments, discounts, or other considerations, to ensure that such benefits are not earned through abusive practices.

(b) [Reserved]

PART 170—REGISTERED FUTURES ASSOCIATIONS

145. The authority citation for part 170 continues to read as follows: Authority: 7 U.S.C. 6d, 6m, 6p, 6s, 12a, and 21.

156. Add § 170.18 to subpart C to read as follows:

§ 170.18 AT Persons.

Each registrant, as defined in § 1.3(oooo) of this chapter, that is an AT Person, as defined in § 1.3(xxxx) of this chapter, that is not otherwise required to be a member of a futures association that is registered under Section 17 of the Act pursuant to §§ 170.15, 170.16, or 170.17 ~~of this chapter must become and remain a member of~~ must submit an application for membership in at least one futures association that is registered under ~~S~~section 17 of the Act and that provides for the membership therein of such registrant, unless no such futures association is so registered, within 30 days of such registrant satisfying the volume threshold test set forth in § 1.3(x)(2) of this chapter.

167. Add reserved subpart D, consisting of reserved § 170.19, ~~to read as follows:~~

Subpart D—Standards for Automated Trading and Algorithmic Trading Systems

§ 170.19 RFA Standards for Automated Trading and Algorithmic Trading Systems.

(a) A registered futures association must establish and maintain a program for the prevention of fraudulent and manipulative acts and practices, the protection of the public interest, and perfecting the mechanisms of trading on designated contract markets by adopting rules for each category of member, as deemed appropriate by the registered futures association, requiring:

- (1) Pre-trade risk controls and other measures for algorithmic trading systems;
- (2) Standards for the development, testing, monitoring, and compliance of algorithmic trading systems;
- (3) Designation and training of algorithmic trading staff; and
- (4) Operational risk management standards for clearing member futures commission merchants with respect to customer orders originating with algorithmic trading systems.

(b) [Reserved]