

Automated and Modern Trading Markets Subcommittee

October 5, 2018

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Evolution of Best Practices

For the Development of Market Integrity Tools and Risk Mitigation

In light of electronic trading's emergence as the principal trade execution method for futures markets, the TAC and its subcommittees have examined numerous topics associated with the increase in automated trading and dynamic changes in our industry evolving from the increased use of technology.

These efforts supported the formation of principles-based guidance for the development and application of market integrity tools across the industry.

Today's Agenda

- Evolution of Best Practices
 - FIA 2010 Market Access Risk Management Recommendations
 - FIA PTG Recommendations for Risk Controls for Trading Firms
 - 2018 Survey of Global Exchange Traded Derivatives Venues
- IOSCO Consultation Report – mechanisms for managing extreme volatility
 - IOSCO Recommendations
 - CME Group Examples of Risk and Volatility Mitigation Assets

FIA Best Practices

2010 Market Access Working Group and PTG Recommendations

- 2010 Market Access Risk Management Recommendations
 - Execution Risk Controls
 - Post Trade Checks / Drop Copy Functionality
 - Co-location Policies
 - Conformance and Certification Testing
 - Error Trade Policies
- FIA PTG Recommendations for Risk Controls for Trading Firms
 - Pre-Trade Risk Management (risk limits, volatility awareness, etc.)
 - Trading Interruptions (i.e. emergency notification procedures)
 - Post-Execution and Back Office
 - Electronic Security
 - Business Continuity

2018 FIA Survey of Exchange Traded Derivatives Venues

Implementation of Market Integrity Tools

With regard to this years survey, FIA found that:

- Out of 17 responses from major derivatives exchanges globally, 11 have implemented dynamic price bands and 13 have implemented trading halts during extreme volatility.
- Every exchange in the Americas that responded to the survey has implemented both price banding and trading halts (without express regulatory requirement).
- All European exchanges regulated under MiFID II that responded to the survey have implemented both price banding and trading halts (under regulatory requirements).
- More than half of Asian exchanges that responded to the survey have implemented both price banding and trading halts (without express regulatory requirement).

IOSCO Consultation Report

Mechanisms Used by Trading Venues to Manage Extreme Volatility and Preserve Orderly Trading

“The importance and establishment of volatility control mechanisms is recognized by trading venues and regulatory authorities globally. IOSCO believes that these mechanisms support the goal of ensuring that markets are ‘fair, efficient and transparent.’”

IOSCO Recommendations:

1. Trading venues should have appropriate volatility control mechanisms
2. Trading venues should ensure that volatility control mechanisms are appropriately calibrated
3. Trading venues should regularly monitor volatility control mechanisms
4. Regulatory authorities should determine what information they require to effectively monitor the volatility control mechanism frameworks
5. Trading venues should provide upon request of regulatory authorities information regarding the triggering of volatility control mechanisms
6. Trading venues should communicate information to market participants and the public about volatility control mechanisms
7. Trading venues should make available to market participants information regarding the triggering of a volatility control mechanism
8. Where the same or related instruments are traded on multiple trading venues there should be communication between the relevant trading venues

IOSCO Recommendations

Trading venues should have appropriate volatility control mechanisms and ensure those mechanisms are appropriately calibrated.

CME Group Risk and Volatility Mitigation Assets:

- **In Line Credit Controls** – (2017) granular pre-trade risk management capability, allowing clearing member firms and Globex executing firms to set daily position limits for CME Globex, per product, at the account level.
- **Velocity Logic Functionality** – (2013) a patented proprietary functionality within the Globex trading engine that is designed to detect significant price moves of futures contracts occurring within a predetermined period.
- **Price Limits and Circuit Breakers** – numerous CME Group products have rules that establish daily price limits and/or circuit breakers in order to promote market confidence and mitigate risks to the market infrastructure by allowing market participants time to assimilate information and mobilize liquidity during periods of sharp price swings.
- **Protection Points for Market & Stop Orders** – proprietary functionality that assigns a limit price (protection point) to each market order entered on the CME Globex platform and to each stop order entered without a limit price. The functionality prevents orders from being filled at significantly aberrant price levels because of the absence of sufficient liquidity to satisfy the order at the time the market order is entered or stop order triggered.
- **Price Banding** – designed to prevent the entry of orders at clearly erroneous prices, thereby mitigating the potential for a market disruption.

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