



# Commodity Futures Trading Commission

## Office of Public Affairs

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## Fact Sheet – Notice of Proposed Rulemaking on Regulation Automated Trading (Regulation AT)

The Commodity Futures Trading Commission (“Commission”) proposed a series of risk controls, transparency measures, and other safeguards to enhance the regulatory regime for algorithmic order origination and electronic trade execution on U.S. designated contract markets (“DCMs”).

Regulation AT generally proposes risk control and other requirements for (a) market participants using algorithmic trading systems (“ATSS”), who are defined as “AT Persons” in the proposed rulemaking, (b) clearing member futures commission merchants (“FCMs”), with respect to their AT Person customers, and (c) DCMs executing AT Person orders.

Regulation AT also proposes to require the registration of certain proprietary traders that, while responsible for significant trading volumes in key futures products, are not currently registered with the Commission. The proposed registration requirement would be applicable specifically to proprietary traders engaged in algorithmic trading through direct electronic access (“DEA”) to a DCM. Such entities must register with the Commission as floor traders, if not already registered in another capacity.

The notice of proposed rulemaking for Regulation AT will be published in the Federal Register and open for a 90-day public comment period.

### Definitions of Algorithmic Trading, AT Person, and DEA.

Regulation AT would codify a number of new defined terms necessary to implement the proposed rules. All such defined terms would be added to § 1.3 of the Commission’s regulations. The defined terms summarized below are particularly important to understand the proposed operation of Regulation AT:

“**Algorithmic Trading**” means trading in any commodity interest (as defined in Commission regulation 1.3(yy)) on or subject to the rules of a DCM, 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 DCM; 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 DCM.

“**AT Person**” means any person registered or required to be registered as an FCM, 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 rules of a DCM. The term AT Person also includes a new class of persons required to be registered as floor traders.

“**Direct Electronic Access**” (DEA) means an arrangement where a person electronically transmits an order to a DCM, without the order first being routed through a separate person who is a member of a derivatives clearing organization to which the DCM submits transactions for clearing.

### Key Elements of Regulation AT for Trading Firms That Fall Within the Proposed Definition of AT Person.

**Risk controls.** AT Persons must implement pre-trade and other risk controls to address the risks of Algorithmic Trading. These must include pre-trade risk controls (maximum order message and execution frequency per unit time, order price and maximum order size parameters), and order cancellation systems. The proposed rules provide AT Persons with flexibility regarding the design and calibration of required pre-trade risk controls.

**Development, testing, and monitoring.** AT Persons must implement standards for development, testing and monitoring of ATSSs, and for the designation and training of algorithmic trading staff. These standards must include: keeping the development environment separate from the production environment; testing prior to implementation; a source code repository; real-time monitoring of such systems; and standards to ensure that systems comply with the Commodity Exchange Act and Commission regulations.

**Compliance reports.** AT Persons must submit annual compliance reports to DCMs regarding their risk controls as well as copies of written policies and procedures developed to comply with testing and other requirements. AT Persons must also keep books and records regarding their Algorithmic Trading procedures for inspection by DCMs.

### Key Elements of Regulation AT for Clearing Member FCMs.

**Risk controls.** Clearing member FCMs must implement risk controls for Algorithmic Trading orders originating with AT Persons. For DEA orders, FCMs must implement DCM-provided risk controls. For non-DEA orders, FCMs must establish the controls themselves. As with AT Persons, the proposed rules provide clearing member FCMs with flexibility regarding the design and calibration of required pre-trade risk controls.

**Compliance reports.** Clearing member FCMs must submit compliance reports to DCMs describing their program for establishing and maintaining the required pre-trade risk controls for their AT Person customers (in the aggregate). The reports must include (a) a description of the clearing member FCM’s program for establishing and maintaining the pre-trade risk controls for its AT Persons at the DCM; and (b) a certification by the chief executive officer or chief compliance officer of the FCM that, to the best of his or her knowledge and reasonable belief, the information contained in the report is accurate and complete. FCMs must also keep, and provide to a DCM upon request, books and records regarding their risk controls for Algorithmic Trading orders for inspection by DCMs. AT Persons are required to provide more detailed reports than clearing member FCMs.

### Key Elements of Regulation AT for DCMs.

**Risk controls.** DCMs must implement risk controls for orders submitted through Algorithmic Trading. These must include pre-trade risk controls (maximum order message and execution frequency per unit time, order price and maximum order size parameters), and order cancellation systems. DCMs must also implement parallel controls for orders not originating from Algorithmic Trading (i.e., manually submitted). The proposed rules provide DCMs with flexibility regarding the design and calibration of required pre-trade risk controls.

**Compliance reports.** DCMs must require risk control compliance reports from AT Persons and their clearing member FCMs. DCMs must periodically review the compliance reports, identify outliers and provide instructions for remediation. DCMs must also review, as necessary, books and records of AT Persons and clearing member FCMs regarding Algorithmic Trading procedures.

**Test environments.** DCMs must provide test environments where AT Persons may test algorithmic trading systems. The test environments must enable AT Persons to test compliance with proposed § 1.80 (risk controls, order cancellation systems) and § 1.81 (development and testing requirements).

**Risk controls for DEA orders.** DCMs must establish risk controls for algorithmic orders submitted to DCMs by AT Persons using DEA, and require clearing member FCMs to use the risk controls for such DEA orders.

### **Use of Self-Trade Prevention Tools.**

DCMs must establish self-trade prevention tools, and either apply such tools or provide them to market participants and require their use. “Self-trading” is proposed to be defined as the matching of orders for accounts with common beneficial ownership or under common control. DCMs may either determine which accounts will be prohibited from trading with each other, or require market participants to identify such accounts. As an exception, DCMs may allow matching of orders for accounts with common beneficial ownership when initiated by independent decision makers. DCMs must publish quarterly statistics disclosing approved self-trading.

### **Disclosure Regarding DCM Trade Matching Systems.**

DCMs must provide public disclosure regarding certain elements of their electronic trade matching systems. Disclosure must include a description of rules, specifications, or known attributes of the trade matching platform that materially affect the time, priority, price or quantity of execution of market participant orders; the ability to cancel or modify orders; and the transmission of market data and order or trade confirmations to market participants.

### **Market Maker and Trading Incentive Programs.**

DCMs must provide certain disclosures regarding their exchange market maker and trading incentive programs, and implement other controls. Such programs must be submitted as “Rule” filings pursuant to Commission regulations 40.5 or 40.6. Filings must describe eligibility criteria and describe payments or other benefits. Payments are prohibited for trades between accounts with common ownership.

### **Role of Registered Futures Associations.**

Registered futures associations (“RFAs”) must adopt certain membership rules—as deemed appropriate by the RFA—relevant to algorithmic trading for each category of member in the RFA. RFAs have discretion as to the rules they issue and the categories of members to which their rules apply. Furthermore, to ensure that all AT Persons are subject to rules of an RFA regarding algorithmic trading, AT Persons must become members of at least one RFA. The proposed rules would allow RFAs to supplement elements of Regulation AT as markets and trading technologies evolve over time.

See also the Q&A regarding the Regulation AT Notice of Proposed Rulemaking, available on the Commission’s website.