

UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

OPEN MEETING OF THE COMMISSION
TO CONSIDER A SUPPLEMENTAL PROPOSAL
TO AUTOMATED TRADING REGULATION

Washington, D.C.

Friday, November 4, 2016

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1 P R O C E E D I N G S

2 (10:00 a.m.)

3 CHAIRMAN MASSAD: Good morning. This
4 meeting will come to order. This is a public
5 meeting of the Commodity Futures Trading
6 Commission. I'd like to welcome members of the
7 public, market participants and members of the
8 media, as well as those taking part on the phone
9 or via webcast. I'm pleased to be joined by my
10 colleagues Commissioner Sharon Bowen and
11 Commissioner Chris Giancarlo. Today we gather to
12 consider a supplemental proposal related to
13 Regulation AT, our proposed rule to address the
14 increased use of automated trading in the markets.

15 As we all know, automated trading now
16 dominates the markets we oversee. More than 70
17 percent of trading in futures is now automated.
18 And this is not just in financial futures. This
19 is in physical commodity futures as well. And our
20 markets have fundamentally changed as a result.
21 We've gone, in just a few years, from the days of
22 open outcry pits where floor traders jostled elbow

1 to elbow to make trades to a machine-dominated
2 market, where today a millisecond is considered
3 slow. In fact, the new measure is a microsecond.
4 In the time it would take a trader, say, to hang
5 up the phone and signal a bid with his hands in
6 the pit, today's machines can probably generate
7 anywhere from 1,600 to 2,000 orders. In fact, in
8 the time it has taken me to read this part of my
9 opening statement, which is about a minute, more
10 than 60 million microseconds have passed, enough
11 time for probably 50,000 orders.

12 But in another respect our markets have
13 not changed at all. Farmers, ranchers,
14 manufacturers, exporters, businesses of all types
15 still depend on these markets to hedge routine
16 risk and engage in price discovery. Whether it is
17 corn or copper, crude oil or cocoa, equities or
18 treasuries, Japanese yen or British pounds,
19 businesses need these markets. They need them to
20 function reliably, fairly and free of manipulation
21 or disruption. And if anything has changed, it is
22 that those needs are even greater today. They are

1 greater because businesses operate worldwide.
2 Commodity markets are global and products are more
3 diverse. Market participants look to us to make
4 sure these markets operate with integrity. And so
5 while the landscape has changed dramatically, our
6 mission has stayed the same.

7 And let me just say that I meet with
8 market participants of all types, and I find that
9 traditional end-users, such as those from the
10 agricultural community in particular, are
11 concerned about the effects of automated trading
12 in these markets today. So it's especially
13 important for us to be able to respond to the
14 concerns of those who are not, let's say the
15 so-called "flash boys," and are only moving at
16 human speed.

17 Today our regulations have not kept up
18 with our modern markets. And today's proposal is
19 a part of what we need to do to keep our
20 regulatory system up to date, just as you need
21 updates periodically for your phone's operating
22 system.

1 There are other things we need to do to
2 modernize our regulatory oversight, and in
3 particular to engage in adequate surveillance of
4 modern trading methods. We must continue to
5 enhance our ability to receive and analyze message
6 and other types of data. We must have adequate
7 data on trading and related cash markets. And
8 regulators must cooperate because markets are
9 increasingly linked. So that's why we are here
10 today. Our proposal is designed to minimize the
11 risk of disruption and other problems that can be
12 caused by automated trading, algorithmic trading,
13 and to make sure we have the tools to deal with
14 those problems should they occur.

15 It requires reasonable controls, using a
16 principles-based approach that would codify many
17 industry best practices. But it does not
18 prescribe the parameters or limits of such
19 controls because we know how diverse market
20 participants can be. And we believe they are the
21 ones who should determine those specifics.

22 It requires testing and monitoring of

1 algorithms. It requires the preservation of
2 source code and other records, the equivalent of
3 the records that those trading at human speed have
4 preserved for years. And it ensures that we would
5 have access to such records when necessary, just
6 as for years we have reviewed the records of the
7 traders who operate at human speed. In the last
8 year we received significant feedback on the
9 proposal that the Commission unanimously approved
10 in November of last year. And today's
11 supplemental proposal makes a number of changes to
12 that initial measure. They reflect the
13 suggestions and comments we have received.

14 The changes we will consider today
15 modify the basic risk control requirements, so
16 that we achieve the proper coverage in an
17 efficient manner. They modify the registration
18 requirement, so that it focuses instead on the
19 larger participants. They lessen some of the
20 reporting requirements while still requiring a
21 certification of compliance. And they address the
22 concerns raised about access to source code. On

1 that issue the proposal requires the Commission
2 itself to make the decision to seek access to
3 source code. No staff member can do so without
4 Commission approval.

5 This is a significant departure from our
6 standard practice which allows staff to seek
7 access to information that registrants are
8 required to preserve without a subpoena or
9 specific Commission authorization. Now the
10 Commission could authorize the staff to seek such
11 access either by means of a subpoena or a special
12 call. That is, the process we are proposing will
13 require the same level of Commission review that
14 comes with the issuance of a subpoena, even if it
15 is for surveillance purposes. Our proposal also
16 describes the steps we can take to preserve the
17 confidentiality of source code. Now our staff
18 will highlight these and the other changes in more
19 detail in a moment and I want to express my great
20 appreciation to all of them for the hard work on
21 this rule. You'll hear from several in a moment.
22 There are many others who have also participated.

1 Let me just conclude by saying we have
2 long engaged in surveillance that involves
3 reviewing information that has significant
4 proprietary value; information on trading
5 strategies, including activities of traders in
6 related markets, information that would go to
7 whether a position truly is a bona fide hedge,
8 such as purchase or supply commitments of related
9 cash commodities, inventory levels, production
10 expectations and so forth.

11 We should not have a regulatory regime
12 where those who still trade at human speed are
13 subject to effective surveillance, but those who
14 use machines are not. Our rules should not favor
15 one method over another. And nobody should be
16 able to hide behind their machines.

17 Thank you. Now let me recognize
18 Commissioner Bowen for her opening remarks.

19 COMMISSIONER BOWEN: Thank you. Good
20 morning. I'm glad to be here this morning as the
21 Commission considers the supplemental proposal for
22 rulemaking in automated trading. I've said

1 several times before that I'm a believer in two
2 things -- the need to enhance our rules to ensure
3 that they are appropriately rigorous and
4 protective and to find a rule that works and that
5 can be effectively implemented. I'm pleased to
6 say that I believe that today's release does both.
7 So I want to commend our staff for your hard work
8 on this proposal. Following significant
9 engagement with a variety of stakeholders, from
10 exchanges, proprietary traders to advocates of
11 financial reform, we're making several important
12 revisions to our proposed rule on automated
13 trading.

14 Of these changes there are two in
15 particular I want to flag. First, we are revising
16 our registration regime to better focus our
17 attention and regulations on the firms responsible
18 for a substantial amount of automated trading in
19 our markets. Under this proposal firms that use
20 Direct Electronic Access, or DEA, to connect to
21 our markets will not automatically have to
22 register. Instead, only those firms which use DEA

1 and also average 20,000 or more trades each day
2 over a six-month period will be required to
3 register.

4 It only seems appropriate that firms
5 responsible for a substantial portion of our
6 markets should have heightened trading regulations
7 than small firms who only enter a handful of
8 trades a day.

9 While a one-size-fits-all system may
10 work in some cases, I believe it will be unduly
11 burdensome to small firms to require that anyone
12 who uses DEA automatically has to register. By
13 offering a specific threshold for registration,
14 however, it is critical that we pick the right
15 number. I therefore am looking forward to
16 comments from market participants on whether
17 20,000 trades per day is the right level. Is it
18 too high? Is it too low? Given the interest in
19 our previous proposal and registration that has
20 engendered in the past, I'm pretty sure that there
21 will be a spirited debate as to what the proper
22 threshold should be.

1 While small firms with small volumes
2 would not be required to register, it is not the
3 case that their trades will be unregulated. In
4 fact, the second major revision of today's
5 proposal will require that all electronic trading,
6 algorithmic as well as non-algorithmic, will have
7 two separate layers of pre-trade risk controls on
8 it. As a result, under this proposal we will be
9 ensuring that every single electronic trade in our
10 markets is subject to two levels of pre-trade risk
11 controls without exception.

12 Given the constant technological
13 innovations and redesigns involving algo trading I
14 believe having two levels of risk controls is not
15 only the most prudent course of action, but it's
16 also a critical protection against market
17 malfunction harming investors in our broader
18 economy.

19 As I've said before however, I believe
20 this regulation is merely a first cut. Having
21 looked at this issue for nearly a year, I have
22 some doubts as to whether we're doing enough to

1 ensure that all market participants, especially
2 end-users in our markets, are being given a level
3 playing field at present, due to the proliferation
4 of algo trading. I therefore believe that we
5 should consider instituting pilot programs in
6 certain small sections of the market that can test
7 the effects of additional and more substantial
8 restrictions on algo trading. Please note I do
9 not believe it is time to place more rigorous
10 restrictions in algo trading in all the markets we
11 regulate. Instead, I only believe that we should
12 see whether there are some markets where a
13 significant percentage of end-users are interested
14 in establishing greater monitoring and regulation
15 of algo trading.

16 If one or two such markets exist, then
17 those markets could be candidates for a tailored
18 pilot program to gather data on the effects of
19 algo trading on their markets. We could then gain
20 important insight on the effects of new market
21 dynamics that can change or evolve. If you are an
22 end-user and believe that your market would

1 benefit from such a tailored pilot program, I
2 encourage you to convey that message to the
3 Commission.

4 I've had the pleasure of meeting with
5 some members of the National Cattlemen's Beef
6 Association earlier this year and more recently.
7 They informed me that they believe algo trading is
8 having a substantial impact on livestock markets.
9 And they are interested in gaining more data on
10 how algo trading is influencing livestock prices.
11 I share the desire for more information, both as
12 to whether this rule is regarded as being a step
13 in the right direction and about what, if any,
14 effects algo trading is having on our markets. If
15 an observer has any issue with any part of this
16 rule, especially if you feel it's too weak, I
17 sincerely hope that you will lay out your concerns
18 in detail and let us know how we can improve it.

19 Finally, I want to thank stakeholders,
20 particularly several industry groups, for their
21 engagement with the Commission since we released
22 our proposal. I was very happy to learn that many

1 aspects of this proposal, including the idea of
2 requiring pre-trade risk controls on all
3 electronic trades were suggested by members of the
4 industry. We have notice-and-comment requirements
5 for many reasons -- increased transparency, an
6 opportunity for public comment, and of course to
7 set procedural strictures on government. But one
8 of the reasons undergirding our system of
9 notice-and-comment is the idea that regulators do
10 not have all the answers all of the time. And
11 there is a role for market participants to play
12 during the regulatory process. The fact that
13 industry participants were able to devise and
14 endorse a broad regulatory requirement on all
15 automated trading is to be commended. Thank you,
16 and I look forward to today's presentation and
17 ongoing dialogue.

18 CHAIRMAN MASSAD: Thank you,
19 Commissioner Bowen. Let me now turn to
20 Commissioner Giancarlo.

21 COMMISSIONER GIANCARLO: Thank you,
22 Chairman and thank you Commissioner Bowen. Good

1 morning, everyone. Thank you to the staff for
2 being here. And I look forward very much to your
3 presentation. What I'd like to do is hold back my
4 oral statement until I've had a chance to hear
5 your presentation and ask you a few questions and
6 thereafter I'll give my statement before the vote,
7 thank you.

8 CHAIRMAN MASSAD: Okay, thank you. All
9 right, in a few moments I'll ask the staff to make
10 a presentation to the Commission on the
11 supplemental proposal. And after the presentation
12 the floor will be open for questions and comments
13 from each of the Commissioners. Following the
14 close of the Commission's discussion, I expect
15 that we will take a vote on the staff proposal as
16 presented. The final vote conducted in this
17 public meeting will be a recorded vote. The
18 result of the vote approving the issuance of the
19 supplemental proposal, should that be the outcome,
20 will be included with that document when it is
21 published in the Federal Register. At this point
22 I ask for the Commission's unanimous consent to

1 allow staff to make technical corrections to the
2 document that may be approved today, assuming it
3 is approved, prior to sending it to the Federal
4 Register.

5 Without objection, it is so ordered.
6 Okay, at this time I would like to welcome the
7 following staff for their presentations on the
8 supplemental proposal to the Commission's
9 automated trading regulation. First, Vince
10 McGonagle, Director of the Division of Market
11 Oversight. And also from the Division of Market
12 Oversight, we have Marilee Dahlman, Sebastian
13 Pujol and Joseph Otchin. Please proceed.

14 MR. PUJOL: Thank you, Mr. Chairman, and
15 good morning, Commissioners. Staff of the
16 Division of Market Oversight is pleased to present
17 today, a supplemental notice of proposed
18 rulemaking to amend and streamline the
19 Commission's rules for Regulation AT. Before
20 beginning, I'd like to thank the divisions and
21 offices of Market Oversight, Enforcement, General
22 Counsel and Chief Economist for their hard work in

1 completing this supplemental. I'd particularly
2 like to acknowledge Mike Penick, Richard Haynes,
3 John Dunfee, Carlin Metzger, Brian Robinson,
4 Andrew Ridenour, Joe Otchin and Marilee Dahlman,
5 as members of the rulemaking team.

6 I'd also like to thank senior staff from
7 the Division of Market Oversight, including Vince
8 McGonagle and Rachel Berdansky for their continued
9 support of our efforts. Staff's presentation
10 today will focus on three areas. First, we'll
11 briefly discuss Regulation AT's development, and
12 its policy objectives. Second, we'll summarize
13 the substantive content of the supplemental,
14 focusing on key areas where staff recommends
15 changes to the NPRM to address public comments and
16 concerns. Finally, my colleagues Marilee and Joe
17 will provide greater detail regarding changes to
18 the risk control framework and to the definition
19 of AT Person in today's supplemental.

20 Regulation AT is a comprehensive effort
21 to reduce risk in algorithmic order origination
22 and electronic trade execution on all U.S. futures

1 exchanges. The proposed rules, both in the NPRM
2 and in today's supplemental, modernize the
3 Commission's regulatory regime, promote the safety
4 and soundness of trading and seek to keep pace
5 with evolving market technologies. To accomplish
6 these aims Regulation AT focuses specifically on
7 registration, pre-trade risk controls, testing,
8 supervision, recordkeeping and transparency in
9 algorithmic and electronic trading.

10 The Commission's consideration of
11 standards in these areas has included numerous
12 opportunities for public comment and input. As
13 early as 2011, the Commission's Technology
14 Advisory Committee developed recommendations for
15 pre-trade risk controls at the trading firm,
16 clearing firm and exchange levels. In 2013, the
17 Commission published its concept release on risk
18 controls and system safeguards, which provided a
19 comprehensive discussion of industry best
20 practices, Commission regulations and work by
21 other U.S. and foreign regulators. In December of
22 2015, the Commission published the NPRM for

1 Regulation AT. And finally, in June of this year
2 Commission staff held a day-long public roundtable
3 to discuss important aspects of the proposed rules
4 and to provide additional opportunities for public
5 comment.

6 As part of this staff process the
7 Commission also reopened the comment period for
8 Regulation AT. I'd like to close this overview by
9 noting that today's supplemental is a continuation
10 of the NPRM procedurally. Therefore, all rules
11 proposed in the NPRM remain under consideration as
12 originally proposed unless specifically amended by
13 the supplemental. Accordingly, the remainder of
14 staff's presentation will focus on areas where the
15 supplemental modifies the Commission's original
16 proposal.

17 The supplemental amends proposed
18 Regulation AT in several respects, including four
19 which we will summarize this morning. First, it
20 revises the proposed risk control framework so
21 that controls are required only at two levels,
22 rather than three as originally proposed. Second,

1 the supplemental adds a volume-based test to the
2 criteria for determining who is an AT Person,
3 including who must register as a new floor trader.
4 Third, the supplemental eliminates annual
5 reporting requirements that would have been
6 applicable to AT Persons and FCMs. Fourth, and
7 finally, the supplemental addresses access to
8 algorithmic trading source code by proposing a new
9 and heightened process that requires Commission
10 authorization for any staff access to source code.

11 We'll take each of these changes in
12 turn. First, as a threshold matter, Regulation AT
13 defines a new category of market participants, AT
14 Persons, and requires pre-trade risk controls,
15 testing, recordkeeping and other safeguards around
16 their algorithmic trading. The NPRM proposed
17 requiring risk controls at three levels -- AT
18 Person, FCM and DCM. Many commenters however,
19 asserted that a two-level structure would be
20 preferable and more cost effective. After careful
21 consideration, today's supplemental proposes
22 shifting Regulation AT to a modified two-level

1 structure. Risk controls would be set at the
2 level, first, of an AT Person or its FCM and,
3 second, at the DCM.

4 The supplemental also provides
5 flexibility by allowing AT Persons who do not wish
6 to operate their own pre-trade risk controls to
7 delegate that responsibility to their FCM. The
8 NPRM also proposed requiring risk controls only
9 with respect to the algorithmic trading of AT
10 Persons. In contrast, the supplemental addresses
11 not only algorithmic trading, but also electronic
12 trading. In this regard, the supplemental is
13 again responsive to public comments indicating
14 that all electronic trading presents potential
15 risks and should pass through appropriate
16 pre-trade controls.

17 A second area of focus is that
18 Regulation AT requires registration of certain
19 market participants who are not already registered
20 with the Commission. Such participants would
21 register as floor traders and would also be
22 required to become members of a registered futures

1 association. Together with existing registrants
2 engaged in algorithmic trading, new floor traders
3 would be considered AT Persons and be subject to
4 the proposed rules. The NPRM specified
5 proprietary, algorithmic trading through direct
6 access as registration criteria for new floor
7 traders.

8 The supplemental adds a trading volume
9 test to these proposed criteria. This amendment
10 responds to concerns that the NPRM would have
11 imposed registration and AT Person status on too
12 large a population of market participants. The
13 supplemental also applies this same trading volume
14 test to existing registrants to determine whether
15 they are also AT Persons. Staff estimates that
16 the proposed rules would result in approximately
17 120 AT Persons, including some 70 who are already
18 registered with the Commission in some capacity.

19 Third, the NPRM proposed that FCMs and
20 AT Persons must provide DCMs with annual reports
21 regarding their compliance with Regulation AT.
22 The NPRM also required DCMs to establish programs

1 for effective review of such reports. In
2 response, the Commission received comments
3 indicating that the annual reports would be an
4 overly burdensome requirement with little benefit
5 in mitigating risks associated with algorithmic
6 trading. Staff evaluated these comments and
7 recommends that the Commission replace the NPRM's
8 reporting requirements with a streamlined simpler
9 annual certification process.

10 To help ensure effective implementation
11 of risk controls and other measures required by
12 the proposed rules, staff also recommends that the
13 Commission leverage the DCM's role as front line
14 regulators and require that they establish
15 programs for effective periodic review of AT
16 Persons' and FCM's compliance with Regulation AT.

17 Finally, source code -- the NPRM's
18 proposal for recordkeeping and access to source
19 code garnered significant attention from
20 commenters, including many who were concerned
21 about the confidentiality and information security
22 of source code if brought on-site to the

1 Commission. To begin this discussion, staff would
2 like to emphasize that the supplemental proposes
3 significant revisions to the Commission's original
4 proposal. These revisions provide for a unique
5 and heightened protections around access to source
6 code, including provisions that would make source
7 code available to staff only through subpoena or
8 special call authorized by the Commission.

9 As background, the NPRM proposed new
10 recordkeeping rules to make clear that AT Persons
11 must maintain copies of their source code. The
12 NPRM also required that AT Persons make records
13 available in accordance with Commission Regulation
14 1.31, which provides that records must be produced
15 to any representative of the Commission upon
16 request. The rules proposed in the NPRM are
17 consistent with the Commission's traditional
18 statutory and regulatory authority governing
19 access to books and records. Staff notes, for
20 example, that the CEA requires registrants and
21 registered entities to maintain books and records
22 and to provide for prompt access to such records

1 by the Commission and its staff in the numerous
2 provisions.

3 These sections include nearly identical
4 language stating that registrants and registered
5 entities must keep books and records in such form
6 and manner and for such period of time as may be
7 required by the Commission and shall keep such
8 books and records open to inspection by any
9 representative of the Commission.

10 Some commenters may have misconstrued
11 the NPRM to require more than intended. For
12 example, the NPRM did not require the routine
13 transfer of all source code to the Commission or
14 other party for centralized storage. As noted
15 previously, other commenters raised
16 confidentiality, information security, and process
17 concerns regarding source code on Commission
18 premises.

19 Staff has taken these comments seriously
20 and has endeavored to address the Commission's
21 regulatory interest, while at the same time
22 respecting AT Persons' concern for their source

1 code. Most importantly, the supplemental
2 transfers access to source code from the general
3 books and records provisions of Regulation 1.31
4 that I described previously to a new proposed
5 Regulation 1.84. Proposed 1.84 clearly
6 articulates that staff's access to source code is
7 limited to subpoena or special call, a new
8 heightened procedure for source code and related
9 records. Execution of a special call must be
10 authorized by the Commission itself.

11 An execution would be limited to the
12 director of the Division of Market Oversight, once
13 authorized by the Commission. The special call's
14 nexus to market oversight emphasizes proposed
15 regulation 1.84's use in understanding markets and
16 market events, a CFTC function that is distinct
17 from the investigative subpoena process. Proposed
18 1.84 also includes other important provisions,
19 including a requirement that AT Persons keep
20 records of the log files generated in the ordinary
21 course of their algorithmic trading systems.
22 Absent subpoena, access to such log files would

1 also be limited to special call authorized by the
2 Commission. As with other regulatory records,
3 both source code and log files would be required
4 to be maintained for five years.

5 Finally, as an additional protection,
6 proposed 1.84 emphasizes in the regulatory text
7 the protections -- the confidentiality protections
8 -- embedded in the Commodity Exchange Act and
9 Commission regulations and emphasizes that section
10 8(a) of the Act would apply to source code and to
11 log files.

12 I'll now turn the presentation over to
13 my colleagues Marilee and Joe for a more detailed
14 description of two items. First, the
15 supplemental's revised risk control framework and
16 second, its new volume threshold test. Thank you.

17 MS. DAHLMAN: As Sebastian indicated,
18 the supplemental revises the overall framework for
19 risk controls. The NPRM imposed pre-trade risk
20 control and other requirements at three levels --
21 AT Persons, FCMS and DCMs. The NPRM allowed the
22 relevant entity discretion in the design and

1 parameters of the controls and the supplemental
2 continues to provide that discretion. However,
3 the supplemental proposes a risk control framework
4 with controls at two, rather than three, levels.
5 At the first level controls must be implemented by
6 either the AT Person or its FCM. DCMs would
7 implement risk controls at the second level.

8 This revised structure is intended to
9 prevent and mitigate potential market disruptions,
10 while at the same time responding to concerns
11 about the complexity of the risk control framework
12 and overall costs of compliance. By requiring two
13 levels of risk controls, failures at one level
14 will have a backstop, thereby reducing the
15 possibility of a trading disruption.

16 At the first level, whether the AT
17 Person or FCM implements the risk controls depends
18 on whether the order is originated by an AT Person
19 or a non-AT Person market participant and whether
20 the AT Person has delegated compliance to its FCM.
21 Specifically, Section 1.80 requires AT Persons to
22 implement risk control measures on their orders,

1 but new section 1.80(d) allows an AT Person to
2 delegate compliance with risk control requirements
3 to its executing FCM.

4 The supplemental's proposed rules do not
5 require the FCM to accept the delegation. If the
6 FCM declines, the AT Person must implement the
7 risk controls itself. As to orders not
8 originating with AT Persons, FCMs are required to
9 implement risk controls on those non-AT Person
10 customer orders. For trading firms that prefer to
11 implement their own risk controls rather than
12 leave the implementation of such measures to their
13 FCM, the supplemental adds to the definition of AT
14 Person a provision that allows a market
15 participant to voluntarily elect to become an AT
16 Person.

17 Another important revision to the risk
18 control structure is that both levels of risk
19 controls now apply to electronic trading rather
20 than only to algorithmic trading. Specifically,
21 pursuant to new section 1.80(g), AT Persons must
22 apply their risk controls and other measures

1 through electronic trading. In addition, the
2 proposed rules applicable to FCMs and DCMs have
3 been revised to generally apply to electronic
4 trading. Paired with these rule changes, the
5 supplemental proposes a new defined term --
6 electronic trading -- and defined term, electronic
7 trading order message. As a whole, the revised
8 risk control framework addresses concerns
9 regarding market disruptions that could arise from
10 electronic trading, while also preserving a focus
11 on the unique risks of algorithmic trading in
12 modern markets.

13 Finally, the supplemental changes
14 terminology in Regulation AT relating to FCMs. In
15 the NPRM, proposed risk control and reporting
16 rules apply to clearing member FCMs. Now such
17 rules apply to executing FCMs in order to respond
18 to the concern that those firms are better
19 positioned to apply risk controls on a pre-trade
20 basis.

21 MR. OTCHIN: The NPRM proposed requiring
22 persons to register as new floor traders if they

1 engaged in proprietary algorithmic trading through
2 direct electronic access on a DCM. The
3 supplemental retains these requirements, but also
4 incorporates a volume-based quantitative test for
5 registration as a new floor trader. This proposal
6 responds to commenter concerns that the NPRM
7 required too large a population of market
8 participants to register with the Commission. In
9 addition to applying to new floor traders, the
10 proposed volume threshold test would also apply to
11 current Commission registrants to help define
12 whether they are AT Persons.

13 The volume threshold test involves
14 quantitative metrics based on a market
15 participant's average daily trading volume across
16 all products. Specifically, supplemental proposed
17 section 1.3(x)(2) requires potential AT Persons to
18 determine whether they trade at least 20,000
19 contracts on average per day over a six-month
20 period. The calculation would include contracts
21 that potential AT Persons trade for their own
22 account, the accounts of customers, or both. In

1 addition, AT Persons would be required to
2 calculate their average daily trading volume
3 across all products on the electronic trading
4 facilities of all DCMs on which they trade.

5 Pursuant to supplemental proposed
6 section 1.3(xxxx), a market participant may fall
7 under the definition of AT Person in one of three
8 ways.

9 First, the category of AT Persons
10 includes market participants currently registered
11 or required to be registered with the Commission
12 that engage in algorithmic trading and satisfy the
13 volume threshold test.

14 Second, AT Persons include new floor
15 traders, i.e., market participants not currently
16 registered with the Commission that engage in
17 algorithmic trading, utilize direct electronic
18 access, and satisfy the volume threshold test.

19 Third, a person who does not satisfy
20 either of the other two prongs of the AT Person
21 definition may nevertheless elect to become an AT
22 Person, provided that such person registers as a

1 floor trader and complies with all requirements of
2 AT Persons pursuant to Commission regulations.

3 The volume threshold test is intended to
4 facilitate the identification of AT Persons
5 through the use of clear numerical standards that
6 can be easily calculated by market participants
7 and are verifiable in the Commission's data.
8 Staff believes that the volume threshold test is
9 an appropriate vehicle to define the scope of AT
10 Persons. Staff also believes that the proposed
11 volume threshold test best matches the goals of AT
12 Person regulation, including risk controls,
13 recordkeeping and testing and monitoring
14 requirements that would prevent and reduce the
15 risk of market disruption caused by technological
16 malfunction or other error. Staff estimates that
17 the proposed volume-based criteria would result in
18 approximately 120 AT Persons, including
19 approximately 70 market participants who are
20 already registered with the Commission in some
21 capacity and approximately 50 new registrants.

22 MR. PUJOL: Thank you, Joe. Mr.

1 Chairman, and Commissioners, this concludes
2 staff's presentation and summary of the
3 supplemental NPRM. We would be happy to answer
4 any questions you may have of us, and we thank you
5 again for your time and consideration.

6 CHAIRMAN MASSAD: Okay. Well thank you
7 Sebastian, Joe and Marilee. Let me also note, in
8 addition to the representatives of the Division of
9 Market Oversight, we have John Dunfee from the
10 Office of General Counsel and Michael Penick from
11 the Office of the Chief Economist available, as
12 well. So to open the Commission's discussion and
13 consideration of this rulemaking proposal, I will
14 now entertain a motion to approve and issue the
15 supplemental proposal related to automated trading
16 as presented by the staff.

17 COMMISSIONER BOWEN: So moved.

18 CHAIRMAN MASSAD: Okay. Second?

19 COMMISSIONER GIANCARLO: Second.

20 CHAIRMAN MASSAD: With that I would now
21 like to open the floor to allow the Commissioners
22 to make any statements and ask any questions that

1 they may have. And I will turn first to
2 Commissioner Bowen.

3 COMMISSIONER BOWEN: No questions.

4 CHAIRMAN MASSAD: Okay. Let me turn to
5 Commissioner Giancarlo.

6 COMMISSIONER GIANCARLO: Let me begin by
7 expressing my great respect for the staff that's
8 worked on this. You've all been very responsive
9 to questions from my team and I thank you for
10 that. I do have a few questions. A focus of mine
11 has been the subpoena process. So I do really
12 want to start with that. And I want to make sure
13 first of all, I understand that right now before
14 this rule, if it's passed or not, but as we stand
15 today, if the staff wants to view source code, it
16 can provided it gets a majority of the Commission
17 to agree to the issuance of a subpoena. If this
18 proposal passes, if the staff wants to view source
19 code, it will still need to get a vote of a
20 majority of the Commission. So procedurally, am I
21 correct that at least for CFTC procedures that
22 step is still the same?

1 MR. PUJOL: Yes, that's right.

2 MR. MCGONAGLE: So for clarification,
3 Commissioner, the staff of the Division of Market
4 Oversight has not sought access to source code to
5 date. And so if the question is whether staff
6 could utilize some process within DMO to access
7 source code today, the question would first
8 involve whether the code, as defined, or the
9 interest of staff fall within either the
10 recordkeeping obligations to the extent it
11 involved a Commission registrant or, separately,
12 are the records of the transactions of the
13 individual where the interest is, is that
14 individual a reportable trader that would be
15 subject to a special call? So while the division
16 hasn't exercised its authority to get source code,
17 I think there is an open question currently
18 concerning whether staff within the Division of
19 Market Oversight might have access to what we've
20 been referring to as source code here, which may
21 also include the log files.

22 CHAIRMAN MASSAD: If I may interject

1 just to clarify. Division of Market Oversight in
2 its surveillance capacity has not accessed source
3 code. Obviously, Enforcement has -- several times
4 -- and that's where the subpoena -- because we
5 issue subpoenas for enforcement and we don't for
6 surveillance.

7 MR. MCGONAGLE: That's right.

8 COMMISSIONER GIANCARLO: So to put it
9 another way, in the past where we've obtained
10 source code, it's been pursuant to a subpoena.

11 MR. MCGONAGLE: Yes. My understanding
12 is that the agency access to date for source code
13 has been through the Division of Enforcement.

14 COMMISSIONER GIANCARLO: Through a
15 subpoena and that's been voted on by the
16 Commission and what you are proposing here to
17 obtain source code would require a vote of the
18 Commission. And what I'm seeking to establish is
19 that that requirement to obtain a Commission vote
20 would remain the same as it is today or if it, the
21 rule passes in the future.

22 MR. MCGONAGLE: Yes, that's correct.

1 COMMISSIONER GIANCARLO: So from CFTC's
2 point of view, the procedural burden is
3 practically the same, needing to get a vote of the
4 Commission.

5 MR. MCGONAGLE: In the event the
6 Commission were to adopt the proposal today,
7 that's right.

8 COMMISSIONER GIANCARLO: Right. So now
9 let's look at it from the point of view of the
10 American people, automated traders who are asked
11 to turn over their algo source code. Right now
12 they are protected under the Fourth Amendment
13 against unreasonable searches and seizures, which
14 means the right to a pre-decision review before a
15 neutral decision maker. That's the subpoena
16 process. And it allows the owners of property to
17 go to a judge and seek to have the request either
18 limited in scope, in duration, or other controls
19 around the data being turned over. Under this
20 proposal, while it may remain the same
21 procedurally for the CFTC, we take away the
22 procedural rights of the property owner. They

1 just have no choice if this rule is passed, but to
2 hand over their source code and basically shut up.
3 How is that fair?

4 MR. MCGONAGLE: Thanks, Commissioner.
5 So with respect to the records that we are
6 discussing, a point of this proposal is to clarify
7 that the books and records requirements do extend
8 to source code and the log files. As I mentioned
9 before, there may be a question under our current
10 rules whether and how staff have access. However,
11 being particularly focused on the question of a
12 taking, the interests that are set forth here
13 relate to CFTC's oversight with respect to trading
14 that occurs on our markets.

15 The proposal that we've set up for
16 source code as a trade secret is the same as we
17 would apply, frankly, to other trade secrets that
18 the Commission has access to -- trading strategies
19 by traders. And that is, to the extent that the
20 information is relevant to the inquiry regarding
21 trading on our markets, staff may have access to
22 that information.

1 That access to information doesn't
2 necessarily take away from the trader or their
3 ability to use that trade strategy. The trader
4 can continue to use that strategy and the balance
5 that gives that trader the ability to continue to
6 use the strategy is, of course, the requirements
7 that the agency staff have with respect to the
8 confidentiality of that information.

9 So while we can evaluate and review
10 trade information to conform compliance with the
11 Act or to understand trading activity in our
12 markets, the traders continue to use that source
13 code or that trade secret as it were, as otherwise
14 appropriate, of course unless and until some
15 subsequent enforcement action occurs.

16 COMMISSIONER GIANCARLO: Okay. So let's
17 talk about that process with the CFTC review. Am
18 I correct that today's proposal lists various
19 statutes and regulations in it in the preamble and
20 in the rule text that require confidentiality?

21 MR. MCGONAGLE: Yes, we cross-referenced
22 existing confidentiality provisions under the Act

1 in the regs.

2 COMMISSIONER GIANCARLO: Right, so that
3 was my second question. So those confidentiality
4 provisions that we're cross-referencing are
5 existing confidentiality requirements, they are
6 not new ones that we're imposing?

7 MR. MCGONAGLE: Yes, that's right.

8 COMMISSIONER GIANCARLO: Okay. So --

9 MR. MCGONAGLE: Just one clarification,
10 the proposal adopts and incorporates within the
11 supplemental, confidentiality requirements. So
12 there'll be an additional confidentiality
13 obligation for staff just by virtue of the
14 proposal if accepted.

15 COMMISSIONER GIANCARLO: Okay. But if
16 we're really serious about confidentiality, why
17 wouldn't we have included some new heightened
18 protections? For example, why wouldn't we at
19 least agree that when we are done with our review,
20 we would either give back the source code or
21 destroy it and not leave it in our premises. Or
22 why would we not put in other protections, such as

1 who has access or that perhaps it might be kept
2 offline and not accessible in an online basis.
3 Why couldn't we build in some new protections?

4 MR. MCGONAGLE: Certainly the Commission
5 could consider whether additional affirmative
6 protections should be available for this type of
7 trade secret. I would indicate that for market
8 participants who view their information as
9 confidential, there is an expectation that all
10 information that the Commission receives are
11 treated confidentially. But to the extent that
12 there are additional restrictions or obligations
13 for the manner in which staff access the
14 information to assure compliance with the
15 confidentiality provisions, that certainly makes
16 sense.

17 COMMISSIONER GIANCARLO: Okay, thank
18 you. And then my last series of questions has to
19 do with more of a broader theme. And that is for
20 the past few years American tech firms have been
21 supported by the U.S. government, the State
22 Department, in fighting a Chinese law that would

1 force them to hand over source code to agencies of
2 the PRC government. Do you think that what we are
3 trying to do here is at odds with our government's
4 efforts against the Chinese effort to obtain
5 source code of tech firms?

6 MR. MCGONAGLE: So I wouldn't propose to
7 be an expert with respect to global intellectual
8 and privacy requirements. I can say within the
9 context of the jurisdiction that we have in the
10 agency to ensure that our markets operate in an
11 orderly and safe fashion that the requirements
12 that we propose here are consistent with those
13 obligations.

14 COMMISSIONER GIANCARLO: Okay. I have no
15 further questions. I would like to give a
16 statement.

17 CHAIRMAN MASSAD: Please go ahead.

18 COMMISSIONER GIANCARLO: Thank you,
19 Chairman. And I thank the staff for those answers
20 to those questions and for your very comprehensive
21 presentation. I've previously said that proposed
22 Reg AT is a reasonable first step in catching up

1 to the transformation of modern financial markets
2 by algorithmic trading and other new exponential
3 digital technologies. There are practical and
4 useful elements in the proposal that could serve
5 as the basis for an effective rule. And some of
6 the changes to the supplemental are quite
7 sensible, and I commend the staff for that.

8 But there are also some problematic and
9 inconsistent provisions ranging from prescriptive
10 compliance burdens to a disproportionate impact on
11 small market participants. A number of these
12 concerns are described in my written statement.
13 But more importantly, I've warned that any public
14 good achieved by the rule is, in my mind, undone
15 by this provision that proprietary source code
16 used in trading algorithms be accessible at any
17 time, anywhere to the CFTC and to the Justice
18 Department without a subpoena. And in these
19 remarks I want to drill down into that a little
20 bit.

21 Let me make clear at the outset the
22 CFTC, as Vince said, can today obtain the computer

1 source code of market participants, pursuant to a
2 subpoena. Therefore, the issue raised by the
3 proposed rule is not whether the CFTC can examine
4 the source code of automated traders where
5 appropriate, to investigate market misbehavior.
6 The CFTC can and does today.

7 The issue raised by this proposal is
8 whether the owners of source code have any say in
9 the matter. The subpoena process provides
10 property owners with due process of law before the
11 government can seize their property. It protects
12 owners of property. The subpoena protects the
13 owners of property. It doesn't protect the
14 government.

15 Its purpose is to provide an opportunity
16 to challenge the scope, the timing and the manner
17 of delivery and whether any legal privileges apply
18 to the process of handing over property. The
19 subpoena process therefore, provides a fair
20 compromise between the rights of property owners
21 and the government's rights to seize their
22 property. Without the subpoena process, there is

1 no balance between the civil liberties of the
2 governed and the unlimited power of the
3 government. Without it, civil liberties can be
4 abrogated to smooth the way for government
5 searches in the name of state security.

6 As a foundation of civil liberties, the
7 subpoena process precedes the American Republic
8 going back to English Common Law. As a legal
9 principal, it is woven into our Bill of Rights.
10 And as a bulwark of modern civil society, it
11 protects the liberty of the governed from the
12 potential tyranny of the government.

13 The supplemental notice before us today,
14 however, would strip owners of intellectual
15 property of due process of law. This abridgement
16 of rights is justified with the condition that
17 before the CFTC can take source code, it will
18 abide by two procedural hurdles -- a majority vote
19 of the Commission and the operation of the special
20 call process by the Division of Market Oversight.
21 Well, that justification entirely misses the
22 point. Abrogating the legal rights of property

1 owners is not assuaged by imposing a few
2 additional procedural burdens on the government.
3 Owners will still have lost any say in the matter.
4 The proposal still gives unchecked power to the
5 CFTC to decide if, when, and how property owners
6 must turn over their property.

7 Moreover, utilizing DMO's special call
8 procedures to seize source code provides an
9 end-run around the subpoena process. There is
10 nothing in the supplemental notice that I can see
11 to limit DMO's sharing of gathered source code
12 with the staff of the Division of Enforcement.

13 The proposal would allow Enforcement to
14 view source code without having to bother, as they
15 do today, to get a subpoena.

16 Now commentators have rightly questioned
17 what level of security the CFTC will deploy to
18 safeguard seized source code. The supplemental
19 notice lists the various statutes and regulations
20 that require confidentiality. The proposed rule
21 text also includes a reference to a specific
22 Commodity Exchange Act provision that prohibits

1 the release of trade secrets and other
2 information. That is all well and good. Yet
3 these are not new protections. They are in place
4 today. Simply citing them in the preamble in the
5 rule text gives little assurance that this
6 information will be safeguarded.

7 If the agency is determined to protect
8 confidentiality, then it should include specific
9 protections in the proposed rule.

10 As I said, it could provide that it will
11 only review source code at the property owner's
12 premises or on computers not connected to the
13 internet. The CFTC could also state that it will
14 return all source code to the property owner once
15 its review is finished. Today's proposal doesn't
16 provide any of those protections.

17 Absent specific measures, I have to say
18 it's absurd to suggest that source code will be
19 kept secure. Just look at the area of government
20 cyber security. In the six months after the CFTC
21 proposed Reg AT, hackers breached the computer
22 networks of the FDIC and the Federal Reserve.

1 Incredibly, the U.S. Office of Personnel
2 Management that gave up 21.5 million personnel
3 records, including mine, my children and my wife's
4 in a yearlong cyber penetration, failed the
5 security audit last November, six months after the
6 breach was discovered.

7 The CFTC itself, I'm sad to say, has an
8 imperfect record as a guardian of confidential
9 proprietary information. If this rule proposal
10 goes forward, it will make itself a target for a
11 broader group of cyber criminals, including now
12 those engaged in cyber espionage.

13 Last Friday we learned that a former
14 employee of the Office of the Comptroller of the
15 Currency downloaded thousands of files from the
16 agency servers onto two removable thumb drives
17 prior to retiring from the agency. The OCC said
18 that when it contacted the former employee about
19 those files he was, "Unable to locate or return
20 the thumb drives to the Agency." News of that
21 security breach surely sent shivers up the spines
22 of automated traders who received notice the same

1 day of the CFTC's intention to move forward with
2 this proposal.

3 And they must have been doubly spooked a
4 few hours later when the CFTC's own servers were
5 crashed by a denial of service attack. If the
6 CFTC adopts the source code provisions of the
7 supplemental notice, the SEC will likely copy it,
8 and so will other U.S. and overseas regulators.
9 And not just regulators of financial markets,
10 regulators like the Federal Communications
11 Commission may demand Apple's iPhone source code.
12 The Federal Trade Commission may seek the source
13 code used in the matching engines of Google,
14 Facebook and Snapchat. The National Security
15 Agency may demand to see the source code of
16 Cisco's switches, Lucent's routers and Oracle's
17 servers. The Department of Transportation may
18 demand Uber's auction technology and Tesla's
19 driverless technology source code. All of this in
20 the name of state security.

21 Where does it end? Well it certainly
22 won't end on American shores. Overseas regulators

1 will also mimic the rule. The German Chancellor
2 said last week that she wants her government to
3 examine the source code used in the matching
4 engines of Google and Facebook because she does
5 not like their political coverage of her
6 administration.

7 Now as I mentioned, the Chinese
8 government has already tried to put in place a
9 rule to obtain the source code of U.S. technology
10 firms. If the CFTC adopts this rule, I hate to
11 say it, but it will make a mockery of the U.S.
12 government's past attempts to oppose China's
13 desire to view proprietary commercial source code
14 and will confirm that the CFTC is not on the same
15 page as its own government counterparts.

16 Unfortunately, this proposed rule is a
17 reckless step onto a slippery slope. Today the
18 Federal government is coming for the source code
19 of seemingly faceless algo trading firms.
20 Tomorrow, however, governments worldwide may come
21 for the source code underlying the storing and
22 matching of American's most personal information

1 -- their Snapchats, their tweets, their
2 Instagrams, their online purchases, their choice
3 of reading materials and their political and
4 social preferences. Seriously, where does it end?

5 Fortunately, our country's founders
6 protected Americans against such unreasonable
7 searches and seizures and guaranteed them due
8 process of law in our U.S. Constitution. The
9 Supreme Court has routinely and recently upheld
10 these fundamental civil rights. If the Commission
11 adopts today's proposal, its source code seizure
12 provisions will likely be challenged in Federal
13 court. The litigation will consume the agency's
14 precious and very limited resources and will erode
15 its credibility in defending such a dubiously
16 constitutional rule. That will be a sad waste of
17 our resources and of taxpayer money.

18 Now it's been my general practice as a
19 CFTC Commissioner to vote to put out proposed
20 rules for public comment, even when I have
21 substantial concerns and issues. That's because
22 on most proposals there are reasonable difference

1 of opinion, and I want to hear a broad range of
2 sensible views before making a final decision.

3 I've taken this approach also because of
4 the enormous respect I have for my two fellow
5 Commissioners. We were sworn in together 28
6 months ago, and it remains an honor and a
7 privilege to serve alongside them. So it's a
8 disappointment that on this rule I must depart
9 from my preferred practice of voting in favor of
10 proposed rulemakings. But Reg AT is really unlike
11 any other rule proposal that I've seen in my time
12 on the Commission.

13 What should be a step forward by the
14 agency, in its mission to oversee 21st century
15 digital markets, is being squandered by this giant
16 lurch backwards in undoing Americans' legal and
17 civil and constitutional rights. The staff
18 recommends that we adopt Reg AT in order to
19 address the growing incidence of algorithmic
20 trading and to determine if algorithms are
21 disrupting financial markets. And yes, that is an
22 important goal. Automated trading does indeed

1 present a number of critical challenges to our
2 markets. My many meetings with America's farmers
3 and ranchers and other end-users have convinced me
4 that the CFTC must quickly catch up to the digital
5 transformation of our financial markets. Yet
6 jettisoning the subpoena process does not address
7 the challenge of automated trading. It just
8 strips the firms we regulate of their
9 constitutional rights. Other than that it really
10 does nothing to enhance market health, durability
11 and safety.

12 In closing, I note that Benjamin
13 Franklin is said to have warned that a people that
14 are willing to give up their liberty for apparent
15 security deserve neither and will lose both.
16 Franklin was right. Reg AT is a threat to our
17 people's liberty and their security. After 12
18 score years of ordered freedom in America, Reg AT
19 is a degree turn in the direction of unchecked
20 state authority. If adopted in its present form
21 it will put out of balance century-old rights of
22 the governed against the creeping power of central

1 government. Thank you.

2 CHAIRMAN MASSAD: Thank you. Let me
3 just start with a question. We have a
4 surveillance function. We monitor the markets.
5 If we see a disruption or abnormal trading, and
6 let's say we, you know, based on the transaction
7 data we get we think, gee, that abnormal activity
8 was perhaps caused by this particular trader
9 because we have very good insight into who is
10 trading. We know the participants. So let's say
11 that's a trader who, I don't know, it's a floor
12 trader. They're registered with us. But it's
13 kind of the traditional old days right?

14 And so let's say they were engaged in a
15 strategy to manipulate the markets. In fact,
16 there are trading logs, there are emails, there
17 are phone calls that evidence that because they
18 kind of communicate -- you do this then, and then
19 I'll do this in this other market, and whatever.

20 How would we go about getting that
21 information? And let's say -- actually, let's say
22 it's not clear they were engaged in it, right.

1 Let's say there is a question, maybe what they did
2 was fully compliant, maybe it wasn't. So
3 Enforcement is not in the picture yet. We're just
4 engaged in surveillance. How would we go about
5 getting that today?

6 MR. MCGONAGLE: Yes. Thank you,
7 Chairman. The division staff, Division of Market
8 Oversight, as well as CFTC staff to the extent
9 that records are required to be maintained. And
10 so records relating to the transactions executed
11 on designated contract markets, for example, are
12 open to inspection and access by staff and also by
13 the Department of Justice.

14 CHAIRMAN MASSAD: So today you would
15 just call up the participant. You wouldn't even
16 come to the Commission. There wouldn't even be a
17 Commission vote?

18 MR. MCGONAGLE: That's correct,
19 Chairman. We would utilize our staff to reach
20 out, to speak to the market participants, to work
21 to get an understanding about what their position
22 in the market is. And what's their intentions

1 concerning the positions that they have.

2 CHAIRMAN MASSAD: And they would have to
3 turn over those records to us. I suppose they
4 could refuse, and you know, then we take them to
5 court. But basically given our jurisdiction,
6 given our responsibilities, they would have to
7 turn that over to let us inspect it.

8 MR. MCGONAGLE: In most instances market
9 participants are very forthcoming to talk about
10 how and why they are trading in the markets.

11 CHAIRMAN MASSAD: And we've probably
12 done that a few times.

13 MR. MCGONAGLE: That's right, Chairman.

14 CHAIRMAN MASSAD: Maybe a few hundred,
15 maybe a few thousand, maybe tens of thousands.
16 Whatever, okay. So instead, let's say the trader
17 is an algo-trader. So the strategy, and again
18 it's not clear whether this is a strategy that is
19 compliant with the law or not. Strategy is, you
20 know, in an algo. And of course first there might
21 be several things we would do. We might just call
22 them up and talk to them. "What were you doing?"

1 We might look at message data. You know, we might
2 address our concerns through any number of ways.
3 But if it came to it, "You know what, you've told
4 us certain things. We're still not so sure. We
5 want to see the source code," then what we're
6 really saying here is because now the strategy
7 isn't in emails. It isn't in phone calls. It
8 isn't in these other old world records, we might
9 even call them today, it's in ones and zeros in a
10 computer code. Sorry, we can't have that.

11 That's where we are. Unless we decide
12 to bring an enforcement action, obviously which,
13 you know, the investigation itself implies --
14 making the appearance of wrongdoing. A lot of
15 firms don't like to get subpoenas because, you
16 know, of that. But if we went that route,
17 Enforcement could seek a subpoena. Of course,
18 Enforcement might not even want subpoenas.
19 Sometimes Enforcement calls rather than DMO calls
20 and people say, "Oh gee, I better, you know, give
21 it." So a lot of times Enforcement gets things
22 even without subpoenas. Have I got it basically

1 right?

2 MR. MCGONAGLE: Yes, Chairman.

3 CHAIRMAN MASSAD: Okay. So in other
4 words if you trade in our markets under the old
5 world ways, you are subject to surveillance. But
6 if you trade in our markets under the new world
7 ways of algos, "Oh no, that's a violation of the
8 Constitution," if we ask to see something that
9 evidenced your trading strategy.

10 MR. MCGONAGLE: So again with the point
11 that I had made with Commissioner Giancarlo
12 earlier, to the extent that staff were interested
13 in evaluating currently today under our existing
14 rules, we would issue a special call and whether
15 --

16 CHAIRMAN MASSAD: I get it.

17 MR. MCGONAGLE: We could, yeah, that's
18 right.

19 CHAIRMAN MASSAD: In other words, today
20 you haven't done it. DMO hasn't done it.
21 Enforcement has done it. But if you haven't done
22 it, that doesn't mean you couldn't --

1 MR. MCGONAGLE: Right.

2 CHAIRMAN MASSAD: -- for what we're
3 seeking today. Let's remember, the first thing we
4 are trying to do today is preserve the source
5 code. Is that right? Because we want to make
6 sure it's preserved, again for a very small group
7 of participants.

8 MR. MCGONAGLE: That's right. The
9 proposal seeks to clarify for recordkeeping
10 purposes for those category registrants which we
11 expect based on the volume measures would capture
12 a small subset of the market. But those market
13 participants who have a substantial impact in the
14 market by the volume of their trading that their
15 source code and associated records be maintained
16 in the event of a need by special call or
17 separately for Division of Enforcement under a
18 subpoena.

19 CHAIRMAN MASSAD: Okay, all right. So I
20 guess to my mind what we're trying to do here is,
21 we are not changing our process. We're updating
22 our rules for the fact that the way trading is

1 conducted has changed. All right, so let me maybe
2 make a few more comments in response. And I have
3 great respect for both of my fellow Commissioners.
4 I agree with Commissioner Giancarlo's statements
5 that we have worked very constructively together.
6 And I think including on this rule. I had hoped
7 that, and I still hope, that what we have proposed
8 today actually was a compromise. There are those
9 who didn't even feel we should require a
10 Commission authorization, given that we, again,
11 don't -- to get trading strategy if you write it
12 down. But we thought that this would be a good
13 compromise.

14 So let me address a few points. First,
15 just because, you know, we get into this and there
16 is lots of things mentioned. And I hear talk
17 about, you know, deprivation of property or
18 takings or so forth. I mean, we're talking about
19 looking at records. We're not talking about
20 taking property. The notion of a "taking" to me
21 means you can't use that property. The government
22 takes it away from you. If we go look at source

1 code, the trader can still trade. We're not
2 telling him to stop. The real concern, I think
3 here, and I recognize it as one we should address,
4 is the confidentiality, making sure it's
5 confidential and kept confidential so that the
6 value of that code is not diminished. And we do
7 take that seriously. But I just want to first get
8 on the table that I don't think we're talking
9 about, you know, a taking in a constitutional
10 sense.

11 Second, there was a mention of cyber
12 security in the recent DDOS, Distributed Denial of
13 Service Attack on our website. Of course, you
14 know, the entire East coast was hit by this --
15 Netflix, Twitter, lots of organizations were hit
16 by this. But all we're talking about here is so
17 much traffic that it overwhelms your website for a
18 brief period of time. And in our case that did
19 happen for parts of the website. Parts of the
20 website were still fine. People could access it.
21 But let's be clear, no one hacked into our system.
22 There was no breach of confidential information.

1 And we're not proposing today to put anyone's
2 source code on our website.

3 So to suggest that because, you know,
4 our website was overloaded by traffic we shouldn't
5 be allowed to conduct our responsibilities, you
6 know, sort of like saying, "Well, let's all not
7 subscribe to Netflix or maybe even any other movie
8 service or Twitter or use JP Morgan or Bank of
9 America because lots of organizations have had
10 DDOS attacks." It's simply the nature of the
11 world today.

12 Again, that's not to say that we don't
13 take confidentiality extremely seriously. And you
14 know, on that point, to Commissioner Giancarlo's
15 point, we've outlined in the preamble a number of
16 the things that we could do, including viewing
17 source code on a computer that is not connected to
18 the internet or any other website. The specifics
19 I think are going to depend on the case.

20 And again, first of all, the fact that
21 we would have the ability under the rule to look
22 at it, doesn't mean that we would even need to in

1 a lot of cases. We might just call up the
2 participant and get our questions answered. But
3 if we needed to look at it, you know, perhaps we
4 could go to their office and look at it. Of
5 course, if we went to their office and look at it,
6 we'd have to be concerned about, you know, the
7 fact that they could probably tell exactly what
8 we're looking at and maybe even reverse engineer
9 what we're doing, and that could compromise our
10 ability. So, you know, you have to decide these
11 things on a case by case basis. You can't say,
12 "Oh, in every single case we will look at it at
13 their office."

14 But again, I think as the preamble says,
15 we take the confidentiality thing very seriously.
16 As far as employees -- our employees are subject
17 to statutory prohibitions on the use of
18 information that they gain by working here. It's
19 not just statutory, it's criminal, criminal
20 penalties. So you know, unless we're suggesting
21 they should be drawn and quartered, I think the
22 penalties today are pretty severe. So, you know,

1 finally, why not just a subpoena then. I'm sure
2 some would say, if you're going to go to the
3 Commission why not just make it a subpoena? Well
4 again, that's not the way we have operated in the
5 past. The Division of Enforcement uses subpoenas
6 often when the person is not a registrant or when
7 they are concerned that the person won't
8 cooperate, or maybe there is an emergency or
9 something like that. They often get a lot of
10 information without subpoenas. There are a lot of
11 agencies that issue subpoenas without it even
12 going to the Commission.

13 So what we're proposing today, I think,
14 is a level of review that addresses what you get
15 by virtue of the subpoena. It would go to the
16 Commission. As far as the rights of the
17 individual, truth is, you know, we have the
18 jurisdiction. That's our job. It's our job to
19 survey the markets to enforce the laws. And, you
20 know, that's simply kind of the fact, if you are
21 going to trade in these markets.

22 Also, as far as confidentiality, I would

1 point out we have gotten the source code and many
2 times through enforcement actions. There haven't
3 been breaches. So I think it might be helpful to
4 think about the track record rather than, you
5 know, what may have happened to OPM.

6 Finally, let me just say on the slippery
7 slope point, it strikes me as the wrong metaphor.
8 This is not a slippery slope, this is an uphill
9 climb. It's an uphill climb because our markets
10 have evolved much faster than our regulatory
11 framework. And we are trying to climb up a steep
12 hill to catch up, to be able to see what is going
13 on in our markets today and engage in adequate
14 oversight. And this information could be
15 critical. Again, I speak to, and I know both of
16 you have as well, a number of participants in our
17 markets, what I would call the more traditional
18 participants in our markets, who have a lot of
19 concerns, who feel these markets have changed
20 dramatically.

21 And so I think we have to recognize that
22 we do need to modernize our markets. Part of that

1 is the ability to update essentially the
2 surveillance function we've been engaged in for
3 decades, where we do look at all sorts of
4 information, confidential proprietary information
5 of great value. And the fact that today, similar
6 information is embodied in ones and zeros in code,
7 should not make a fundamental difference. You
8 should not be able to hide behind machines, as I
9 said earlier. Are there any other comments or
10 Commission business?

11 COMMISSIONER GIANCARLO: Chairman, I'd
12 just like to make one point. And I have a lot of
13 respect for your points, but I just do want to say
14 for the record that comparing records of historic
15 trades to the most valuable algorithmic systems
16 that project a firm's business strategy going
17 forward, are comparing apples to oranges. Trades
18 of historic trades, that's books and records.
19 Firms' algorithms that show what they will do in
20 the future in the event of certain market factors
21 is an entirely different thing.

22 CHAIRMAN MASSAD: Let me just say,

1 requiring the preservation of source code because
2 source code is changed all the time. What we're
3 looking at in any given instance is the past. It
4 is what they did. And it is the same thing as a
5 trade. From the standpoint of our mission, it's
6 the same thing as if you wrote down exactly how
7 you want to trade on a piece of paper.

8 With that I will entertain a motion to
9 vote. Is that right? Is that my next move? I've
10 got my script mixed up.

11 We already have the motion. Okay. I
12 will now ask for a vote -- all in favor -- at
13 least -- I'm sorry. You are going to do it.

14 MR. KIRKPATRICK: Yeah.

15 CHAIRMAN MASSAD: Thank you.

16 MR. KIRKPATRICK: The motion now before
17 the Commission is on the approval and issuance of
18 the regulation automated trading supplemental
19 notice of proposed rulemaking. Commissioner
20 Giancarlo?

21 COMMISSIONER GIANCARLO: No.

22 MR. KIRKPATRICK: Commissioner

1 Giancarlo, no. Commission Bowen?

2 COMMISSIONER BOWEN: Aye.

3 MR. MCGONAGLE: Commissioner Bowen, Aye.

4 Chairman Massad?

5 CHAIRMAN MASSAD: Aye.

6 MR. KIRKPATRICK: Chairman Massad, aye.

7 Mr. Chairman, on this matter the ayes have two,

8 the nos have one.

9 CHAIRMAN MASSAD: Okay, therefore the
10 motion is adopted. Is there any other Commission
11 business? Sorry, thank you, there it is. Okay,
12 there being no further business, I would entertain
13 a motion to adjourn the meeting.

14 COMMISSIONER BOWEN: So moved.

15 COMMISSIONER GIANCARLO: Second.

16 CHAIRMAN MASSAD: Okay. The ayes have
17 it. Again, I want to thank the staff. There has
18 been a lot of work that has gone into this. And I
19 also want to thank Commissioners Bowen and
20 Giancarlo and their staffs for their
21 consideration. The meeting is adjourned.

22 (Whereupon, at 11:48 a.m., the

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PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

DISTRICT OF COLUMBIA

I, Carleton J. Anderson, III, notary public in and for the District of Columbia, do hereby certify that the forgoing PROCEEDING was duly recorded and thereafter reduced to print under my direction; that the witnesses were sworn to tell the truth under penalty of perjury; that said transcript is a true record of the testimony given by witnesses; that I am neither counsel for, related to, nor employed by any of the parties to the action in which this proceeding was called; and, furthermore, that I am not a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

(Signature and Seal on File)

Notary Public, in and for the District of Columbia

My Commission Expires: March 31, 2017