



Via Electronic Submission

March 16, 2016

Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre, 1155 21st Street NW
Washington, DC 20581

Re: Regulation Automated Trading (RIN Number 3038-AD52)

Dear Mr. Kirkpatrick:

The American Gas Association (“AGA”) respectfully submits these comments on the proposed rule on Regulation Automated Trading in response to the Notice of Proposed Rulemaking (“NPRM”) for Regulation Automated Trading (“Proposed Regulation AT”)¹ of the Commodity Future Trading Commission (“CFTC” or “Commission”).

I. Identity and Interests

The AGA, founded in 1918, represents more than 200 local energy companies that deliver clean natural gas throughout the United States. There are more than 72 million residential, commercial and industrial natural gas customers in the U.S., of which 95 percent — just under 69 million customers — receive their gas from AGA members. AGA is an advocate for local natural gas utility companies and provides a broad range of programs and services for member natural gas pipelines, marketers, gatherers, international gas companies and industry associates.²

AGA member companies provide natural gas service to consumers and businesses under rates, terms and conditions that are regulated at the local level by a state commission or other regulatory authority with jurisdiction. They use financial tools to hedge the commercial risks arising from the regulatory obligation to provide affordable, reliable natural gas service to customers – risks that include commodity price volatility. These tools may include futures contracts traded on CFTC-regulated exchanges, and over-the-counter energy derivatives. AGA members also participate in the physical natural gas commodity market and contract for pipeline transportation, storage and asset management services in order to procure and deliver affordable, reliable natural gas to their customers. AGA members have an interest in transparent and efficient financial markets for energy commodities, so that they can engage in commercial risk management activities at a reasonable cost for the benefit of America’s natural gas consumers.

¹ *Regulation Automated Trading*, 80 Fed. Reg. 78824 (Dec. 17, 2015) (“Proposed Rule”).

² For more information, please visit www.aga.org.

II. Introductory Background

In the NPRM, the CFTC proposes a series of risk controls, transparency measures, and other safeguards to enhance the regulatory regime for automated trading on U.S. designated contract markets (“DCMs”).³ Proposed Regulation AT focuses on automation of order origination, transmission and execution, and the risks that may arise from such activity.⁴ The risk controls and other rules that are proposed focus on potential risks and volatility associated with algorithmic trading on several levels – order origination, intermediary routing, and electronic execution by DCMs.⁵ The CFTC states that it believes appropriate pre-trade and other risk controls are necessary at the level of market participants, clearing futures commission merchants (“FCMs”), and DCMs, in order to ensure the integrity of Commission-regulated markets and provide market participants with greater confidence that intentional, bona fide transactions are being executed.⁶ As an overarching goal, the CFTC seeks to update its rules in response to the evolution from pit trading to electronic trading and, in particular, to reduce risk associated with algorithmic trading activity.

Proposed Regulation AT would bring all CFTC registrants under the definition of “AT Persons,” in part by amending the definition and the registration category of “floor traders” to include certain persons not currently registered with the CFTC, but who now would be required to register solely because of their use of “Algorithmic Trading” activities as defined in the NPRM. The substantial requirements that would be imposed on “floor traders” as “AT Persons” cover pre- and post-trade risk controls, development, system testing and monitoring, personnel training, and record-keeping and reporting requirements. Additionally, “AT Persons” would be required to join a registered futures association.

As users of the futures markets, AGA members support and appreciate the efforts and the amount of work the Commission and its staff have undertaken in this NPRM to bolster safeguards and risk controls in order to protect against the risk of malfunctioning algorithmic trading systems, and to increase transparency. AGA agrees that it is appropriate to update the Commission’s regulations in response to the evolution from pit to electronic trading and to ensure that the standards and practices appropriately address current and foreseeable risks arising from automated trading.

However, AGA submits that it is vitally important that any new rules promulgated as part of Regulation AT preserve, and do not negatively impact, the ability of commercial end-users to access the futures markets and use futures as part of their risk management tools. AGA is concerned that Proposed Regulation AT sweeps too broadly in its reach, and as such, may: 1) have the unintended consequence of hindering the ability of commercial end-users to efficiently and cost-effectively access the futures markets; and 2) create inconsistency and regulatory uncertainty regarding issues that commercial end-users and the Commission just recently

³ Proposed Rule at 78824.

⁴ *Id.* at 78827.

⁵ The NPRM describes that the Proposed Regulation AT rules also are intended to increase and promote transparency surrounding DCM electronic trade matching platforms, and DCM market maker and trading incentive programs and activities.

⁶ Proposed Rule at 78828.

addressed in other rules, such as margin requirements for uncleared swaps (the “Margin Rules”), and recordkeeping requirements.⁷

Simply put, AGA’s concern regards the impact of Regulation AT on its commercial end-user members that may transact in futures contracts via Direct Electronic Access (“DEA”) to a DCM for “Algorithmic Trading.” As proposed, the definitions, including “Algorithmic Trading,” “DEA,” and “floor trader,” are so broad and far reaching in scope that they may have the unintended consequence of actually discouraging companies looking to hedge their commercial risks from trading futures, particularly through the use of DEA, as commercial end-users would – with just one DEA futures transaction – fall within the definition of a “floor trader” which requires registration with the CFTC, and concurrently fall within the definition of an “AT Person” subject to all the requirements of Regulation AT. Additionally, this adverse impact potentially would impact the commercial end-user’s status under other rules that the Commission has recently adopted or amended that address concerns raised by end-users. Becoming a “floor trader” by virtue of Regulation AT may inadvertently result in commercial end-users becoming “registered members” for purposes of the CFTC’s general recordkeeping rules, specifically Rule 1.35(a). This would be an unfortunate step in the wrong direction, given that Rule 1.35 was recently amended to provide that commercial end-users, as “Unregistered Members,e” do not have to retain pre-swap-trade communications or text messages, or link all relevant data to a particular swap. Additionally, AGA is concerned that because “floor traders” fall within the defined term “financial end-users” for purposes of the CFTC’s recently-adopted Margin Rules, commercial end-users that are “floor traders,” solely because of their automated trading in futures, would be subject to margin requirements in their swap trading. Thus, the impact on commercial end-users of the definitions in Proposed Regulation AT is not insignificant.

Further, the proposed definition of DEA also appears so broad as to include tools that DCMs currently are marketing, and make available for use by commercial end-users, including AGA members. The definition of DEA could be interpreted to include these common order management tools, such as WebICE and CME Direct, even if they include DCM-administered risk controls, and notably, even if the market participant is accessing the DCM via an FCM with additional risk controls. As such, commercial end-users may not be able to use these DCM-administered tools going forward – notwithstanding that the use of these tools may result in decreased fees – due to the high cost and burden that would be associated with the Regulation AT rules. AGA submits this result is not in line with the Commission’s commitment to minimizing the burdens and costs of its regulations on commercial end-users, and therefore recommends that the Commission revise Proposed Regulation AT to address these impacts and address the proposal’s inconsistencies with other recent rules of significance to commercial end-users.

Of the 164 Requests for Comment contained in the NPRM, AGA’s comments below are limited to the proposed questions of particular concern as discussed above.

⁷ See *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, Final Rule and Interim Final Rule, 81 *Fed. Reg.* 636 (January 6, 2016,) and *Records of Commodity Interest and Related Cash or Forward Transactions*, Final Rule, 80 *Fed. Reg.* 80247 (December 24, 2015).

III. Comments

A. Definition of “Algorithmic Trading” and “Direct Electronic Access”

The Commission proposes a new Regulation 1.3(ssss) that defines the activity of “Algorithmic Trading.” This proposed term means any trading in any commodity interest as defined in 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 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.”⁸

In response to Request for Comment number 1 in the NPRM regarding the scope of the proposed definition, AGA submits that the scope of the definition of “Algorithmic Trading” is too broad in its application to “computer systems” that determine any aspect of an order, modification, or cancellation.

As proposed, the definition is so broad (including its vague reference to undefined “computer systems”) that the use of even a small amount of electronic technology, such as the use of a simple Excel spreadsheet to make commercial risk management hedging strategy decisions, may be enough to pull a commercial end-user within its scope. Moreover, once an end-user relies on a computer system at some point in its process, it would be deemed to be engaging in “Algorithmic Trading” virtually regardless of the extent of human intervention that occurs before an order is submitted.⁹ AGA submits that if there is a natural person that reviews and makes the ultimate trading decision, notwithstanding that the back office may have generated information determining one or more elements of the trade using a computer system (including a computerized spreadsheet), this activity should not bring a commercial end-user within the scope of the definition of “Algorithmic Trading” and potentially subject it to all the requirements of Regulation AT.

AGA recognizes that under Proposed Regulation AT, the definition of “Algorithmic Trading” would only be relevant to commercial end-users if they trade through DEA to a DCM.

⁸ Proposed Rule at 78839.

⁹ *Id.* at 78840 (“In sum, the only circumstance in which natural person intervention by definition would cause trading to not represent Algorithmic Trading is if the proviso in clause (2) of the definition of Algorithmic Trading were met.”).

As noted, though, the proposed definition of DEA is itself too broad. DCMs are marketing DEA to commercial end-users, and AGA's members should not be deterred from utilizing DEA if they determine it is otherwise advantageous for them because, given the overly broad definitions of "Algorithmic Trading" and "Direct Electronic Access," doing so would subject them to all the requirements imposed on "floor traders" and "AT Persons" under Proposed Regulation AT (including, among other things, requirements to maintain source code repositories and to submit annual compliance reports).

In Request for Comment number 7, the Commission states that it is considering the expansion of the definition of "Algorithmic Trading" to encompass orders that are generated using algorithmic methods, but are then manually entered into a front-end system by a natural person who determines all aspects of the routing of the orders. AGA urges that the CFTC not expand the definition of "Algorithmic Trading" in this manner, because it may have a negative impact on the futures trading hedging activities that commercial end-users, such as AGA members, may engage in. AGA is concerned that such an expansion of the Proposed Regulation AT rules to include the manual entry of trades would likely have an impact on whether and how commercial end-users use futures as part of their risk management activities. In the event that commercial end-users decrease futures trading because the costs and burdens of compliance with Regulation AT are considered too high, this could have a resulting detrimental impact on the futures markets. Given this, AGA submits that the definition of "Algorithmic Trading" as ultimately finalized should continue to fully exclude an order, modification, or order cancellation if manually entered into a front-end system by a natural person with no further discretion by a computer system or algorithm for processing on or subject to the rules of a DCM.

B. Classification as a "Floor Trader"

The CFTC proposes to amend the definition of "floor trader" in Commission Regulation 1.3(x) to require the registration of proprietary traders using DEA for "Algorithmic Trading" on a DCM, as follows:

"any person who purchases or sells futures or swaps solely for such person's own account in a place provided by a contract market for the meeting of persons similarly engaged, where such place is accessed by such person in whole or in part through DEA for Algorithmic Trading, and such person is not otherwise registered with the Commission as a futures commission merchant, swap dealer, floor broker, major swap participant, commodity pool operator, commodity trading advisor, or introducing broker."¹⁰

AGA respectfully submits that there is no reason to sweep commercial end-users into the "floor trader" definition in order to achieve the objectives that the Commission is pursuing in Proposed Regulation AT, for two reasons.

First, a commercial end-user can only utilize DEA to the extent permitted by, and subject to the terms and conditions of, the clearing FCM that clears its trades and the DCM on which it trades. Proposed Regulation AT already addresses the risks posed by DEA through the

¹⁰ *Id.* at 78846.

requirements that it would place on clearing FCMs and DCMs. That is, DCMs would be required to have systems and controls reasonably designed to facilitate an FCM's management of the risks that may arise from "Algorithmic Trading," and FCMs would be required to implement (*i.e.*, control and calibrate) such DCM-provided controls for its customers' DEA orders.¹¹ There is no doubt that the costs and burdens to "AT Persons" of compliance with Proposed Regulation AT would be significant. Commercial end-users should not be subjected to these costs and burdens – and, as a result, effectively prevented from using DEA – when Proposed Regulation AT can achieve its objectives through its provisions addressing the FCMs and DCMs that govern the end-user's DEA in the first instance.

Second, the Commission imposes various obligations on market participants where it has concluded that such obligations are appropriate under the Commodity Exchange Act ("CEA") – but without defining those market participants as "floor traders" and requiring them to register. The obligation that market participants comply with speculative position limits, and file Form 204 reports with the Commission if they hold or control reportable positions in certain agricultural commodities, any part of which constitute bona fide hedging positions – and the obligation to submit a Form 40 if they exceed large trader thresholds and receive a special call – provide a few examples. The Commission similarly could adopt rules appropriately tailored to the trading practices it is concerned about (*i.e.*, "algorithmic trading") without classifying end-users as "floor traders" – with the associated requirement to register with the Commission. The Commission need not, and should not, deem end-users to be floor traders solely because they utilize DEA for "Algorithmic Trading."

AGA therefore requests that the Commission not adopt its proposed amendment to the "floor trader" definition in Regulation 1.3(x) – which also would remove end-users from the definition of "AT Person."

If the Commission nevertheless believes that a "floor trader" regime is necessary to some degree in order for it to fulfill its regulatory responsibilities with regard to automated trading, AGA respectfully submits that the amended "floor trader" definition exclude commercial end-users.¹² Commercial end-users¹³ were not responsible for the recent disruptive events in the automated trading environment that the Commission cites in the NPRM.¹⁴ Subjecting all commercial end-users that use DEA to access the futures markets to the comprehensive and substantial requirements in Proposed Regulation AT – including the requirement to register with the Commission – would run counter to the Commission's laudable recent efforts to fine-tune its

¹¹ *Id.* at 78844 and 78861.

¹² The Commission has the authority to do so pursuant to Section 1a(23)(B) of the CEA, 7 U.S.C. § 1a(23)(B), which provides that the Commission, by rule or regulation, "may include within, or exclude from, the term 'floor trader' any person . . . if the Commission determines that the rule or regulation will effectuate the purposes of this Act."

¹³ For these purposes, we believe that the statutory end-user clearing exception provides an appropriate benchmark for defining the scope of commercial end-users that should be excluded from the "floor trader" definition. If a market participant would be eligible to elect the end-user clearing exception if it were to enter into swaps to hedge or mitigate commercial risk, it also is the type of entity that should be excluded from any amended "floor trader" definition.

¹⁴ Proposed Rule at 78837.

regulations to make sure that commercial businesses can continue to use the futures markets effectively.¹⁵ AGA notes and appreciates that it has been a priority of the Commission to make sure the overall regulatory scheme it puts in place recognizes the needs and concerns of commercial end-users, and that the overall framework is designed to minimize burdens on commercial end-users who depend on the markets to hedge normal business risks.¹⁶

Additionally, AGA's concern with respect to the proposal to amend the "floor trader" definition to include commercial end-users that use DEA for "Algorithmic Trading" is heightened by the consequences that such a classification, and the associated registration requirement, may have under other recently-adopted CFTC rules. If Regulation AT defines certain commercial end-users as "floor traders" that would be required to register, as indicated above, such registration may inadvertently result in those commercial end-users becoming "Registered Members" for purposes of the CFTC's general recordkeeping rules, specifically Rule 1.35(a). Currently, under Rule 1.35 as amended after extensive and comprehensive consideration by the Commission, "Unregistered Members" do not have to retain pre-swap-trade communications or text messages, or link all relevant data to a particular swap. There is no reason for the Commission to reach a different conclusion with regard to recordkeeping requirements for swaps, simply because a commercial end-user engaged in proprietary trading happens to use DEA for "Algorithmic Trading." Further, AGA expresses concern that once an end-user becomes a "floor trader" for purposes of Regulation AT, this may result in it being a "financial end-user" for purposes of the Commission's recent Margin Rules.¹⁷ Yet, there is no reason that an end-user's use of DEA for "Algorithmic Trading" on a DCM should have any relevance to its obligations with respect to margin on uncleared swaps. AGA submits that excluding commercial end-users from the "floor trader" definition would serve to harmonize Proposed Regulation AT with these recently-adopted CFTC rules.¹⁸

In sum: In Request for Comment number 40, the Commission seeks comment on its proposed multi-layered approach requiring pre-trade risk controls and other procedures at each of the levels of "AT Persons," clearing member FCMs, and DCMs. And in Request for Comment

¹⁵ At a minimum, if the Commission amends the floor trader definition and declines to exclude commercial end-users from that definition, it should not require such commercial end-users to register.

¹⁶ *Opening Statement, Chairman Timothy G. Massad*, Open Meeting on Proposed Rule on Margin Requirements for Uncleared Swaps and Final Rule on Utility Special Entities (September 17, 2014).

¹⁷ *Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants*, Final Rule and Interim Final Rule, 81 Fed. Reg. 636 (January 6, 2016).

¹⁸ AGA does not believe that the Commission intended Proposed Regulation AT to undermine its recently-adopted recordkeeping and margin rules. As noted in the text above, AGA believes that commercial end-users that use DEA for "Algorithmic Trading" should not be classified or have to register as "floor traders", which would eliminate the inconsistency with these other rules. However, if the Commission nevertheless concludes that commercial end-users meeting the requirements of Regulation AT must be deemed "floor traders", then at a minimum, it should create a separate category of "floor trader" solely for purposes of Regulation AT. The Commission should specifically confirm that registration in this new category of "floor trader" applies solely to Regulation AT, and does not result in an entity becoming a "floor trader" for purposes of Regulation 1.35(a) or a "financial end-user" for purposes of the Margin Rules. As noted above, this could be done by exercising the flexibility granted to the Commission under Section 1a(23)(B) of the CEA.

number 48, the Commission asks whether the requirements proposed to be imposed on “AT Persons” should vary in some manner depending on the “AT Person.” For the reasons stated above, AGA believes that the requirements of Proposed Regulation AT, including the proposed registration requirement, should not be imposed on commercial end-users that use DEA for “Algorithmic Trading.” AGA therefore requests that the “floor trader” definition not be amended as proposed, or in the alternative, that commercial end-users be excluded from any amended “floor trader” definition that ultimately is adopted. In this way, commercial end-users would fall outside the proposed definition of “AT Person,” a result consistent with the Commission’s recent efforts to minimize burdens on commercial end-users and to make sure the futures markets work for commercial end-users who use them to hedge their normal business risks.

IV. Conclusion

AGA appreciates the opportunity to provide these comments on Proposed Regulation AT and respectfully requests that the Commission consider them as it proceeds to a final rule. As stated herein, the potential impact of Proposed Regulation AT on AGA’s members is not insignificant, and absent an appropriately tailored and modified definition of “Algorithmic Trading,” there would be a strong disincentive for AGA members and other commercial end-users to use DEA for futures trading activity on or subject to the rules of a DCM. AGA also is particularly concerned about the requirement that, for the first time, commercial end-users might be deemed “floor traders” and have to register with the CFTC based solely on the manner in which they trade – and the potential for Regulation AT, if applicable, to unwind or render inapplicable many of the provisions in other rules that were put in place to limit the burden and costs for commercial end-users such as AGA members.

Respectfully submitted,

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