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Beginning in late 2019 and continuing into early 2020, the Commodity Futures Trading Commission (CFTC) was active proposing a series of new rules with potentially significant implications for all swap market participants and particularly for designated contract markets (DCMs) and swap execution facilities (SEFs). CFTC staff within the Division of Market Oversight is also reportedly considering an additional proposal, which is intended to improve regulatory standards for modern, automated financial markets. The new proposed rules and rumored proposal represent both a continuation of certain CFTC policy positions, while offering new perspectives geared towards increasing market transparency, ensuring market integrity and improving the CFTC's and regulated exchanges' tools for reducing risks.

In this article, we provide an overview of two of the CFTC's recent proposed rules: a new position limits regime and proposed rules to preclude the use of post-trade name give-up practices on SEFs. This article also highlights CFTC staff's recent efforts to develop a new proposal focused on automated trading, while providing a brief history of the CFTC's prior rulemaking efforts in this area. Specifically, we consider the stated reasoning behind each proposal and the CFTC's development of its current policy positions, as well as its responses to concerns with past proposals.

The new CFTC rulemaking proposals offer insight into the agency's larger strategic plan, and provide market participants with new considerations for their business and compliance plans looking forward into 2020 and beyond.

- **Section I**: Position Limits Proposal Summary
- **Section II**: Post-Trade Name Give-Up Proposal Summary
- **Section III**: Summary of CFTC Regulation AT Proposals and Its Development of a New Proposal

I. Position Limits Proposal Summary

Introduction

On January 30, 2020, the Commodity Futures Trading Commission (CFTC) approved for publication in the *Federal Register* proposed federal rules (the "Current Proposal") regarding position limits for derivatives contracts on certain commodities.[1] Position limits are authorized by the Commodity Exchange Act (CEA),[2] as amended by Title VII of the Dodd–Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act).[3] The Current Proposal is the latest in a line of numerous attempts by the CFTC to establish such position limits, including a prior set of final rules approved in 2011 but later vacated by the US District Court for the District of Columbia.[4] Public comments on the Current Proposal are due by April 29, 2020. If adopted, market participants would be required to comply with the new position limit regime by one year after publication of the final rule in the *Federal Register*.

In issuing the Current Proposal, the CFTC has indicated that it aims to: (1) recognize and accordingly tailor position limits to address differences in various commodities and commodity derivatives contracts; (2) focus on derivatives contracts "that are critical to price discovery and distribution of the underlying commodity" to help avoid excessive speculation in contracts having "a particularly acute impact on

[1] The Current Proposal was approved in a 3-2 vote, with dissents from Commissioners Behnam and Berkovitz. For a PDF copy of the Current Proposal, *see* Press Release No. 8112-20, Commodity Futures Trading Commission, CFTC Approves Two Proposed Rules at January 30 Open Meeting: Position Limits Proposal Advances After Long Delay (Jan. 30, 2020), https://www.cftc.gov/PressRoom/PressReleases/8112-20.

[2] *See* 7 U.S.C. § 1 *et seq*.

[3] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010), https://www.govinfo.gov/content/pkg/PLAW-111publ203/pdf/PLAW-111publ203.pdf.

[4] In the text of its rule proposal, the CFTC indicated the Current Proposal was the fifth in a line of proposals focused on position limits since the enactment of the Dodd-Frank Act. According to this view, relevant prior proposals include: the rules proposed and finalized in 2011 (Position Limits for Derivatives, 76 Fed. Reg. 4752 (Jan. 26, 2011) (the "2011 Rules")) (which were later vacated by *Int'l Swaps & Derivatives Ass'n v. CFTC*, 887 F. Supp. 2d 259 (D.D.C. 2012)); newly proposed rules in 2013 (Position Limits for Derivatives, 78 Fed. Reg. 75680 (Dec. 12, 2013) (the "2013 Proposed Rules")); supplemental guidance in 2016 (Position Limits for Derivatives: Certain Exemptions and Guidance, 81 Fed. Reg. 38458 (June 13, 2016)); and re-proposed rules in 2016 (Position Limits for Derivatives, 81 Fed. Reg. 96704 (Dec. 30, 2016) (the "2016 Proposed Rules")). *See* Current Proposal at 5-6. However, if one counts *all* relevant rulemaking proposals, the Current Proposal would be the seventh in line because that list would include the two proposals addressing aggregation of positions for purposes of compliance with position limits — a 2013 initial proposal (77 Fed. Reg. 68946 (Nov. 15, 2013)) and the supplemental (and subsequently finalized) proposed rules from 2015 (80 Fed. Reg. 58365 (Sept. 29, 2015)). If one considers only proposals that embody revised numeric position limits, the current proposal is the fourth proposal, following the 2011 Rules, the 2013 Proposed Rules, and the 2016 Proposed Rules. No matter how viewed, however, there have been many proposals related to position limits since the passage of the Dodd-Frank Act in 2010.

interstate commerce" for such commodity; and (3) leverage expertise and processes at designated contract markets (DCMs) to "reduce duplication and inefficiency."[5]

Summarized below are key components of the Current Proposal, organized into five general categories:

1. new concepts and definitions impacting position limits more generally;
2. position limits themselves;
3. bona fide hedging and other exemptions from federal position limits;
4. changes to cash-market position reporting; and
5. legal matters (i.e., the "necessity" finding).

Note that the discussion herein is intended as an overview of certain aspects of the Current Proposal and is not intended to be a comprehensive analysis of every aspect of the Current Proposal.

Current Proposal

New Concepts and Definitions Impacting Position Limits More Generally

Today, futures contracts on only nine commodities are subject to federal position limits. Separate limits are set for the spot month and non-spot months, as well as for all months combined. These legacy futures contracts all reference agricultural products.[6] The Current Proposal would expand this core futures list to cover an additional 16 contracts, including seven new agricultural contracts, four energy contracts and five metals contracts, for a total of 25 covered contracts.[7]

Under the Current Proposal, position limits would also apply to any contract that is directly or indirectly linked to, or that has a pricing relationship with, a core referenced futures contract, including cash-settled futures contracts and "economically equivalent" swaps. These contracts, along with the core legacy contracts, are broadly defined in the Current Proposal as "referenced contracts."[8] Four types of contracts are specifically excluded from the definition of referenced contract: (1) location basis contracts; (2) commodity index contracts; (3) swap guarantees; and (4) trade options.[9] Should the Current Proposal

[5] Current Proposal at 7.
[6] These legacy commodity contracts are CBOT Corn (C), CBOT Oats (O), CBOT Soybeans (S), CBOT Wheat (W), CBOT Soybean Oil (SO), CBOT Soybean Meal (SM), MGEX Hard Red Spring Wheat (MWE), ICE Cotton No. 2 (CT), and CBOT KC Hard Red Winter Wheat (KW). *See* 17 C.F.R. § 150.2; Current Proposal at 11.
[7] The non-legacy contracts included in the Current Proposal are CBOT Rough Rice (RR), ICE Cocoa (CC), ICE Coffee C (KC), ICE FCOJ-A (OJ), ICE U.S. Sugar No. 11 (SB), ICE U.S. Sugar No. 16 (SF), CME Live Cattle (LC), COMEX Gold (GC), COMEX Silver (SI), COMEX Copper (HG), NYMEX Platinum (PL), NYMEX Palladium (PA), NYMEX Henry Hub Natural Gas (NG), NYMEX Light Sweet Crude Oil (CL), NYMEX New York Harbor ULSD Heating Oil (HO), and NYMEX New York Harbor RBOB Gasoline (RB). *See* Current Proposal at 11.
[8] *See id*. at 10.
[9] *See id*. at 91.

be finalized, the CFTC anticipates maintaining an up-to-date, non-exhaustive list of referenced contracts on its website; the CFTC previously published "workbooks" on this subject alongside prior rule releases and has indicated it will do so again in support of the Current Proposal.[10]

As noted above, economically equivalent swaps are considered referenced contracts and are thus subject to the Current Proposal's position limits regime. Economically equivalent swaps are swaps that have identical "material" contractual specifications, terms and conditions with a referenced contract.[11] As such, any differences with respect to terms that are not deemed to be material would thus be disregarded in determining whether a particular swap meets this definition.[12] The Current Proposal provides that this determination of materiality is at the discretion of market participants, as long as they exercise "reasonable, good-faith effort" in making any such determination.[13]

Unsurprisingly, the Current Proposal also contains a generally applicable anti-evasion provision. According to the Current Proposal, the purpose of this provision is to prevent "willful evasion of federal position limits."[14]

Position Limits Themselves

Under the Current Proposal, the nine legacy referenced contracts would continue to be subject to federal limits in both the spot and non-spot months, as well as combined for all months. However, these limits would increase substantially for most contracts.[15] Non-spot limits would be set at 10 percent of open interest for the first 50,000 contracts and then 2.5 percent open interest thereafter.[16] The Current Proposal only contains spot month limits for the other 16 referenced contracts, though DCMs will be required to establish limits or accountability levels outside the spot month for these contracts.[17] A higher "conditional" position limit for spot month cash-settled NYMEX Henry Hub Natural Gas (NG) contracts is

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[10] *See id*. at 95.
[11] Examples of such material provisions include the underlying commodity, maturity or termination dates, settlement type, and delivery specifications (for physically settled contracts). *See id*. at 77.
[12] Examples of disregarded provisions include lot size or notional amount, delivery dates diverging by less than one calendar day (two calendar days for natural gas), post-trade risk management arrangements (such as those relating to clearing or margin), business day or holiday conventions, and choice of law. *See id*. at 78, 80.
[13] *Id*. at 79-80.
[14] The Current Proposal includes three different examples of trading strategies or structures that could be violations of the anti-evasion provision, one of which explicitly provides that a swap contract designed to evade position limits would be deemed "economically equivalent" and thus a referenced contract. *See id*. at 142-43.
[15] With respect to spot month limits, the only legacy contract for which the limit remains unchanged is CBOT Oats (O). *See id*. at 107-08. With respect to non-spot month and all months' limits, the limit for CBOT Oats (O) is again unchanged, as are the limits for KC Hard Red Winter Wheat (KCW) and MGEX Hard Red Spring Wheat (MWE). *See id*. at 124.
[16] *See id*. at 125.
[17] *See id*. at 122.

available to market participants who do not hold or control any spot month physically settled NYMEX NG positions.[18]

All proposed spot month limits have been set at levels that are equal to or less than 25 percent of the total deliverable supply for such commodity, which supply figure has been estimated from data provided by the relevant DCMs.[19] All spot month limits are separately calculated with respect to cash-settled and physically settled positions; as such, in the spot month, a person can net positions within but not across each settlement category.[20] There is no such distinction for non-spot month limits, so cash-settled and physically settled positions can be netted against each other. Relevant futures equivalent positions would be calculated by combining a person's futures, options on futures and economically equivalent swaps positions.

With respect to contracts that are subject to federal position limits, DCMs may not establish spot month exchange-set limits that are higher than applicable federal limits; with respect to any commodity contract that is not otherwise subject to federal position limits, DCMs are authorized to establish spot and/or non-spot limits or accountability levels.[21]

Bona Fide Hedging and Other Exemptions from Federal Position Limits

The Current Proposal contains a revised definition of bona fide hedging. Substantively, the most important changes include: (1) the removal of the concept of "risk management" hedging as covered by the definition, since the CFTC is interpreting that bona fide hedges must always be in connection with the production, sale or use of a physical, cash-market commodity;[22] (2) the explicit acknowledgment that term "risks" as used in the definition only applies to pricing risk;[23] (3) the elimination of the incidental trading test, the orderly trading requirement and the so-called "five-day" rule (which in its current form prevents hedgers from electing an exemption for certain enumerated edges in physical delivery contracts during the last five days of trading in the spot month — per the Current Proposal, DCMs could choose if and in which instances to keep this rule in place);[24] and (4) the inclusion of pass-through swaps as bona fide hedges, provided that the non-hedging party (a) can demonstrate that the swap is a bona fide pass-through and (b) enters into the offset swap to reduce price risk attendant to the pass-through swap.[25]

The Current Proposal also includes an expanded list of enumerated hedges. These enumerated hedges are automatically considered to be bona fide and are self-effectuating at the federal level, meaning that

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[18] *See id*. at 163.
[19] *See id*. at 111.
[20] *See id*. at 145-46.
[21] *See id*. at 177, 186.
[22] *See id*. at 36-37.
[23] *See id*. at 39.
[24] Per the Current Proposal, DCMs could choose if and in which instances to keep the "five-day" rule in place. *See id*. at 41-42, 61-62.
[25] *See id*. at 68.

positions that meet one of the enumerated hedges would not count toward federal position limits with respect to that contract.[26] There are 11 enumerated hedges in the Current Proposal, five of which are new, while most of the other six are subject to some limited modifications compared to their current forms. The five new enumerated hedges are short hedges of anticipated mineral royalties, hedges of anticipated services, hedges by agents, offsets of commodity trade options, and hedges of anticipated merchandising.[27] The six existing enumerated hedges that would remain valid as bona fide hedges would be somewhat revised from their existing definitions — these enumerated hedges include hedges of unsold production, hedges of offsetting unfixed-price cash commodity sales and purchases, cross-commodity hedges, hedges of inventory and cash commodity fixed-price purchase contracts, hedges of cash commodity fixed-price sales contracts and hedges of unfilled anticipated requirements.[28]

Beyond enumerated hedges, the Current Proposal establishes a procedure by which market participants can request exemptive recognition for other bona fide hedges. Such exemptive relief can be requested either directly from the CFTC or from a DCM. In the case of exemptions requested from DCMs, a streamlined process applies — upon approval by the DCM of an application for hedging treatment, the trader can immediately benefit from such hedge treatment at the relevant exchange, and the hedge remains a valid exemption unless the CFTC Commissioners vote to overturn the DCM's approval, which the Commissioners must do within 10 days of such approval (two days under expedited procedures, which are available for exigent circumstances).[29] After this period, the non-enumerated hedge exemptions are available at the federal level, absent CFTC reversal.

In evaluating their positions against federal position limits, the Current Proposal provides that market participants can measure their risk on either a gross or net basis. However, they must do so consistently and cannot use this flexibility as a means to evade federal position limits.[30]

Changes to Cash-Market Position Reporting

Existing regulations require market participants that hold bona fide hedging positions in excess of the position limits for the legacy contracts to justify those overages by filing either Form 204 or Form 304 (the latter being used for cotton positions). The Current Proposal would eliminate Form 204 and Parts 1 and 2 of Form 304, which pertains to fixed-price positions in cotton.[31] Instead, the CFTC proposes that it would receive monthly data on hedging recognitions and exemptions via reporting by DCMs.[32]

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[26] Exchange-set limits must be considered separately, and thus exemptions from those limits would need to be requested from the exchange. *See id*. at 153.
[27] For further details on each of these hedges, *see id*. at 479-82 (Appendix A).
[28] *See id*.
[29] *See id*. at 204-05.
[30] *See id*. at 65.
[31] *See id*. at 221.
[32] *See id*. at 224. It is not clear from the Current Proposal what equivalent information DCMs receive on an ongoing basis. No additional information collection from market participants would be required by DCMs under the Current Proposal.

Legal Matters (i.e., the "Necessity" Finding)

As discussed at length in the Current Proposal, the CFTC has preliminarily interpreted Sections 4a(a)(1) and 4a(a)(2) of the CEA as requiring that the CFTC establish position limits as it "finds are necessary to diminish, eliminate, or prevent" certain enumerated burdens on interstate commerce.[33] Thus, in issuing the Current Proposal, the CFTC asserts that it has made this required finding to support the establishment of speculative position limits with respect to the 25 core referenced contracts (and the referenced contracts therewith).[34]

Each CFTC Commissioner, including the two dissenters, issued a statement in connection with the Current Proposal. These statements demonstrate the differing views within the Commission over how to approach the required necessity determination, which ultimately derives from somewhat ambiguous wording in the CEA[35] and from unclear language in the court decision that vacated the CFTC's first effort to revise its position limits regime in 2011.[36] It is apparent that reasonable people can fairly disagree on the precise meaning or legal standard underlying this "necessity" determination.

Final Rule Timing?

As CFTC Chairman Tarbert acknowledged in his statement supporting the Current Proposal, the CFTC has "grappled with position limits for a decade," noting that the Current Proposal is "the culmination of 10 years of effort across four Chairmen's tenures."[37] Chairman Tarbert, in particular, has shown a distinct interest in closing the book on the position-limits saga — in a recent *Bloomberg TV* interview, he indicated that he plans to finalize the proposed rules later this year.[38] It remains to be seen whether this goal can be accomplished in an election year, but it seems likely that there will be more developments on this issue in the near term.

[33] *Id*. at 232.
[34] *Id*. at 253.
[35] *See* 7 U.S.C. § 6a(a).
[36] *See Int'l Swaps & Derivatives Ass'n v. CFTC*, 887 F. Supp. 2d 259 (D.D.C. 2012).
[37] Heath P. Tarbert, Chairman, CFTC, Statement in Support of Proposed Rule on Speculative Position Limits (Jan. 30, 2020), https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement013020.
[38] Ben Bain, *U.S. to Propose Oil Speculation Rule This Month: CFTC's Tarbert*, Bloomberg Law, Jan. 13, 2020, https://news.bloomberglaw.com/securities-law/u-s-to-propose-oil-speculation-rule-this-month-cftcs-tarbert.

II. Post-Trade Name Give-Up Summary

Introduction

On December 18, 2019, the Commodity Futures Trading Commission (CFTC) issued a request for comment on a proposed rule (2019 Proposal) that, if adopted, would prohibit "post-trade name give-up" (PTNGU) practices related to trading on swap execution facilities (SEFs).[39] The 2019 Proposal follows the CFTC's consideration of comments received in response to its November 2018 request for comment regarding the practice (2018 Release).[40] Below, we provide an overview of the CFTC's proposed rule, current industry criticisms and the potential for CFTC exemptions to the restriction on PTNGU.

What Is Post-Trade Name Give-Up and Why Does the CFTC Want It Prohibited?

PTNGU is the practice where some SEFs disclose or cause to be disclosed the identity of each swap counterparty to the other after a swap transaction has been matched anonymously on a SEF and submitted for clearing to a derivatives clearing organization (DCO).[41] A SEF may facilitate this disclosure through either its own trade protocols or through a third-party service provider that it utilizes to process and route transactions to a DCO for clearing.[42]

The practice of PTNGU originates in anonymous markets for uncleared swaps and pre-dates the impartial access mandate of the Dodd-Frank Wall Street Reform and Consumer Protection Act.[43] Participants in an anonymous, uncleared swaps market reasonably need to limit the firms with which they may trade to manage counterparty credit risk. Consistent with record keeping requirements, a firm is required to record each new bilateral swap with a given counterparty on their books and requiring participants to learn the identity of the counterparty with whom they were matched.

Proposed CFTC rule § 37.9(d), if adopted, would prohibit a SEF from directly or indirectly (including through third-party service providers) disclosing the identity of a counterparty to a swap that is executed anonymously and intended to be cleared.[44] The proposed regulation would also require SEFs to establish

[39] 84 Fed. Reg. 72262 (Dec. 31, 2019) ("2019 Proposal").
[40] 83 Fed. Reg. 61571 (Nov. 30, 2018) ("2018 Release").
[41] 2019 Proposal at 72262-63.
[42] *Id.* at 72263.
[43] *See* Managed Funds Association, MFA Position Paper: Why Eliminating Post-Trade Name Disclosure Will Improve the Swaps Market (Mar. 31, 2015), *available at* https://www.managedfunds.org/wp-content/uploads/2015/04/MFA-Position-Paper-on-Post-Trade-Name-Disclosure-Final.pdf.
[44] 2019 Proposal at 72262-63.

and enforce rules that prohibit any person from effectuating such a disclosure.[45] As drafted, the prohibition would not apply to uncleared swaps or with respect to any method of execution whereby the identity of a counterparty is disclosed prior to execution (such as a disclosed request-for-quote system).[46]

Criticisms of the Proposal

On November 30, 2018, the CFTC issued an initial request for comment on a proposed rule to prohibit PTNGU.[47] The 2018 Release noted that the PTNGU negatively effects marketwide competition by deterring some market participants from trading on SEF platforms that employ the practice.[48] While the CFTC acknowledged that the practice may be necessary to trading in uncleared swaps, the CFTC found that the processes of clearing and straight-through processing would make PTNGU unnecessary for cleared swaps.[49]

The 2018 Release received diverging comments from market participants, largely depending on the market participants' roles within the market as either a liquidity provider or a liquidity taker. Generally buy-side firms took the position that PTNGU may deter some market participants from trading on SEFs that employ this practice, due to concerns about "information leakage" that could potentially expose a market participant's trading positions, strategies and objectives.[50]

In contrast, liquidity providers (i.e., swap dealers) in general took the view that PTNGU is necessary because PTNGU may have efficiency benefits in specific situations and therefore should not be subject to an outright ban.[51] These market participants have contended that, in fact, PTNGU may promote swap liquidity and accurate pricing because, among other things, it permits swap dealers to manage risk and

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[45] *Id.* at 72262-63.
[46] *Id*. at 72265.
[47] 83 Fed. Reg. 61571 (Nov. 30, 2018)
[48] 2018 Release at 61571-72. The CFTC acknowledged that the practice may be necessary and serve a purpose such as to manage counterparty credit risk for market participants trading in uncleared swaps. For uncleared swaps, post-trade name give-up enables a market participant to perform a credit-check on a potential counterparty prior to finalizing the transaction. Due to the bilateral nature of an uncleared swap agreement, the practice also allows counterparties to manage credit exposure and payment obligations with respect to those transactions.
[49] 2019 Proposal at 72265
[50] *See* Better Markets, Prohibition of Post-Trade Name Give-Up on Swap Execution Facilities (RIN 3038-AE79) (Mar. 2, 2020), *available at* https://bettermarkets.com/sites/default/files/Better_Markets_Comment_Letter_on_Post-Trade_Name_Give-Up_on_Swap_Execution_Facilities%28RIN_3038-AE79%29%28March_2_2020%29.pdf.
[51] *See* Securities Industry and Financial Markets Association, Comment Letter on Post-Trade Name Give-Up on Swap Execution Facilities; Proposed Rule-RIN 3038-AE79, 84 Fed. Reg. 72262 (Dec. 31, 2019), *available at* https://www.sifma.org/wp-content/uploads/2020/03/SIFMA-Comment-on-Post-Trade-Name-Give-Up-on-SEFs-Proposal-RIN-3038%E2%80%93AE79.pdf.

minimizes spread by maximizing execution choice in assessing how swap liquidity and underlying capital is allocated among various clients.[52]

Potential Exemptions Discussed in the 2019 Proposal

In the 2019 Proposal, the CFTC aims to adopt a rule that promotes competition and liquidity, but remains open to the possibility that the proposed rule requires exemptions tailored to specific issues. In particular, the CFTC requested comment on 17 specific questions, in addition to a general request for comments on whether the proposed rule would advance the statutory and regulatory goals and requirements discussed in the release.[53] The questions relate to, among other things, how the rule would affect liquidity and pricing and whether the rule should apply to so-called "package transactions" in which a cleared swap is a component of a larger transaction that includes an uncleared swap component or a non-swap instrument component (such as Treasury securities).[54] The deadline for comments was March 2, 2020.

In comment letters submitted in response to the 2019 Proposal, industry members have suggested the CFTC moderate their proposed rule and allow for greater market participant flexibility following considerations such as counterparty consent to PTNGU as well as provide clear exemptions for package transactions involving non-swap instruments.

On February 19, 2020, the CFTC issued a request for comment on a proposed amendment (2020 Amendment) to Proposed CFTC rule § 37.9(d) creating a specific exemption for certain package transactions with the goal of "allow[ing] market participants to choose the most suitable execution method."[55] The 2020 Amendment suggests a continuing openness by the CFTC to engage with market participants in creating flexibility where PTNGU may be beneficial for SEFs.

The CFTC is expected to respond to comments on the 2019 Proposal in the near future, and we will continue to actively monitor developments on this topic.

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[52] *See* American Bankers Association, Comments to CFTC re Post Trade Name Give Up on Swap Execution Facilities (Mar. 2, 2020), *available at* https://www.aba.com/-/media/documents/comment-letter/cftc-post-trade-name-give-up-on-sefs-030220.pdf?rev=bf313718037942eaa59a288a32fc3b27.
[53] *See* Securities Industry and Financial Markets Association, Comment Letter on Post-Trade Name Give-Up on Swap Execution Facilities; Proposed Rule-RIN 3038-AE79, 84 Fed. Reg. 72262 (Dec. 31, 2019), *available at* https://www.sifma.org/wp-content/uploads/2020/03/SIFMA-Comment-on-Post-Trade-Name-Give-Up-on-SEFs-Proposal-RIN-3038%E2%80%93AE79.pdf.
[54] 85 Fed. Reg. 9407 (Feb. 19, 2020). The CFTC would consider a transaction to be a package transaction if (i) execution of each component transaction is contingent upon the execution of all other component transactions and (ii) all component transactions are priced or quoted together as part of one economic transaction with simultaneous or near-simultaneous execution of all components. In order to qualify for an exception from the prohibition on pre-execution communications away from a SEF, a package transaction must include at least one component transaction that is not subject to the trade execution mandate. 85 Fed. Reg. 9412.
[55] 85 Fed. Reg. 9412-13.

III. Summary of CFTC Regulation AT Proposals and Its Development of a New Proposal

Introduction

In November 2015, the Commodity Futures Trading Commission (CFTC) proposed Regulation Automated Trading (Regulation AT),[56] which would impose many new obligations on certain CFTC registrants that use algorithmic trading systems to trade futures, options or swaps on designated contract markets (Initial Proposal).[57] The Initial Proposal was met by strong industry opposition to, among other elements, the rules' heavily prescriptive requirements including the CFTC's handling of the proprietary source code of algorithmic trading systems. In response, the CFTC issued a revised supplemental in November 2016 (Supplemental Proposal). The Supplemental Proposal too was criticized by the industry as failing to address many concerns in the Initial Proposal. By October 2018, former CFTC Chairman J. Christopher Giancarlo announced that the proposal was officially "dead."[58]

Below, we provide an overview of the Initial Proposal and Supplemental Proposal, then analyze the status and implications for potential future rulemaking.

What Is Regulation AT? The CFTC's Initial Proposed Rulemaking

As presented in the 517-page release, the goal of the Initial Proposal was to federally codify industry best practices by adopting "a comprehensive approach to reducing risk and increasing transparency in automated trading."[59] At a high level, the Initial Proposal attempted to achieve this goal through requiring the registration of persons that engage in "algorithmic trading"[60] using "direct electronic access" (DEA),[61] standardized pre-trade risk controls, transparency

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[56] Proposed Regulation Automated Trading, 80 Fed. Reg. 78824 (Dec. 17, 2015) ("Proposed Rulemaking Release"), *available at* https://www.cftc.gov/sites/default/files/idc/groups/public/@newsroom/documents/file/federalregister112415.pdf.
[57] The CFTC noted that at this time, Regulation AT does not address trading on swap execution facilities (SEFs); however, "the requirements for DCMs arising out of Regulation AT may ultimately be imposed on SEFs." 80 Fed. Reg. at 78827 n.14.
[58] Remarks of Chairman J. Christopher Giancarlo, CFTC (Oct. 17, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo58.
[59] Proposed Rulemaking Release at 2.
[60] "Algorithmic trading" is broadly defined to mean trading in any commodity interest on or subject to the rules of a designated contract market (DCM), where: 1) one or more computer algorithms or systems determine whether to initiate, modify or cancel an order, or otherwise makes determinations with respect to an order; and 2) such order, modification or order cancellation is electronically submitted for processing on or subject to the rules of a DCM.
[61] "Direct electronic access" is defined to mean an arrangement where a person electronically transmits an order to a DCM, without the order first being routed through a separate person that is a member of a derivatives clearing organization to which the DCM submits transactions for clearing.

measures and other safeguards. Under the Initial Proposal, three categories of participants were to be principally regulated: AT Persons, clearing futures commission merchants (FCMs) and designated contract markets (DCMs).

Much of the focus of Regulation AT was on new or additional regulatory requirements for AT Persons.[62] Under the Initial Proposal, an entity would become an AT Person, intentionally or unintentionally, if such entity engaged in algorithmic trading and fell into one of two categories: (1) certain existing CFTC registrants (FCMs, floor brokers, swap dealers, major swap participants, commodity pool operators, commodity trading advisors and introducing brokers (collectively, the "Enumerated Registrants")); or (2) persons not otherwise registered with the CFTC as Enumerated Registrants that are engaged in algorithmic trading for their own account using DEA.[63]

With respect to the second category, the CFTC's proposed rules would mandate the registration with the CFTC as a floor trader any person who uses an algorithmic trading system that electronically and directly routes orders to a DCM other than first through a clearing member FCM, unless such person is otherwise registered with the CFTC in another capacity.[64] Initially, the CFTC estimated that there would be a maximum of 100 potential new floor trader registrants under this proposed new requirement.[65] However, this estimate was met with skepticism by market participants, who asserted that the number of AT Persons would likely be much higher.

In the Initial Proposal, the CFTC defined algorithmic trading broadly, including any computer algorithm or system that determines whether to initiate, modify or cancel an order where such order is electronically transmitted to the DCM.[66] The proposed definition would capture nearly all forms of automated trading, from the highly sophisticated proprietary trading firms and financial institutions to small market participants using off-the-shelf automated systems.[67] Under the CFTC's proposal, algorithmic trading would not include the manual entry of orders into a front-end system initially derived by an automated trading system.[68]

Where an entity has AT Person status under Regulation AT they would be obligated to fulfill four major requirements: (1) trade controls and monitoring; (2) developing and testing standards; (3) compliance reports; and (4) source code repository maintenance and regulator access.

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[62] Proposed CFTC Rule § 1.3(xxxx) (defining the term "AT Persons").
[63] Proposed Rulemaking Release at 76-78.
[64] *See id.* at 76-78.
[65] *Id.* at 93.
[66] Proposed CFTC Rule § 1.3(ssss) (defining the term "algorithmic trading").
[67] Proposed Rulemaking Release at 66 ("The Commission notes that even if a computer algorithm or system makes one or more determinations with respect to an order (such as product, timing, price or quantity), the submission of the order would not constitute Algorithmic Trading if every parameter or attribute of the order 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.").
[68] *See Bridging the Week* by Gary DeWaal: November 30, 2015 (CFTC's Proposed New Algorithmic Trading Rules Augur Potential Increased Obligations and Costs and a New Registration Requirement (includes My View)), *available at* https://www.bridgingtheweek.com/Commentary/PrintCommentary/2387.

1. Trade Controls and Monitoring

An AT Person would be required to have pre-trade risk controls in place that are "reasonably" designed to prevent issues and disruptions caused by algorithmic trading, also known in the rule as an "algorithmic trading event."[69] Under proposed Regulation AT, an algorithmic trading event occurs when there is a compliance breach of any magnitude or an operational breakdown that is disruptive at any level or that constitutes a "material" degradation.[70] An algorithmic trading event is formally defined as an "algorithmic trading compliance issue" or an "algorithmic trading disruption."[71] Specific required controls include maximum limits on order messages and execution frequency, maximum order size and price parameters and order cancellation systems.[72] Additionally, Regulation AT would require "trained and qualified staff" to conduct continuous and real-time monitoring of these controls during trading sessions and to have the authority to implement controls, such as order kill switches, when needed.[73]

2. Developing and Testing Standards

An AT person would be required to have policies and procedures that meet certain standards for the development, testing and maintenance of algorithmic trading systems. The development standards would require documentation of software design and a development environment that is adequately isolated from production.[74]

3. Compliance Reports

Each AT person would be required to submit an annual compliance report to any DCM where it algorithmically trades.[75] This report would have to describe the firm's pre-trade risk controls and contain relevant compliance policies and procedure. Prior to submission, the AT Person's CEO or CCO would be required to certify that the report is accurate and complete.

4. Source Code Repository Maintenance and Regulator Access

Finally, and most controversially,[76] all current categories of CFTC registrants that engage in algorithmic trading and newly required to be registered floor traders would be required to maintain copies of all source

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[69] Proposed Rule § 1.3(uuuu) defines an "algorithmic trading disruption" as an event originating with an AT Person that disrupts, or materially degrades, (i) the algorithmic trading of such AT Person, (ii) the operation of the DCM on which such AT Person is trading, or (iii) the ability of other market participants to trade on the DCM on which such AT Person is trading.
[70] *See* Proposed Rulemaking Release at 70-72.
[71] *See id.* at 73.
[72] *Id.* at 93.
[73] *Id.* at 133-134.
[74] *Id.* at 135-143.
[75] *Id.* at 161-62.
[76] *See Bridging the Week* by Gary DeWaal: March 14-18, and 21, 2016 (Regulation AT; Equivalence Recognition; Fund Manager Misstatements; Conflicts of Interst; Trade Options), *available at*

code used in a production environment, including all changes, in accordance with general CFTC record keeping requirements (e.g., retain for five years) and, upon request, make available such source code for inspection by CFTC and US Department of Justice staff without subpoena or other process of law.[77]

The Initial Proposal garnered extensive comment and criticism. Although industry group responders generally approved of the CFTC's objective of ensuring robust controls, transparency measures and other safeguards to mitigate risks arising from algorithmic trading on DCMs, the majority of comment letters criticized the proposed rules as being too prescriptive. Specifically, many industry participants emphasized that because source code is often extremely valuable intellectual property, so much so that it is the "lifeblood of many firms' commercial success," mandating access to the source code has negative implications both commercially and constitutionally.[78]

Following the request for comment, the CFTC held a staff roundtable on Regulation AT on June 10, 2016, seeking additional feedback on a number of issues in the Initial Proposal, including: (1) whether the definition of AT Person should be subject to a quantitative threshold so as not to impact more market participants than was appropriate; (2) whether the definition of DEA was overly broad; (3) the appropriate entities on which to impose pre-trade risk control and development, testing and monitoring requirements; (4) source code access and retention; and (5) the ability of AT Persons using third-party algorithms or systems to comply with Regulation AT.[79]

The Supplemental Proposal

In November 2016, the CFTC issued a Supplemental Proposal that attempted to resolve some of the more contentious critiques of the Initial Proposal.[80] The CFTC's Supplemental Proposal contained six broad modifications to the Initial Proposal:

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https://www.bridgingtheweek.com/Commentary/PostDetails/2403#RegulationAT; *see also* Remarks of CFTC Chairman Timothy Massad (Mar. 16, 2016), https://www.cftc.gov/PressRoom/SpeechesTestimony/opamassad-44.

[77] Proposed CFTC Rule § 1.31.

[78] *See* CFTC, Statement of Dissent by Commissioner J. Christopher Giancarlo Regarding Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading (Nov. 4, 2016), http://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110416 (noting the lack of specific confidentiality protections for source would deprive intellectual property owners of due process of law); s*ee, e.g.*, Protect Source Code to Protect Innovation in Markets, FIA Principal Traders Grp. (Apr. 21, 2016, 7:15 pm), https://ptg.fia.org/articles/protect-source-code-protect-innovation-markets.

[79] *See Bridging the Week* by Gary DeWaal: June 1, 2016 (CFTC to Hold Public Roundtable Regarding Regulation AT; Five Topics to be Discussed Including Who Should be Covered), *available at* https://www.bridgingtheweek.com/Commentary/PostDetails/2414#.Xl1RFahKi70.

[80] Regulation Automated Trading, 81 Fed. Reg. 85334 (Nov. 25, 2016) ("Supplemental Rulemaking Release") *available at* https://www.cftc.gov/sites/default/files/idc/groups/public/@lrfederalregister/documents/file/2016-27250c.pdf.

1. Risk Controls at Two Not Three Levels

In the Initial Proposal, the CFTC required risk controls to be maintained at three levels: DCMs, FCMs and so-called "AT Persons." The Supplemental Proposal would require that risk controls only be maintained at DCMs and either by FCMs or AT Persons — but not both.[81] Under this system, an AT Person could choose to delegate compliance with risk control requirements to its FCM (with the FCM's consent). The two-tier structure would replace the three-tier structure proposed in Regulation AT and expand its risk control requirements to encompass algorithmic trading and electronic trading, including electronic trading at the FCM and DCM levels.[82]

2. Volume-Based Quantitative Threshold to Be Used to Determine Floor Broker Registration Requirement and AT Person Determination

As first proposed, Regulation AT would require the registration of persons as Floor Traders if they engaged in so-called algorithmic trading for their own accounts through direct electronic access on a DCM and they were not registered with the CFTC in any one of certain enumerated capacities.[83] The Floor Trader registration requirement is continued in the Supplemental Proposal. However, the registration requirement would only apply to an otherwise relevant non-registered person if the person trades 20,000 or more contracts in aggregate across all DCMs on an average daily basis during the prior six-month counting period.[84]

3. CFTC Inspection of Source Code and Obligations of AT Persons for Third-Party Provided Algorithmic Trading Systems

In the Initial Proposal, the CFTC sought to require that all AT Persons maintain their algorithmic trading source code in a special repository and be required to make such source code available — whether proprietary or third party developed. In Supplemental Proposal, the CFTC would require all AT Persons to retain algorithmic trading source code and certain ancillary records in their native format for five years, but eliminates the requirement to maintain source code in a special repository.[85] The CFTC retains the ability,

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[81] Supplemental Rulemaking Release at 85336.
[82] *See* CFTC, Fact Sheet – Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading (2016), http://www.cftc.gov/idc/groups/public/@newsroom/documents/file/regat_factsheet110316.pdf.
[83]Supplemental Rulemaking Release at 85340 (i.e., an FCM, floor broker, swap dealer, major swap participant, commodity pool operator, commodity trading advisor or introducing broker).
[84] *Id.* at 85340 (i.e., January 1 through June 30 or July 1 through December 31). Traded contracts only include "consummated transactions" according to the CFTC's SNPRM. The 20,000 contracts volume threshold test would also apply to existing enumerated registrants who engage in algorithmic trading on or subject to a DCM's rules. Previously, these enumerated registrants were automatically deemed "AT Persons" under the CFTC's November 2015 proposed rules. Under the CFTC's new proposed scheme, such registrants would only be deemed AT Persons (and thus subject to most of Regulation AT's most onerous requirements) if they exceeded the volume threshold test. In assessing its volume of traded contracts against the volume threshold, a person would have to aggregate both its proprietary and customer contracts (if applicable) across all products on all electronic trading facilities of all DCMs. A person would also have to include with its own trading volume that of any other person controlling, controlled by or under common control with it. Calculations would be based on the number of actual trading days during the relevant six-month counting period, whether the relevant person traded on those days or not.
[85] *Id.* at 85349 n.121.

however, to request source code either through a special call or a subpoena that it expressly authorizes.[86] The CFTC proposed to protect any source code provided to it under a new confidentiality rule, as well as under existing law.[87]

4. Wider Application of Risk Controls

In the Supplemental Proposal, the CFTC proposed that risk controls apply to all electronic trading.[88] In the Initial Proposal, the CFTC dealt only with algorithmic trading.

5. Certifications Not Annual Reports

The Initial Proposal would require all AT Persons and FCMs to provide each DCM on which they operated an annual report covering certain regulatory obligations. The Supplemental Proposal substitutes a certification requirement for all AT Persons and executing FCMs made by the CCO or CEO.[89]

6. Granularity of Risk Controls

The Initial Proposal would require pre-trade risk controls to be established at the level of each AT Person or more granular level as the AT Person, FCM or DCM determined was appropriate. The Supplemental Proposal would give AT Persons, FCMs and DCMs greater flexibility to determine at what level pre-trade controls must be set.[90]

Where Are We Now? The Potential for Future DCM Proposal

The Supplemental Proposal represented a paring back of some of the more controversial elements of the Initial Proposal. However, it too was widely criticized by the industry as overly prescriptive, inadequate in achieving the CFTC's goals and potentially "unworkable" in the suggested resolution of issues such as compliance responsibility for third party developed algorithmic trading systems (ATS) that would require AT Persons to cause (through bilateral negotiations) independent third-party ATS to comply with relevant regulations and would remain responsible for both the third party's record keeping and allowing CFTC access to proprietary source code.[91] Ultimately, retention of the

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[86] *Id.* at 85350.
[87] *Id.* at 85348.
[88] Proposed CFTC Rule § 1.82.
[89] *Id.* at 85364.
[90] *Id.* at 85336.
[91] *See* ISDA Comment Letter, Regulation Automated Trading; Proposed Rule: 17 CFR Parts 1, 38, 40 et al. Supplemental Notice of Proposed Rulemaking, RIN 3038-AD52 (May 1, 2017), *available at* https://www.isda.org/a/ZniDE/supplemental-reg-at-comment-letter-isda-05-01.pdf; *see also Bridging the Week* by Gary DeWaal: May 1 to 5 and May 8, 2017 (Views on Reg AT; COO Obligations and Annual Reports; Jay Clayton; KISS and Tell) *available at* https://www.bridgingtheweek.com/Commentary/PostDetails/2458#.Xl1el6hKi70.

source code, high compliance costs and potential drag on innovation remained key issues for former Chairman J. Christopher Giancarlo, who voted against the Supplemental Proposal.[92] Additionally, critics like former Chairman Giancarlo feared that adopting the regulatory precedent would increase the potential for government overreach.[93]

These unresolved issues remained, impeding any movement of the rule forward in the end of Chairman Timothy Massad's term. In October 2017, in his first public speech since becoming a CFTC Commissioner, Brian Quintenz indicated that the CFTC's original proposal to require algorithmic source code to be maintained in a special repository would no longer be pursued.[94]Similarly, in October 2018, former Chairman Giancarlo said that while he was open to considering whether there are parts of Regulation AT that might serve as the foundation for a "new and truly effective rule" that the proposal would require fundamental reconsideration and would not be advanced in its current form.[95]

Starting in early 2020, the CFTC has expressed an interest in revitalizing rulemaking to protect against potential market failures resulting from automated trading systems. Currently, the CFTC is considering an approach that would re-shift the regulatory focus from prescriptive obligations of individual AT Persons to high-level principles implemented at the DCM level. The drafted principles are rumored to represent a dramatic departure from the abandoned proposed Regulation AT. CFTC Staff is said to be drafting a potential new regulation that would leverage more of the existing requirements of DCMs and best practices already followed by the majority of the industry, in a principle-based, non-prescriptive way. Some of the principles may include:

1. DCMs would be required to have reasonable means to identify market participants, subject to its jurisdiction, that may pose operational risk from electronic trading.
2. DCMs would be required to adopt and implement rules for such participants reasonably designed to detect, prevent and mitigate the effects of a trading disruption.
3. DCMs would be required to subject electronic orders to pre-trade risk controls, many of which exchanges already utilize (e.g., maximum order size, message throttles, price collars, message policies, daily price limits, etc.).
4. DCMs would be required to monitor and evaluate market conditions and trading and messaging volumes, price movements to detect price disruptions that would impact the DCM and market participants.

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[92] Statement of Dissent by Commissioner J. Christopher Giancarlo Regarding Supplemental Notice of Proposed Rulemaking on Regulation Automated Trading, CFTC (Nov. 4, 2016), https://www.cftc.gov/PressRoom/SpeechesTestimony/giancarlostatement110416.
[93] Megan Woodward, *The Need for Speed: Regulatory Approaches to High Frequency Trading in the United States and the European Union*, 50 Vanderbilt J. of Transnational L. 1, 35 (2017).
[94] Keynote Remarks of Commissioner Brian Quintenz, CFTC (October 4, 2017), https://www.cftc.gov/PressRoom/SpeechesTestimony/opaquintenz1.
[95] Remarks of Chairman J. Christopher Giancarlo, CFTC (Oct. 17, 2018), https://www.cftc.gov/PressRoom/SpeechesTestimony/opagiancarlo58; *see also* Lisa Lambert, *U.S. automated trading proposal out of date: CFTC commissioner*, Reuters Bus. News (Sept. 21, 2016, 12:14 PM), http://www.reuters.com/article/us-usaregulation-trading-idUSKCN11R256 (Commissioner J. Christopher Giancarlo neatly outlined some of the major concerns regarding Reg AT and has publicly condemned Reg AT as a "20th century analog response to the 21st century digital revolution in trading markets.").

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