MANAGED FUNDS ASSOCIATION
The Voice of the Global Alternative Investment Industry
WASHINGTON, DC | NEW YORK

August 24, 2020

VIA ELECTRONIC SUBMISSION

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

Re: RIN 3038-AF04; Electronic Trading Risk Principles

Dear Mr. Kirkpatrick:

Managed Funds Association[1] ("**MFA**") appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "**CFTC**" or "**Commission**") proposed rulemaking on electronic trading risk principles for designated contract markets ("**DCMs**").[2] We support the Proposal and commend the Commission for undertaking to address "the prevention, detection, and mitigation of market disruptions and system anomalies associated with the entry of electronic orders and messages into DCMs' electronic trading platforms."[3] We believe current market structure and rules governing electronic trading are robust and effective, but think the Proposal creates a stable regulatory structure to maintain and enhance electronic trading in future years. We concur with the view articulated by Chairman Tarbert that "principles-based regulations

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[1] Managed Funds Association ("**MFA**") represents the global alternative investment industry and its investors by advocating for sound industry practices and public policies that foster efficient, transparent, and fair capital markets. MFA, based in Washington, DC, is an advocacy, education, and communications organization established to enable hedge fund and managed futures firms in the alternative investment industry to participate in public policy discourse, share best practices and learn from peers, and communicate the industry's contributions to the global economy. MFA members help pension plans, university endowments, charitable organizations, qualified individuals and other institutional investors to diversify their investments, manage risk, and generate attractive returns over time. MFA has cultivated a global membership and actively engages with regulators and policy makers in Asia, Europe, North and South America, and many other regions where MFA members are market participants.

[2] Electronic Risk Trading Principles, 85 Fed. Reg. 42761 (July 15, 2020) (the "**Proposal**"), *available at* https://www.cftc.gov/sites/default/files/2020/07/2020-14381a.pdf

[3] *Id.* at 42762.

can bring simplicity and flexibility while also promoting innovation,"[4] and submit that the Proposal accomplishes this goal by directing DCMs to have objectively reasonable processes and risk controls in place to address market disruptions and system anomalies associated with electronic trading, while also leaving flexibility for those processes and risk controls to evolve over time.

I. Background

MFA has been engaged with the Commission for several years on ways to further strengthen the regulation of electronic trading, including in connection with the Commission's proposed rulemakings on Regulation AT.[5] Our members have a significant interest in the safety and soundness of the U.S. derivative markets, particularly as those markets – and the technologies used for trading – continue to evolve. As such, we greatly appreciate the Commission's efforts to address the risks associated with electronic trading.

II. Comments

MFA supports the Proposal. As we stated in our March 2016 Letter in response to the proposed rulemaking on Regulation AT, "[o]verly prescriptive and extraneous regulations will not only stunt innovation and growth but hamper the ability of market participants to continue using the futures markets for the very purposes for which they were created—i.e., hedging and risk management."[6] In our view, the Proposal strikes an appropriate balance by establishing a risk control framework at the DCM level based on an "objectively reasonable" standard while also providing DCMs the flexibility to determine the best way to implement that framework. In this manner, the Proposal, if adopted, will allow DCMs to adjust their controls and processes as necessary or appropriate to address new technologies and circumstances that may arise in the future.

As the Proposal recognizes, DCMs and other market participants have already taken important steps to identify and mitigate the risks and disruptions associated with electronic trading. In our view, while DCMs have taken important steps to develop controls and processes for identifying and managing the risks of electronic trading, the Proposal is nonetheless important to help encourage DCMs to "continue to monitor these risks as they evolve along with the markets,

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4 Statement of Chairman Heath P. Tarbert in Support of the Proposed Rule on Electronic Trading Risk Principles (June 25, 2020), *available at* https://www.cftc.gov/PressRoom/SpeechesTestimony/tarbertstatement062520b.

5 *See, e.g.*, letter from Stuart J. Kaswell, Executive Vice President & General Counsel, MFA, to Melissa D. Jurgens, Secretary, CFTC, dated December 11, 2013, on the Concept Release on Risk Controls and System Safeguards for Automated Trading Environments; letter from Stuart J. Kaswell, Executive Vice President & General Counsel, MFA, to Christopher Kirkpatrick, Secretary, CFTC, dated March 16, 2016, on proposed regulation automated trading ("**March 2016 Letter**") ; and letter from Stuart J. Kaswell, Executive Vice President & General Counsel, MFA, and Jiří Król, Deputy CEO, Alternative Investment Management Association, to Christopher Kirkpatrick, Secretary, CFTC, dated May 1, 2017, on proposed regulation automated trading.

6 March 2016 Letter at 4.

and [to] make reasonable modifications as appropriate."[7] The Proposal is also beneficial insofar as it "provide[s] further clarity to DCMs about their obligations to address certain situations associated with electronic trading."[8]

In our view, the Proposal is appropriately tailored to encourage DCMs to focus on disruptions and system anomalies associated with electronic trading. In particular, MFA agrees with the Commission's approach to defining "market disruption," which we believe places the focus correctly on events impacting the operations of the DCM and/or the ability of other market participants to trade on the DCM, rather than the impact on trading of a single firm whose electronic trading was the source of the disruption. We also appreciate that the Proposal allows room for a DCM to exercise discretion in identifying market disruptions and system anomalies as they relate to the DCM's particular market and the trading activities of participants in that market.[9] In our view, the flexibility provided by the Proposal and the different approaches that DCMs may take to implement the Proposal as a result of this flexibility do not create the risk of harmful effects on market liquidity or integrity. We also believe that any framework to address the risks associated with electronic trading should permit a DCM to take into account industry best practices and existing technologies (as well as changes to those best practices and technologies over time).

The oversight function of the Commission fosters the integrity of the U.S. derivative markets and, on that basis, we support the aspect of the Proposal that will require notice to the Commission in the event of a "significant" disruption caused by electronic trading. We believe the Proposal's definition of "significant" establishes a threshold for when notification is required that will promote meaningful reporting and oversight. We agree that an internal disruption in a market participant's own trading system "should not be considered significant unless it causes a market disruption materially affecting the DCM's trading platform and other market participants."[10]

For the reasons discussed above, MFA strongly supports the Proposal and believes it is important for the Commission to move forward at this time with the Proposal's framework for addressing the risks associated with electronic trading. We agree with the Commission that the adoption of an appropriate risk management framework is "important to ensure the integrity of Commission-regulated markets and to foster market participants' confidence in the transactions executed on DCM platforms."[11] We do not believe that it would be beneficial or cost-effective for the Commission to continue to search for potential alternatives to the Proposal, particularly in light of the degree to which electronic trading has become even more prevalent since the Commission first issued its 2013 Concept Release on Risk Controls and System Safeguards for Automated Trading Environments.

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7 Proposal at 42767.

8 *Id.* at 42762

9 *See id.* at 42765.

10 *Id.* at 42769.

11 *Id.* at 42762-63.

Lastly, the preamble to the Proposal notes that the National Futures Association ("**NFA**") has issued binding interpretive guidance to NFA members relating to the supervision of automated order routing systems, and in connection with the Proposal the Commission has encouraged NFA to evaluate whether additional supervisory guidance should be provided to its members.[12] MFA has discussed electronic trading risk management practices by member firms with NFA and is pleased to continue to serve as a resource to NFA as it considers updates to its supervisory guidance with respect to electronic trading.

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MFA appreciates the opportunity to contribute to the Commission's efforts to address the risks associated with electronic trading. If the Commission or its staff have questions regarding our comments, please do not hesitate to contact the undersigned at (202) 730-2600.

Respectfully Submitted,

/s/ Jennifer W. Han

Jennifer W. Han
Managing Director & Counsel
Regulatory Affairs

cc: The Honorable Heath P. Tarbert, Chairman
The Honorable Brian D. Quintenz, Commissioner
The Honorable Rostin Behman, Commissioner
The Honorable Dawn DeBerry Stump, Commissioner
The Honorable Dan M. Berkowitz, Commissioner

[12] *Id.* at 42764. As noted in the preamble to the Proposal, NFA's Interpretive Notice 9046 "applies to all NFA members that employ [automated order routing systems], and provides binding guidance to, among other things, implement firewalls, conduct testing, and perform capacity reviews, as well as consider implementation of pre-trade controls." *Id.*