Investment Management Alert

Akin Gump
STRAUSS HAUER & FELD LLP

CFTC Proposes Electronic Trading Principles in Lieu of Reg AT

July 15, 2020

Key Points

- The Commodity Futures Trading Commission (CFTC) formally withdrew its highly controversial “Regulation Automated Trading” (Reg AT).
- In its place, the CFTC proposed principles-based rules applicable to designated contract markets (DCMs) that focus on preventing, detecting and mitigating market disruptions and system anomalies associated with electronic trading.

On June 25, 2020, the CFTC approved a proposed rulemaking (Proposal) that would require DCMs to (i) implement exchange rule applicable to market participants to prevent, detect and mitigate market disruptions and system anomalies associate with electronic trading, (ii) implement exchange-based pre-trade risk controls for all electronic orders and (iii) promptly notify the CFTC of any significant disruptions to their electronic trading platforms that had occurred due to malfunctions of the technological systems of trading firms executing orders electronically on the DCM.[1] The Proposal is a significant departure from Reg AT, which the CFTC formally withdrew over the dissenting votes of the two Democratic commissioners. Unlike Reg AT, the Proposal would **not** impose such prescriptive requirements as registration of all proprietary algorithmic traders, stringent testing standards for the development of algorithmic trading systems, compliance reporting programs and maintenance of a source code repository. Rather, the Proposal establishes three risk principles that the CFTC noted “may not necessitate the adoption of additional measures by DCMs” and, in certain respects, are already addressed in existing CFTC regulations.

To the extent not already in compliance, the Proposal establishes acceptable practices for implementing the risk principles. Provided that a DCM establishes and implements rules and pre-trade risk controls that are objectively reasonable in their design to prevent, detect and mitigate market disruptions and system anomalies associated with electronic trading, no strict liability would apply to the DCM in the event any market disruptions or system anomalies were to nevertheless occur. The Proposal defines electronic trading to encompass all trading and order messages submitted by electronic means to the DCM’s electronic trading platform, whether through automated or manual order entry. In addition, the Proposal notes that the risk principles are meant

Contact Information

If you have any questions regarding this alert, please contact the Akin Gump lawyer with whom you usually work or

Jason M. Daniel
Partner
jdaniel@akingump.com
Dallas
+1 214.969.4209

Jan-Paul Bruynes
Partner
jpbruynes@akingump.com
New York
+1 212.872.7457

W. Graham McCall

to target those market disruptions and system anomalies that originate with market participants and either disrupt the DCM's order processing and trade execution functions, or otherwise disrupt the ability of others to trade on the DCM. While DCMs would have discretion to implement rules and risk controls that are best-suited to their individual markets, the CFTC would be able to enforce a DCM's compliance with the Proposal's risk principles through rule enforcement reviews whereby the practices of DCMs could be compared against one another.

[1] The voting draft of the Proposal is available online at: https://www.cftc.gov/media/4056/votingdraft062520b/download

akingump.com