**(o) Alternative Methods of Compliance (AMOCs)**

(1) The Manager, Seattle ACO Branch, FAA, has the authority to approve AMOCs for this AD, if requested using the procedures found in 14 CFR 39.19. In accordance with 14 CFR 39.19, send your request to your principal inspector or local Flight Standards District Office, as appropriate. If sending information directly to the manager of the certification office, send it to the attention of the person identified in paragraph (p)(1) of this AD. Information may be emailed to: *9-ANM-Seattle-ACO-AMOC-Requests@faa.gov.*

(2) Before using any approved AMOC, notify your appropriate principal inspector, or lacking a principal inspector, the manager of the local flight standards district office/certificate holding district office.

(3) An AMOC that provides an acceptable level of safety may be used for any repair, modification, or alteration required by this AD if it is approved by The Boeing Company Organization Designation Authorization (ODA) that has been authorized by the Manager, Seattle ACO Branch, FAA, to make those findings. To be approved, the repair method, modification deviation, or alteration deviation must meet the certification basis of the airplane, and the approval must specifically refer to this AD.

(4) AMOCs approved previously for AD 2019–02–03 are approved as AMOCs for the corresponding provisions of paragraph (g) of this AD.

**(p) Related Information**

(1) For more information about this AD, contact Tak Kobayashi, Aerospace Engineer, Propulsion Section, FAA, Seattle ACO Branch, 2200 South 216th St., Des Moines, WA 98198; phone and fax: 206–231–3553; email: *takahisa.kobayashi@faa.gov.*

(2) For service information identified in this AD, contact Boeing Commercial Airplanes, Attention: Contractual & Data Services (C&DS), 2600 Westminster Blvd., MC 110–SK57, Seal Beach, CA 90740–5600; telephone 562–797–1717; internet *https://www.myboeingfleet.com.* You may view this referenced service information at the FAA, Airworthiness Products Section, Operational Safety Branch, 2200 South 216th St., Des Moines, WA. For information on the availability of this material at the FAA, call 206–231–3195.

Issued on July 7, 2020.

**Lance T. Gant,**

*Director, Compliance & Airworthiness Division, Aircraft Certification Service.*

[FR Doc. 2020–15127 Filed 7–14–20; 8:45 am]

**BILLING CODE 4910–13–P**

## COMMODITY FUTURES TRADING COMMISSION

## 17 CFR Parts 1, 38, 40, and 170

**RIN 3038–AD52**

## Regulation Automated Trading; Withdrawal

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Proposed rule; withdrawal.

**SUMMARY:** On December 17, 2015, the Commodity Futures Trading Commission (''CFTC'' or the ''Commission'') published a notice of proposed rulemaking, Regulation Automated Trading (''Regulation AT NPRM''). On November 25, 2016, the Commission issued a supplemental notice of proposed rulemaking to modify certain rules in the Regulation AT NPRM (''Supplemental Regulation AT NPRM''). In light of feedback the Commission received in response to the Regulation AT NPRM and Supplemental Regulation AT NPRM (together, the ''Regulation AT NPRMs''), the Commission has determined to withdraw the Regulation AT NPRMs and reject certain policy approaches relating to the regulation of automated trading contained therein.

**DATES:** The Commodity Futures Trading Commission is withdrawing proposed rules published on December 17, 2015 (80 FR 78824) and November 25, 2016 (81 FR 85334) as of July 15, 2020.

**ADDRESSES:** Comments previously submitted in response to the Regulation AT NPRMs remain on file at the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581 and may also be accessed via the CFTC Comments Portal: *https://comments.cftc.gov.*

**FOR FURTHER INFORMATION CONTACT:** Marilee Dahlman, Special Counsel, Division of Market Oversight, *mdahlman@cftc.gov* or 202–418–5264; Joseph Otchin, Special Counsel, Division of Market Oversight, *jotchin@cftc.gov* or 202–418–5623; Esen Onur, *eonur@cftc.gov* or 202–418–6146, Office of the Chief Economist; in each case at the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.

**SUPPLEMENTARY INFORMATION:** On December 17, 2015, the Commission issued the Regulation AT NPRM, which proposed pre-trade risk controls at three levels in the life-cycle of an order executed on a designated contract market (''DCM''), including: (i) Certain trading firms designated as automated traders (''AT Persons''); (ii) futures commission merchants (''FCMs''); and (iii) designated contract markets (''DCMs'').[1] In response to the Regulation AT NPRM, the Commission received 54 comment letters from exchanges, industry trade associations, public interest organizations, and others. The views expressed in the comment letters included, among other things, (i) opposition to the proposed three-level risk control framework; (ii) opposition to identification and registration of AT Persons; (iii) opposition to provisions relating to source code preservation and accessibility to the Commission without a subpoena; and (iv) opposition to prescriptive, one-sized fits all rules. On June 10, 2016, Commission staff held a public roundtable to discuss elements of the Regulation AT NRPM. In connection with the roundtable, the Commission reopened the Regulation AT NPRM comment period and received 19 additional comment letters, all of which also expressed concern with Regulation AT.

On November 25, 2016, following the conclusion of the reopened comment period, the Commission issued the Supplemental Regulation AT NPRM.[2] The Supplemental Regulation AT NPRM proposed a revised framework with pre-trade risk controls at two levels (instead of the initially proposed three levels) in the life-cycle of an order, including: (1) The AT Person *or* the FCM; and (2) the DCM. In addition, the Supplemental Regulation AT NPRM proposed some modifications to the risk control framework, trading firm registration criteria, reporting requirements, source code provisions, and compliance options for trading firms that use third-party algorithmic trading systems. The Commission received 27 comment letters during the comment period for the Supplemental Regulation AT NPRM. Commenters asserted, among other things, that (i) the proposed rules were overly prescriptive and, if the Commission was intent on proceeding with a rulemaking, should be principles-based; (ii) the proposed rules could result in redundant or overlapping risk controls; and (iii) the benefits of the proposed rules were not commensurate with the costs.

The Commission had proposed the Regulation AT NPRM and Supplemental Regulation AT NPRM based on certain assumptions about the relative risk

[1] Regulation Automated Trading, 80 FR 78824 (Dec. 17, 2015).

[2] Regulation Automated Trading, 81 FR 85334 (Nov. 25, 2016).

associated with automated trading or algorithmic trading relative to other forms of electronic trading. In addition, the Regulation AT NPRMs included provisions that would have:

(1) Required certain types of market participants, based on their trading functionality, strategies, or market access methods, to register with the Commission notwithstanding that they did not hold customer funds or otherwise intermediate futures markets.

(2) Compelled those registrants, including participants not currently registered with the Commission, to produce source code to the Commission without a subpoena; and

(3) Applied prescriptive requirements for the types of risk controls that exchanges, FCMs, and others would be required to implement.

In light of feedback the Commission received in response to the Regulation AT NPRMs, and upon further consideration, the Commission has determined to withdraw the pending Regulation AT NPRMs, to specifically reject the policy responses listed above as means of addressing the perceived risk underlying the Regulation AT NPRMs. Furthermore, the Commission has determined not to proceed with detailed, prescriptive requirements such as those contained within the Regulation AT NPRMs. Finally, the Commission has decided not to pursue regulatory proposals that would require additional classes of market participants to become registrants or compel market participants to divulge their source code and other intellectual property absent a subpoena.

Issued in Washington, DC, on June 29, 2020, by the Commission.

**Christopher Kirkpatrick,**

*Secretary of the Commission.*

**Note:** The following appendices will not appear in the Code of Federal Regulations.

## Appendices to Regulation Automated Trading—Commission Voting Summary, Chairman's Statement, and Commissioners' Statements

## Appendix 1—Commission Voting Summary

On this matter, Chairman Tarbert and Commissioners Quintenz and Stump voted in the affirmative. Commissioners Behnam and Berkovitz voted in the negative.

## Appendix 2—Supporting Statement of Chairman Heath P. Tarbert

The mission of the CFTC is to promote the integrity, resilience, and vibrancy of U.S. derivatives markets through sound regulation. We cannot achieve this mission if we rest on our laurels—particularly in relation to the ever evolving technology that makes U.S. derivatives markets the envy of the world. What is sound regulation today may not be sound regulation tomorrow.

I am reminded of the paradoxical observation of Giuseppe di Lampedusa in his prize-winning novel, The Leopard:

If we want things to stay as they are, things will have to change.[1]

While the novel focuses on the role of the aristocracy amid the social turbulence of 19th century Sicily, its central thesis—that achieving stability in changing times itself requires change—can be applied equally to the regulation of rapidly changing financial markets.

Today we are voting on a proposal to address the risk of disruptions to the electronic markets operated by futures exchanges. The risks involved are significant; disruptions to electronic trading systems can prevent market participants from executing trades and managing their risk. But how we address those risks—and the implications for the relationship between the Commission and the exchanges we regulate—is equally significant.

*The Evolution of Electronic Trading*

A floor trader from the 1980s and even the 1990s would scarcely recognize the typical futures exchange of the 21st Century. The screaming and shouting of buy and sell orders reminiscent of the film *Trading Places* has been replaced with silence, or perhaps the monotonous humming of large data centers. For over the past two decades, our markets have moved from open outcry trading pits to electronic platforms. Today, 96 percent of trading occurs through electronic systems, bringing with it the price discovery and hedging functions foundational to our markets.

By and large, this shift to electronic trading has benefited market participants. Spreads have narrowed,[2] liquidity has improved,[3] and transaction costs have dropped.[4] And the most unexpected benefit is that electronic markets have been able to stay open and function smoothly during the Covid–19 lockdowns. By comparison, traditional open outcry trading floors such as options pits and the floor of the New York Stock Exchange were forced to close for an extended time. Without the innovation of electronic trading, our financial markets would almost certainly have seized up and suffered even greater distress.

But like any technological innovation, electronic trading also creates new and unique risks. Today's proposal is informed by examples of disruptions in electronic markets caused by both human error as well as malfunctions in automated systems—disruptions that would not have occurred in open outcry pits. For instance, ''fat finger'' orders mistakenly entered by people, or fully automated systems inadvertently flooding matching engines with messages, are two sources of market disruptions unique to electronic markets.

*Past CFTC Attempts To Address Electronic Trading Risks*

The CFTC has considered the risks associated with electronic trading during much of the last decade. Seven years ago, a different set of Commissioners issued a concept release asking for public comment on what changes should be made to our regulations in light of the novel issues raised by electronic trading. Out of that concept release, the Commission later proposed Regulation AT. For all its faults, Regulation AT drove a very healthy discussion about the risks that should be addressed and the best way to do so.

Regulation AT was based on the assumption that automated trading, a subset of electronic trading, was inherently riskier than other forms of trading. As a result, Regulation AT sought to require certain automated trading firms to register with the Commission notwithstanding that they did not hold customer funds or intermediate customer orders. Most problematically, Regulation AT also would have required those firms to produce their source code to the agency upon request and without subpoena.

Regulation AT also took a prescriptive approach to the types of risk controls that exchanges, clearing members, and trading firms would be required to place on order messages. But this list was set in 2015. In effect, Regulation AT would have frozen in time a set of controls that all levels of market operators and market participants would have been required to place on trading. Since that list was proposed, financial markets have faced their highest volatility on record and futures market volumes have increased by over 50 percent.[5] Improvements in technology and computer power have been profound—Moore's Law would predict that computing power would have increased at least ten-fold in that time.[6] Of course, I commend my predecessors for focusing on the risks that electronic trading can bring. But times change, and Regulation AT would not have changed with them.

*An Evolving CFTC for Evolving Markets*

In withdrawing Regulation AT, the CFTC is consciously moving away from the registration requirements and source code production. But in voting to advance the Risk Principles proposal outlined further below, the CFTC is committing to address risk posed

[1] Giuseppe Tomasi di Lampedusa, *The Leopard* (Everyman's Library Ed. 1991) at p. 22.

[2] Frank, Julieta and Philip Garcia, ''Bid-Ask Spreads, Volume, and Volatility: Evidence from Livestock Markets,'' American Journal of Agricultural Economics, Vol. 93, Issue 1, page 209 (January 2011).

[3] Henderschott, Terrence, Charles M. Jones, and Albert K. Menkveld, ''Does Algorithmic Trading Improve Liquidity? '' Journal of Finance, Volume 66, Issue 1, page 1 (February 2011).

[4] Onur, Esen and Eleni Gousgounis, ''The End of an Era: Who Pays the Price when the Livestock Futures Pits Close?'', Working paper, Commodity Futures Trading Commission Office of the Chief Economist.

[5] Futures Industry Association, ''A record year for derivatives,'' (March 5, 2019), available at *https://www.fia.org/articles/record-year-derivatives.*

[6] ''Moore's Law'' predicts that the number of transistors in an integrated circuit doubles about every two years, and has held generally true since 1965. *See generally* Sneed, Annie, ''Moore's Law Keeps Going, Defying Expectations,'' Scientific American (May 19, 2015).

by electronic trading while strengthening our longstanding principles-based approach to overseeing exchanges.

The markets we regulate are changing. To maintain our regulatory functions, the CFTC must either halt that change or change our agency. Swimming against the tide of developments like electronic markets is not an option, nor should it be. The markets exist to serve the needs of market participants, not the regulator. If a technological change improves the functioning of the markets, we should embrace it. In fact, one of this agency's founding principles is that CFTC should ''foster responsible innovation.'' [7] Applying this reasoning alongside the overarching theme of *The Leopard* leads us to a single conclusion: As our markets evolve, the only real course of action is to ensure that the CFTC's regulatory framework evolves with it.

*The Need for Principles-Based Regulation*

So then how do we as a regulator change with the times while still fulfilling our statutory role overseeing U.S. derivatives markets? I recently published an article setting out a framework for addressing situations such as this.[8] I believe that principles-based regulations can bring simplicity and flexibility while also promoting innovation when applied in the right situations. Such an approach can also create a better supervisory model for interaction between the regulator and its regulated firms—but only so long as that oversight is not toothless.

There are a variety of circumstances in which I believe principles-based regulation would be most effective. Regulations on how exchanges manage the risks of electronic trading are a prime example. This is about risk management practices at sophisticated institutions subject to an established and ongoing supervisory relationship. But it is also an area where regulated entities have greater understanding than the regulator about the risks they face and greater knowledge about how to address those risks. As a result, exchanges need flexibility in how they manage risks as they constantly evolve.

At the same time, principles-based regulation is not ''light touch'' regulation. Without the ability to monitor compliance and enforce the rules, principles-based regulation would be toothless. Principles-based regulation of exchanges can work because the CFTC and the exchanges have constant interaction that engenders a degree of mutual trust. The CFTC—as overseen by our five-member Commission—has tools to monitor how the exchanges implement principles-based regulations through reviews of license applications and rule changes, as well as through periodic examinations and rule enforcement reviews.

Monitoring compliance alone is not enough. The regulator also needs the ability to enforce against non-compliance. Principles-based regimes ultimately give discretion to the regulated entity to find the best way to achieve a goal, so long as that method is objectively reasonable. To that end, the CFTC has a suite of tools to require changes through formal action, escalating from denial of rule change requests, to enforcement actions, to license revocations. The CFTC consistently needs to address the effectiveness and appropriateness of these levers to make sure the exchanges are meeting their regulatory objectives. And given that exchanges will be judged on a reasonableness standard, it must be the Commission itself—based on a recommendation from CFTC staff [9]—who ultimately decides whether an exchange has been objectively unreasonable in complying with our principles.

*Proposed Risk Principles for Electronic Trading*

This brings us to today's proposed Risk Principles. The proposal centers on a straightforward issue that I think we can all agree is important for our regulations to address. Namely, the proposal requires exchanges to take steps to prevent, detect, and mitigate market disruptions and system anomalies associated with electronic trading.

The disruptions we are concerned about can come from any number of causes, including:

Excessive messages,

fat finger orders, or

the sudden shut off of order flow from a market maker.

The key attribute of the disruptions addressed in this proposal is that they arise because of electronic trading.

To be sure, our current regulations do require exchanges to address market disruptions. But the focus of those rules has generally been on disruptions caused by sudden price swings and volatility. In effect, the proposed Risk Principles would expand the term ''market disruptions'' to cover instances where market participants' ability to access the market or manage their risks is negatively impacted by something other than price swings. This could include slowdowns or closures of gateways into the exchange's matching engine caused by excessive messages submitted by a market participant. It could also include instances when a market maker's systems shut down and the market maker stops offering quotes.

As noted in the preamble to the proposal, exchanges have worked diligently to address emerging risks associated with electronic trading. Different exchanges have put in place rules such as messaging limits and penalties when messages exceed filled trades by too large a ratio. Exchanges also may conduct due diligence on participants using certain market access methods and may require systems testing ahead of trading through those methods.

It is not surprising that exchanges have developed rules and risk controls that comport with our proposed Risk Principles. The Commission, exchanges, and market participants have a common interest in ensuring that electronic markets function properly. Moreover, this is an area where exchanges are likely to possess the best understanding of the risks presented and have control over how their own systems operate. As a result, exchanges have the incentive and the ability to address the risks arising from electronic trading. Principles-based regulations in this area will ensure that the exchanges have reasonable discretion to adjust their rules and risk controls as the situation dictates, not as the regulator dictates.

The three Risk Principles encapsulate this approach. First, exchanges must have rules to prevent, detect, and mitigate market disruptions and system anomalies associated with electronic trading. In other words, an exchange should take a macro view when assessing potential market disruptions, which can include fashioning rules applicable to all traders governing items such as onboarding, systems testing, and messaging policies. Second, exchanges must have risk controls on all electronic orders to address those same concerns. Third, exchanges must notify the CFTC of any significant market disruptions and give information on mitigation efforts.

Importantly, implementation of the Risk Principles will be subject to a reasonableness standard. The proposed Acceptable Practices clarify that an exchange would be in compliance if its rules and its risk controls are reasonably designed to meet the objectives of preventing, detecting, and mitigating market disruptions and system anomalies. The Commission will have the ability to monitor how the exchanges are complying with the Principles, and will have avenues through Commission action to sanction non-compliance.

*Framework for Future Regulation*

I hope that today's Risk Principles proposal will serve as a framework for future CFTC regulations. Electronic trading presents a prime example of where principles-based regulation—as opposed to prescriptive rule sets—is more likely to result in sound regulation over time. Through thoughtful analysis of the regulatory objective we aim to achieve, the nature of the market and technology we are addressing, the sophistication of the parties involved, and the nature of the CFTC's relationship with the entity being regulated, we can identify what areas are best for a prescriptive regulation or a principles-based regulation.[10] In the present context, a principles-based approach—setting forth concrete objectives while affording reasonable discretion to the exchanges—provides flexibility as electronic

[7] Commodity Exchange Act, section 3(b), 7 U.S.C. 3(b).

[8] Tarbert, Heath P., ''Rules for Principles and Principles for Rules: Tools for Crafting Sound Financial Regulation,'' Harv. Bus. L. Rev. (June 15, 2020). Vol. 10 (*https://www.hblr.org/volume-10-2019-2020/*).

[9] CFTC Staff conduct regular examinations and reviews of our registered entities, including exchanges and clearinghouses. As part of those examinations and reviews, Staff may identify issues of material non-compliance with regulations as well as recommendations to bring an entity into compliance. Ultimately, however, the Commission itself must accept an examination report or rule enforcement review report before it can become final, including any findings of non-compliance. Likewise, Staff are asked to make recommendations regarding license applications, reviews of new products and rules, and a variety of other Commission actions, although ultimate authority lies with the Commission.

[10] Tarbert, at 11–17.

trading practices evolve, while maintaining sound regulation. In sum, it recognizes that things will have to change if we want things to stay as they are.[11]

## Appendix 3—Supporting Statement of Commissioner Brian Quintenz

I support today's proposal that would require designated contract markets (DCMs) to adopt rules that are reasonably designed to prevent, detect, and mitigate market disruptions or system anomalies associated with electronic trading. It would also require DCMs to subject all electronic orders to pre-trade risk controls that are reasonably designed to prevent, detect and mitigate market disruptions and to provide prompt notice to the Commission in the event the platform experiences any significant disruptions. I believe all DCMs have already adopted regulations and pre-trade risk controls designed to address the risks posed by electronic trading. As I have noted previously, many—if not all—of the risks posed by electronic trading are already being effectively addressed through the market's incentive structure, including exchanges' and firms' own self-interest in implementing best practices. Therefore, today's proposal merely codifies the existing market practice of DCMs to have reasonable controls in place to mitigate electronic trading risks.

Significantly, the proposal puts forth a principles-based approach, allowing DCM trading and risk management controls to continue to evolve with the trading technology itself. As we have witnessed over the past decade, risk controls are constantly being updated and improved to respond to market developments. It is my view that these continuous enhancements are made possible because exchanges and firms have the flexibility and incentives to evolve and hold themselves to an ever-higher set of standards, rather than being held to a set of prescriptive regulatory requirements which can quickly become obsolete. By adopting a principles-based approach, the proposal would provide exchanges and market participants with the flexibility they need to innovate and evolve with technological developments. DCMs are well-positioned to determine and implement the rules and risk controls most effective for their markets. Under the proposed rule, DCMs would be required to adopt and implement rules and risk controls that are objectively reasonable. The Commission would monitor DCMs for compliance and take action if it determines that the DCM's rules and risk controls are objectively unreasonable.

The Technology Advisory Committee (TAC), which I am honored to sponsor, has explored the risks posed by electronic trading at length. In each of those discussions, it has become obvious that both DCMs and market participants take the risks of electronic trading seriously and have expended enormous effort and resources to address those risks.

For example, at one TAC meeting, we heard how the CME Group has implemented trading and volatility controls that complement, and in some cases exceed, eight recommendations published by the International Organization of Securities Commissions (IOSCO) regarding practices to manage volatility and preserve orderly trading. We also heard from the Futures Industry Association (FIA) about current best practices for electronic trading risk controls. FIA reported that through its surveys of exchanges, clearing firms, and trading firms, it has found widespread adoption of market integrity controls since 2010, including price banding and exchange market halts. FIA also previewed some of the next generation controls and best practices currently being developed by exchanges and firms to further refine and improve electronic trading systems. The Intercontinental Exchange (ICE) also presented on the risk controls ICE currently implements across all of its exchanges, noting how its implementation of controls was fully consistent with FIA's best practices. These presentations emphasize how critical it is for the Commission to adopt a principles-based approach that enables best practices to evolve over time. I believe the proposal issued today adopts such an approach and provides DCMs with the flexibility to continually improve their risk controls in response to technological and market advancements. I look forward to comment on the proposal.

It is also long overdue for the Commission to withdraw the Regulation Automated Trading Proposal and Supplemental Proposal (Regulation AT NPRMs). The Regulation AT NPRMs would have required certain types of market participants, based purely on their trading functionality, strategies or market access methods, to register with the Commission, notwithstanding that they did not act as intermediaries in the markets or hold customer funds. Moreover, the NPRMs proposed extremely prescriptive requirements for the types of risk controls that exchanges, futures commission merchants, and trading firms would be required to implement. Lastly, by withdrawing these NPRMs, the market and public can finally consider as dead the prior Commission's significant, and likely unconstitutional, overreach on accessing firms' proprietary source code and protected intellectual property without a subpoena.

In my view, the Regulation AT NPRMs were poorly crafted and flawed public policy that failed to understand the true risks of the electronic trading environment and the intrinsic incentives that exchanges and market participants have to mitigate and address those risks. I am pleased the Commission is officially rejecting the policy rationales and regulatory requirements proposed in the Regulation AT NPRMs and is instead embracing the principles-based approach of today's proposal.

## Appendix 4—Statement of Dissent of Commissioner Rostin Behnam

I strongly support thoughtful and *meaningful* policy that addresses the use of automated systems in our markets.[1] As Chris Clearfield of System Logic, a research and consulting firm focusing on issues of risk and complexity remarked, ''In every situation, a trader or a piece of technology might fail, or a shock might trigger a liquidity event. What's important is that structures are in place to limit—not amplify—the impact on the overall system.'' [2] Any rule that we put forward should both minimize the potential for market disruptions and other operational problems that may arise from the automation of order origination, transmission or execution, and create structures to absorb and buffer breakdowns when they occur. Unfortunately, today's proposal regarding Electronic Trading Risk Principles does not meaningfully achieve this, and thus I respectfully dissent.

A little over ten years ago, on May 6, 2010, the Flash Crash shook our markets.[3] The prices of many U.S.-based equity products, including stock index futures, experienced an extraordinarily rapid decline and recovery. After this event, the staffs of the U.S. Securities and Exchange Commission (''SEC'') and CFTC issued a report to the Joint CFTC–SEC Advisory Committee on Emerging Regulatory Issues.[4] The report noted that ''[o]ne key lesson is that under stressed market conditions, the automated execution of a large sell order can trigger extreme price movements, especially if the automated execution algorithm does not take prices into account. Moreover, the interaction between automated execution programs and algorithmic trading strategies can quickly erode liquidity and result in disorderly markets.'' [5] In 2012, Knight Capital, a securities trading firm, suffered losses of more than $460 million due to a trading software coding error.[6] Other volatility events related to automated trading have followed with increasing regularity.[7]

After the Flash Crash, the CFTC initially worked with the SEC to establish controls to minimize the risk of automated trading disruptions. Knight Capital demonstrated that the Flash Crash was not a one-off event, and in 2013 the Commission published an extensive Concept Release on Risk Controls

[11] Di Lampedusa, at 22.

[1] The Commission's Office of the Chief Economist has found that over 96 percent of all on-exchange futures trading occurred on DCMs' electronic trading platforms. Haynes, Richard & Roberts, John S., ''Automated Trading in Futures Markets—Update #2'' at 8 (Mar. 26, 2019), available at *https://www.cftc.gov/sites/default/files/2019-04/ATS_2yr_Update_Final_2018_ada.pdf.*

[2] Chris Clearfield, *Vision Zero for Our Markets,* The Risk Desk, Dec. 21, 2016, at 4.

[3] *See* Findings Regarding the Market Events of May 6, 2010, Report of the Staffs of the CFTC and SEF to the Joint Advisory Committee on Emerging Regulatory Issues (Sept. 30, 2010), available at *http://www.cftc.gov/ucm/groups/public/@otherif/documents/ifdocs/staff-findings050610.pdf.*

[4] *Id.*

[5] *Id.* at 6.

[6] *See* SEC Press Release No. 2013–222, ''SEC Charges Knight Capital With Violations of Market Access Rule'' (Oct. 16, 2013), available at *http://www.sec.gov/News/PressRelease/Detail/Press Release/1370539879795.*

[7] For a list of volatility events between 2014 and 2017, *see* the International Organization of Securities Commissions (''IOSCO'') March 2018 Consultant Report on Mechanisms Used by Trading Venues to Manage Extreme Volatility and Preserve Orderly Trading (''IOSCO Report''), at 3, available at *https://www.iosco.org/library/pubdocs/pdf/IOSCOPD607.pdf.*

and System Safeguards for Automated Trading Environments (''Concept Release'').[8] Following public comments on the Concept Release, the Commission published ''Regulation AT,'' which proposed a series of risk controls, transparency measures, and other safeguards to address risks arising from automated trading on designated contract markets or ''DCMs.'' [9] Reg AT proposed pre-trade risk controls at three levels in the life-cycle of an order executed on a DCM: (i) Certain trading firms; (ii) futures commission merchants (''FCMs''); and (iii) DCMs. In 2016, again based on public comments, the Commission issued a supplemental notice of proposed rulemaking for Reg AT, proposing a revised framework with controls at two levels (instead of three levels initially proposed): (1) The AT Person or the FCM; and (2) the DCM.[10]

Since 2016, the Commission has not advanced policy designed to prevent or restrain the impact of these market disruptions resulting from automated trading. While the Commission has not acted, these events have continued to occur. In September and October 2019, the Eurodollar futures market experienced a significant increase in messaging.[11] According to reports, the volume of data generated by activity in Eurodollar futures increased tenfold.[12] The DCM responded by changing its rules to increase penalties for exceeding certain messaging thresholds and cutting off connections for repeat violators.[13] The DCM acted appropriately in such a situation and strengthened the rules for its participants; however, Commission policy could well have prevented this event by requiring pre-trade risk controls, including messaging thresholds.

Given the importance of the issue, I would like to commend the Chairman for stepping forward with a proposal today. However, as I considered this proposal, I found myself questioning what the proposed Risk Principles do differently than the status quo. The preamble seems to go to great lengths to make it clear that the Commission is not asking DCMs to do anything. The preamble states that the ''Commission believes that DCMs are addressing most, if not all, of the electronic trading risks currently presented to their trading platforms.'' [14] As the preamble discusses each of the three ''new'' Risk Principles, it goes on to describe all of the actions taken by DCMs today that meet the principles. The fact that the Commission is not asking DCMs to do anything new is clearest in the cost benefit analysis, which states that ''DCMs' current risk management practices, particularly those implemented to comply with existing regulations 38.157, 38.251(c), 38.255, and 38.607, already may comply with the requirements of proposed rules 38.251(e) through 38.251(g).'' [15] If the appropriate structures are in place, and we have dutifully conducted our DCM rule enforcement reviews and have found neither deficiencies nor areas for improvement, then is the exercise before us today anything more than creating a box to check? The only potentially new aspect of this proposal is that the preamble suggests different application in the future, as circumstances change. The Commission seems to want it both ways: We want to reassure DCMs that what they do now is enough, but at the same time the new risk principles potentially provide a blank check for the Commission to apply them differently in the future. Or perhaps, viewed differently, when there is a technology failure—and there will be—will the Commission stand by its principles or will it fashion an enforcement action around a black swan event so that everyone walks away bruised, but not harmed?

For market participants, this may be extremely confusing. What precisely are DCMs being asked to do, and what will they be asked to do in the future? Frankly, I am not sure. But it could be more than they bargained for.

The first Risk Principle requires DCMs to ''[a]dopt and implement rules . . . to prevent, detect, and mitigate market disruptions or system anomalies associated with electronic trading.'' None of the key terms in this principle are defined in the regulation or the preamble. DCMs are left some clues, but they are not told precisely what a market disruption or system anomaly is. Perhaps most importantly, they are not told what it means for something to be ''reasonably designed'' to prevent these things. This lack of clarity continues through the other two new Risk Principles. And while the Commission provides some clues by stating that current practice ''may'' meet the new principles, it then goes on to say that future circumstances may require future action by DCMs in order to comply with the principles.

As a recent article by our Chairman in the Harvard Business Law Review points out, the CFTC has a long tradition of principles-based regulation.[16] The concept runs through our core principles, which form the framework for much of what we do and how we regulate. It certainly is tempting to promulgate broad rules that provide the CFTC with flexibility to react to changes in the marketplace. The problem is that this flexibility comes at a number of costs—it potentially denies market participants the certainty they need to make business decisions, and, if the principles are too flexible, it denies market participants the notice and opportunity to comment that is required by the Administrative Procedures Act. These costs become too high where, as today, we promulgate rules that are too broad in their terms and too vague in application. There is a reason why the core principles for swap execution facilities (''SEFs, DCMs, and derivatives clearing organizations (''DCOs'') in our rule set are extensive, and why the regulations include appendices explaining Commission interpretation and acceptable practices. Without sufficient clarity, principles actually can become a vehicle for government overreach—a blank check for broad government action—and that includes enforcement action.

There is a saying in basketball that a good zone defense looks a lot like a man-to-man defense, and a good man-to-man defense looks a lot like a zone defense. I think the same can be said of principles-based regulation and rules-based regulation. Good principles-based regulation should look a lot like rules-based regulation—it should have enough clarity to provide market participants with certainty and the opportunity to provide comment regarding what regulation will look like.

It is worth noting that the Commission described the unanimously approved Reg AT proposal as principles-based.[17] Multiple commenters to that proposal noted that it was too principles-based.[18] I suspect that each of us on the Commission believes that the CFTC has a tradition of principles-based regulation, and that that tradition should continue. However, I think there is disagreement as to precisely what that means.[19]

Finally, I want to make a few comments on the vote regarding the withdrawal of Reg AT. On one hand, the Risk Principles proposal today expressly is not about automated or algorithmic trading. This applies to electronic trading generally. Yet there seems to be a perception that this is a replacement for Reg AT, and that is already reflected in media accounts of our action today.[20] And if

[8] Concept Release on Risk Controls and System Safeguards for Automated Trading Environments, 78 FR 56542 (Sept. 12, 2013).

[9] Regulation Automated Trading, Proposed Rule, 80 FR 78824 (Dec. 17, 2015).

[10] Supplemental Regulation AT NPRM, 81 FR 85334 (Nov. 25, 2016).

[11] *See* Osipovich, Alexander, ''Futures Exchange Reins in Runaway Trading Algorithms,'' *Wall Street Journal* (Oct. 29, 2019), available at *https://www.wsj.com/articles/futures-exchange-reins-in-runaway-trading-algorithms-11572377375.*

[12] *Id.*

[13] *See* CME Group Globex Messaging Efficiency Program, available at *https://www.cmegroup.com/globex/trade-on-cme-globex/messaging-efficiency-program.html.*

[14] Proposal at I.A.

[15] Proposal at IV.C.3.

[16] Press Release Number 8183–20, CFTC, ICYMI: Harvard Business Law Review Publishes Chairman Tarbert's Framework for Sound Regulation (June 15, 2020), *https://www.cftc.gov/PressRoom/PressReleases/8183-20.*

[17] Reg AT at 78838.

[18] *See* Comments of Americans For Financial Reform and Better Markets, Inc., available at *https://comments.cftc.gov/PublicComments/CommentList.aspx?id=1762.*

[19] As I have stated before, ''A principles-based approach provides greater flexibility, but more importantly focuses on thoughtful consideration, evaluation, and adoption of policies, procedures, and practices as opposed to checking the box on a predetermined, one-size-fits-all outcome. However, the best principles-based rules in the world will not succeed absent: (1) clear guidance from regulators; (2) adequate means to measure and ensure compliance; and (3) willingness to enforce compliance and punish those who fail to ensure compliance with the rules.'' *See* Rostin Behnam, Commissioner, CFTC, Remarks of Commissioner Rostin Behnam before the FIA/SIFMA Asset Management Group, Asset Management Derivatives Forum 2018, Dana Point, California (Feb. 8, 2018), *https://www.cftc.gov/PressRoom/SpeechesTestimony/opabehnam2.*

[20] *See* Bain, Ben, ''Flash Boys New Rules Won't Make Them Hand Over Trading Secrets,'' Bloomberg (Jun. 18, 2020), *https://www.bloomberg.com/news/articles/2020-06-18/flash-boys-new-rules-won-t-make-them-hand-over-trading-secrets.*

there is any question, the Commission is separately voting on withdrawal of Reg AT (and mentions Reg AT repeatedly in the document) at the same time it is issuing this NPRM.

A separate vote specifically to withdraw a prior Commission proposal is highly unusual—particularly in a situation where, as here, the original proposal was unanimously issued. I believe that this action establishes a dangerous precedent for a Commission that has historically prided itself on its collegiality and efforts to work in a bipartisan fashion. I have followed in a tradition of some of my predecessors on the Commission, at times voting for proposals that I would not have supported as final rules, for the purpose of advancing the conversation.[21] I worry that the withdrawal of Reg AT could lead to future withdrawals of Commission proposals, and a loss of this historical collegiality. We should be standing on the shoulders of those who came before us, not tearing down what came before us.

Market participants expressed valid concerns to the original Reg AT, as they do with many of our proposals. But, market displeasure with just one or even a few of those original policy concepts is not a reason to throw away the rest of the proposal. Let's revisit, review, and refresh sound policy to better reflect modern market structure and a healthy relationship between market participant and market regulator. I firmly believe we collectively strive for the same goal: Safe, transparent, orderly, and fair markets. Unfortunately, today's proposal does not advance the conversation, and as such I cannot support it.

The preamble to today's NPRM expressly says ''The Risk Principles proposed here are intended to accomplish a similar goal . . .'' to the original Reg AT.[22] The Reg AT proposal rule text took up more than 6 pages in the **Federal Register**, and made revisions and additions to Parts 1, 39, 40, and 170, providing a comprehensive—and principles-based—framework for addressing a very real issue that all market participants should be concerned about. Today's proposed principles are all of three sentences long. This is not a miracle of brevity. It just shows that the proposal today does not really do anything—while paradoxically writing the Commission a blank check to change its mind about what the principles mean in the future and who will stand by them when the next black swan lands.

## Appendix 5—Statement of Commissioner Dan M. Berkovitz

I support issuing for public comment the proposed rule on Electronic Trading Risk Principles (''Proposed Rule''). The Proposed Rule is a limited step to address potential market disruptions arising from system errors or malfunctions in electronic trading. Although it leaves important issues unaddressed, the Proposed Rule recognizes the need to update the Commission's regulations to keep pace with the speed, interconnection, and automation of modern markets. I support the Commission's long-overdue re-engagement in this area.

While I support issuing the Proposed Rule for public comment, I do not support withdrawing the proposed rule known as Regulation Automated Trading (''Reg AT'').[1] The notice of withdrawal reflects a belief that there is nothing of value in Reg AT. That is simply not true. Reg AT was a comprehensive approach for addressing automated trading in Commission regulated markets. Certain elements of Reg AT attracted intense opposition and may have been a bridge too far. However, I applaud that proposal's efforts to identify the sources of risk and implement meaningful risk controls. I believe the comments received on Reg AT are worth evaluating going forward.

The Proposed Rule would codify in part 38 of the Commission's regulations three ''Risk Principles'' applicable to electronic trading on designated contract markets (''DCMs''). Risk Principle 1, for example, would require DCMs to implement rules applicable to market participants to prevent, detect, and mitigate market disruptions and system anomalies. Risk Principle 2 would also require DCMs to implement their own pre-trade risk controls. While worthwhile as statements of principle, these proposed requirements are drafted in terms that may ultimately prove too high-level to achieve the goal of effectively preventing, detecting, and mitigating market disruptions and system anomalies. This concern is discussed in greater detail below, and I look forward to public comment on the issue.

The Proposed Rule includes Acceptable Practices in Appendix B to part 38, which provide that a DCM can comply with the Risk Principles through rules and risk controls that are ''reasonably designed'' to prevent, detect, and mitigate market disruptions and system anomalies. The Proposed Rule specifies that reasonableness is an objective measure, and that a DCM rule or risk control that is not ''reasonably designed'' would not satisfy the Acceptable Practices or the Risk Principles. As the Proposed Rule indicates, the Commission will monitor DCMs' compliance with the Risk Principles. In this regard, the Commission has multiple oversight activities at its disposal, including market surveillance activities, reviews of new rule certifications and approval requests, and rule enforcement reviews.

The Proposed Rule is also clear on the fundamental division of authority under the Commodity Exchange Act (''CEA'') between DCMs and the Commission. Amendments to the CEA made through the Commodity Futures Modernization Act (''CFMA'') in the year 2000 introduced the core principle regime and provided DCMs with flexibility in establishing how they comply with a core principle.[2] Ten years later, however, learning from the 2008 financial crisis and the excesses of deregulation, the Dodd-Frank Act overhauled the CEA, including in its treatment of the core principle regime.[3] Specifically, section 735 of the Dodd-Frank Act made clear that a DCM's discretion with respect to core principle compliance was circumscribed by any rule or regulation that the Commission might adopt pursuant to a core principle.[4] I am able to support today's Proposed Rule for publication in the **Federal Register** because of improvements that clarify the respective authorities between a DCM and the Commission. Under the CEA, the Commission is the ultimate arbiter of whether a DCM's rules and risk controls are reasonably designed, under an objective standard. I thank the Chairman for his efforts at building consensus in this regard.

The Proposed Rule overlaps with existing requirements in part 38 of the Commission regulations, including regulation 38.255, which requires DCMs to ''establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions . . . .''[5] While the Proposed Rule and Risk Principle 2 are more explicit with respect to electronic trading, they may add little to existing requirements and practices regarding the risk controls that DCMs build into their own systems. Indeed, the Proposed Rule provides numerous examples of specific risk controls at major DCMs that likely already meet this requirement, and of disciplinary actions taken by DCMs against market participants related to electronic trading. Although the Commission articulates a need for updating its risk control requirements, the fact that the Risk Principles as proposed are likely to have no practical effect undermines the usefulness of this exercise.

The Proposed Rule possibly may be of greater benefit in with respect to Risk Principle 1 and its requirement that DCMs implement risk control rules applicable to their market participants. Market participants, who originate orders via systems ranging from comparatively simple automated order routers to nearly autonomous algorithmic trading systems, are crucial focal points for any adequate system of risk controls. An effective system of risk controls must therefore include controls at multiple stages in the life cycle of an automated order submitted to an electronic trade matching engine. Although Risk Principle 1 could benefit from greater rigor, it is nonetheless a critical recognition that market participants have an important role in any effective risk control framework.

I look forward to public comments on additional measures that the Commission should consider for effective risk controls across the ecosystem of electronic and algorithmic trading. My support for any final rule that may arise from this proposal is conditioned upon a thorough articulation of the technology-driven risks present in today's markets, and a concomitant regulatory

[21] *See* Concurring Statement of Commissioner Rostin Behnam Regarding Swap Execution Facilities and Trade Execution Requirement, (Nov. 5, 2018). *https://www.cftc.gov/PressRoom/SpeechesTestimony/behnamstatement110518a.*

[22] Proposal at I.B.

[1] Regulation Automated Trading, 80 FR 78824 (Dec. 17, 2015); 81 FR 85334 (Nov. 25, 2016) (supplemental notice of proposed rulemaking for Regulation Automated Trading).

[2] Commodity Futures Modernization Act of 2000, Public Law 106–554, 114 Stat. 2763A–365 (2000).

[3] Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

[4] Commodity Exchange Act section 5(d)(1)(B), 7 U.S.C. 7(d)(1)(B) (2010).

[5] 17 CFR 38.255 (2012).

response that will meaningfully address such risks. In a market environment where the vast majority of trading is now electronic and automated, inaction is a luxury that we can ill-afford.

Although the Proposed Rule may be characterized as a ''principles-based'' approach, in fact the Risk Principles are not a new approach to the regulation of risks from electronic trading. The current regulation establishing requirements on DCMs to impose risk controls—Regulation 38.255—is principles-based. Regulation 38.255 states: ''The designated contract market must establish and maintain risk control mechanisms to prevent and reduce the potential risk of price distortions and market disruptions, including, but not limited to, market restrictions that pause or halt trading in market conditions prescribed by the designated contract market.'' One might ask, therefore, why do we need another principles-based regulation when we already have a principles-based regulation? The preamble to the Proposed Rule notes the ''overlap'' between Regulation 38.255 and the proposed Risk Principles, and states ''it is beneficial to provide further clarity to DCMs about their obligations to address certain situations associated with electronic trading.'' In other words, the principles-based regulations previously adopted by the Commission *are not prescriptive enough* to address the risks currently posed by electronic trading. I fully agree. Although I am voting today to put out this proposal for public comment, I am not yet convinced—and I look forward to public comment on whether—the principles-based regulations proposed today are in fact sufficiently detailed or comprehensive to effectively address those risks.

I thank the staff of the Division of Market Oversight for their work on the Proposed Rule and for their patience as the Commission worked through multiple iterations of this proposal. I also thank the Chairman for his engagement and effort to build consensus. I believe that the Proposed Rule is a much better regulatory outcome because of the extensive dialogue and give-and-take that led to the rule before us today.

[FR Doc. 2020–14383 Filed 7–14–20; 8:45 am]

**BILLING CODE 6351–01–P**

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## COMMODITY FUTURES TRADING COMMISSION

## 17 CFR Part 38

### RIN 3038–AF04

## Electronic Trading Risk Principles

**AGENCY:** Commodity Futures Trading Commission.

**ACTION:** Notice of proposed rulemaking.

**SUMMARY:** The Commodity Futures Trading Commission (''CFTC'' or ''Commission'') is proposing amendments to its regulations to address the potential risk of a designated contract market's (''DCM'') trading platform experiencing a disruption or system anomaly due to electronic trading. The proposed regulations consist of three principles applicable to DCMs concerning: The implementation of exchange rules applicable to market participants to prevent, detect, and mitigate market disruptions and system anomalies associated with electronic trading; the implementation of exchange-based pre-trade risk controls for all electronic orders; and the prompt notification of the Commission by DCMs of any significant disruptions to their electronic trading platforms. The proposed regulations are accompanied by proposed acceptable practices (''Acceptable Practices''), which provide that a DCM can comply with these principles by adopting and implementing rules and risk controls that are reasonably designed to prevent, detect, and mitigate market disruptions and system anomalies associated with electronic trading.

**DATES:** Comments must be received on or before August 24, 2020.

**ADDRESSES:** You may submit comments, identified by RIN 3038–AF04, by any of the following methods:

- *CFTC Comments Portal: https://comments.cftc.gov.* Select the ''Submit Comments'' link for this rulemaking and follow the instructions on the Public Comment Form.
- *Mail:* Send to Christopher Kirkpatrick, Secretary of the Commission, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.
- *Hand Delivery/Courier:* Follow the same instructions as for Mail, above.

Please submit your comments using only one of these methods. Submissions through the CFTC Comments Portal are encouraged.

All comments must be submitted in English or, if not, accompanied by an English translation. Comments will be posted as received to *https://comments.cftc.gov.* You should submit only information that you wish to make available publicly. If you wish the Commission to consider information that you believe is exempt from disclosure under the Freedom of Information Act (''FOIA''), a petition for confidential treatment of the exempt information may be submitted according to the procedures established in 17 CFR 145.9.

The Commission reserves the right, but shall have no obligation, to review, pre-screen, filter, redact, refuse, or remove any or all of your submission from *https://comments.cftc.gov* that it may deem to be inappropriate for publication, such as obscene language. All submissions that have been redacted or removed that contain comments on the merits of the rulemaking will be retained in the public comment file and will be considered as required under the Administrative Procedure Act and other applicable laws, and may be accessible under FOIA.

**FOR FURTHER INFORMATION CONTACT:** Marilee Dahlman, Special Counsel, *mdahlman@cftc.gov* or 202–418–5264; Joseph Otchin, Special Counsel, *jotchin@cftc.gov* or 202–418–5623, Division of Market Oversight; Esen Onur,*eonur@cftc.gov* or 202–418–6146, Office of the Chief Economist; in each case at the Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street NW, Washington, DC 20581.

**SUPPLEMENTARY INFORMATION:**

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