



Principal Traders Group

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December 12, 2011

Commissioner Scott O'Malia
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Dear Commissioner O'Malia:

The Futures Industry Association Principal Traders Group ("FIA PTG") is pleased to submit this letter in response to your letter of November 14, 2011 proposing a definition for what constitutes "High Frequency Trading" or "HFT." The FIA PTG, a division of the Futures Industry Association, is composed of 36 firms that trade their own capital in the exchange-traded markets. We engage in manual, automated and hybrid methods of trading and are active in a variety of asset classes, such as futures, equities, foreign exchange, commodities and fixed income. Members of the FIA PTG are a critical source of liquidity in the exchange-traded markets, allowing those who use these markets to manage their business risks to enter and exit the markets efficiently.

In your letter, you asked for feedback from members of the Technology Advisory Committee and other market participants and stakeholders about the definition. The letter indicates that you are interested in defining HFT because "[t]he CFTC needs to collect reliable data so it can define their trading activity before imposing regulations."

It is indeed important to base regulation on reliable data and to understand the characteristics and behaviors of various market participants. For this reason, classifications should neither be too broad nor too narrow. As proposed in your letter of November 14, 2011, the definition of HFT would require the CFTC to draw arbitrary boundaries which in turn may lead to an overly broad or overly narrow definition. For example, the terms "high", "numerous" and "very-short", which are each in the proposal, are inherently arbitrary. Making such arbitrary definitional choices; however, may be unnecessary given the stated goal of the definition. For instance, if a market participant uses an automated trading system ("ATS") and is directly connected to an exchange; does it really make a difference if he or she enters a thousand orders per day instead of one million orders per day? Does it really matter, for purposes of monitoring trading activity, whether or not a trader holds positions at the end of the day? In fact, it seems quite difficult to devise any meaningful definition for HFT that is not, in significant part, arbitrary.

Therefore, we would like to suggest a slightly different approach that would be more likely to provide the CFTC with information to further its regulatory objectives. We suggest that the CFTC define a new term: "Direct ATS Participant" characterized by use of an ATS directly connected to an exchange.

By defining the set of market participants in this manner, the CFTC can readily use data that is already collected by the exchanges to further study any risks posed by this group. On all major U.S. exchanges, there is a complete audit trail of every order and every trade. Each order or trade is directly traceable to the individual or the automated trading system (ATS) and its operator(s). The Commission has the authority to request and review any of this information from the exchanges at any time in pursuit of its regulatory and oversight objectives.

The leading U.S. derivatives exchanges already possess, and indeed, through exchange rules, require that market participants provide information sufficient to classify trading and traders by any number of criteria. For example, the CME Group's Globex electronic trading specification requires each order to indicate whether an order originated from an ATS.¹ The CME defines an ATS as "...a system that automates the generation and routing of orders to Globex."² Other exchanges explicitly define an ATS similarly.³

Additionally, CME requires that any ATS generating orders be identified by a unique FIX tag 50 which is itself registered to the person or team of persons directly responsible for oversight of the ATS's operation.⁴ Similarly, ICE requires registration of Authorized Trader IDs for all individuals and ATSs directly accessing ICE markets.⁵ Such registration ensures that all orders are attributable to either an individual or an ATS (and the person(s) responsible for oversight of the ATS operation).

Finally, NYSE LIFFE U.S. requires members to register all trading algorithms, referred to as Automated Price Injection Models, prior to use.⁶ The registration information provided to the exchange specifies the trader ID (and thus, the person responsible for the algorithm's orders) under which the algorithm will be operated, as well as contact information of those responsible for supervising the algorithm's operation in the market.

As far as the list of market participants that connect directly to exchanges, we believe this information should be readily available to the CFTC from the exchanges.

From a surveillance perspective, by defining Direct ATS Participants in this manner, the CFTC still has the ability to do studies that only focus on a subset of these market participants. For example, staff could filter

¹ By populating FIX tag 1028.

² CME Group Advisory Notice 09-392.

³ See, e.g., NYSE LIFFE General Notice No. 1901.

⁴ CME Group rule 576 "Identification of Globex Terminal Operators" and related advisories such as Advisory Notice 09-392 apply to all CME Group markets.

⁵ ICE Futures Rule 27.09 and related notices from Nov. 22, 2010.

⁶ NYSE LIFFE U.S. General Notice No. 1901.

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the audit trails of Direct ATS Participants to examine trading from those that submit more than a certain number of orders in a day, or that trade more than a certain number of contracts. These numbers would certainly vary from query to query depending on the area of interest.

In the matter of risk management, orders of all market participants should be subject to risk controls. The broader term "Direct ATS Participant" would appropriately include any firm directly accessing the market with an ATS, rather than a narrow subset meeting a definition of HFT. Indeed, the FIA Principal Traders Group's "Recommendations for Risk Controls for Trading Firms" and other documents published by the FIA over the past several years have been well received by the industry and were developed with input from a broad variety of market participants including Direct ATS Participants, exchanges, clearing firms and other more traditional market participants. We believe this process also would work well as the Commission considers the role automated trading plays in our markets. The outcome of this process is critically important not only to FIA PTG members but also to a wider group of market participants. We would welcome the opportunity to participate in a working group, which includes all interested parties – clearing members, exchanges and customers, to further consider this issue. We suggest you consider representatives beyond the current Technology Advisory Committee members who have special experience and expertise in the issues you have highlighted in your letter.

Thank you for the opportunity to comment on your initiative. We hope you find our feedback useful.

Sincerely,

A handwritten signature in black ink, appearing to read "John M. Damgard". The signature is fluid and cursive, with the first name "John" being the most prominent.

John M. Damgard
President
Futures Industry Association
On Behalf of the FIA Principal Traders Group