Recent Developments in Commodity and Derivatives Regulations

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OVERVIEW

- EU / UK Developments
  - Update on EMIR
  - MiFID II Issues

- United States Developments
  - U.S. Margin for Uncleared Swaps
  - U.S. Position Limits
  - U.S. Clearing Mandates
  - CFTC OCR Rules
  - Proposed Regulation AT
Update on EMIR
KEY PROVISIONS OF EMIR

1. Clearing
   - Connection to affirmation platform has to be established
   - Connection to at least two clearing members has to be established

2. Reporting
   - All derivatives (OTC and ETD) will start to be reported from 12 February 2014 onwards
   - Backlog derivative transactions have to be reported

3. Risk Management & Valuation
   - New capital requirements have to be fulfilled
   - Risk mitigation techniques for non-standard OTC derivatives have to be implemented
   - Risk valuation methods have to be aligned with requirements

4. Agreements
   - Existing legal documentation with counterparties, custodian bank and collateral manager has to be updated
   - New contractual relationships with clearing members and affirmation platforms providers have to be set up

5. Customers
   - Portfolios’ OTC derivative activities have to be mapped and monitored
   - Portfolios have to be assessed in the light of collateral eligibility

6. Collateral and Margin
   - Margin requirements for non-cleared swaps
   - Daily variation calls
   - Eligible collateral has to be transferred as initial margin
   - Collateral management process to be updated
CLEARING OBLIGATION (1)

- Following conditions must be satisfied:
  - Counterparties are subject to the clearing obligation
  - Class of contract has been declared by ESMA as being subject to clearing
  - Contract was entered into on or after the date on which the clearing obligation applies ("front-loading")
CLEARING OBLIGATION (2)

- Applies to all future OTC contracts above applicable threshold
  - Exclude transactions designed to reduce risks to commercial or treasury financing activity
  - Includes contracts entered into by all non-financial entities within an NFC’s group

<table>
<thead>
<tr>
<th>Gross Notional Value</th>
<th>Class of OTC Contract</th>
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<tbody>
<tr>
<td>€1bn</td>
<td>Credit</td>
</tr>
<tr>
<td>€1bn</td>
<td>Equity</td>
</tr>
<tr>
<td>€3bn</td>
<td>Interest rate</td>
</tr>
<tr>
<td>€3bn</td>
<td>Foreign exchange</td>
</tr>
<tr>
<td>€3bn</td>
<td>Commodity and others (combined)</td>
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</table>
CLEARING OBLIGATION (3)

- Exemptions
  - Pension Funds
  - Covered Bonds
  - Intra-group transactions

- Where Art 13 (Jurisdiction) equivalence applies, counterparties can follow third country rules; even if not, Art 25 (CCP) equivalence should still enable relevant third country CCPs to be used for the purpose of meeting the clearing obligation
CLEARING OBLIGATION (4)

- Interest Rates Swaps RTS and entered into force on 21 December 2015
  - Euro, sterling, yen and US dollar that have specific features, including the index used as a reference for the derivative, its maturity, and the notional type (i.e. the nominal or face amount used to calculate payments)
    - Fixed-to-float “plain vanilla” interest-rate swaps
    - Float-to-float basis swaps
    - Forward rate agreements
    - Overnight index swaps
  - Category 1 firms to start clearing interest rate contracts from 21 June 2016
  - Front-loading for Category 1 from 21 February 2016 and Category 2 firms from 21 May 2016

- CDS RTS entered into force on 9 May 2016
  - Category 1 firms to start clearing CDS contracts from 9 February 2017
  - Frontloading for Category 1 and 2 firms from 9 October 2016

- Clearing obligation not proposed at this stage for NDFs as more time needed to address main concerns raised during consultation (market infancy and international convergence)
### CLEARING OBLIGATION (5)

The clearing obligation under EMIR will apply:

<table>
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<tr>
<th>Scenario</th>
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<tr>
<td>Between two FCs</td>
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<td>Between an FC and an NFC+ entity</td>
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<tr>
<td>Between two NFC+ entities</td>
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<tr>
<td>Between an FC or an NFC+ entity and a TCE (only where the TCE would be</td>
</tr>
<tr>
<td>subject to clearing obligation if it was established in the EU)</td>
</tr>
<tr>
<td>Between two TCEs if the contract has a “direct, substantial or foreseeable effect” in the EU (or where it is necessary or appropriate to prevent the evasion of EMIR’s requirements)</td>
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OTC MARGIN REQUIREMENTS

- IM exclusion – below €8 billion (in notional amount)
- IM threshold - up to €50 million (in IM provided)
- Minimum transfer amount – €500,000
- Intragroup exemption – conditions
- Swaps linked to covered bonds – conditions
- FX exchanges – only VM
- One-way obligations, e.g. options – one-way margin
- Concentration limits
OTC MARGIN PHASE IN

- 2016 (September) for entities (on a group basis) with €3 trillion (in notional amount)
- 2017 (September) – €2.25 trillion
- 2018 (September) – €1.5 trillion
- 2019 (September) – €0.75 trillion
- 2020 (September) – other (above €8 billion)
EMIR REVIEW

- EMIR review and ESMA’s reports to the EP and EC August 2015:
  - Counterparty classifications
  - Hedging v non-hedging contracts
  - Additional guidance on margin for CCPs
  - Segregation and ISAs/OSAs
  - Clarifying application to municipalities and regional governments
  - Improving clearing obligation procedure
  - Introduce a power to temporarily suspend clearing
  - Remove front-loading
  - Intraday trade-reporting
  - Trade reporting delegation
MiFID II issues
IMPLEMENTATION UPDATE

- Originally expected 3 January 2017
- Following industry feedback and ESMA’s own readiness, proposed to be delayed by one year to 3 January 2018
- Full plenary of European Parliament set to give final approval on 7 June
- European Council will formally adopt the texts before it can be published in the Official Journal (expected at the end of June/early July)
- Member States will have until 3 July 2017 to implement in local law
OTC AND COMMODITY DERIVATIVES

- Only contracts that are eligible for clearing
  - Subject to sufficient liquidity
- Derivative transactions subject to the trading obligation to be concluded only on RMs, MTFs, OTFs or certain third country venues
  - MiFIR imposes the trading obligation on transactions concluded between (i) financial counterparties as defined by Article 2(8) of EMIR (broadly investment firms and credit institutions), and (ii) non-financial counterparties subject to EMIR’s clearing threshold (referred to in Article 10(1b) of EMIR)
- Rules to support liquidity, prevent market abuse and provide for orderly functioning of commodity derivatives markets
- Introduction of power to introduce position limits, or alternative arrangements with equivalent effect, on the number of commodity contracts which any person can hold
- ESMA given intervention powers in order to preserve market integrity and orderliness
MiFID EXEMPTIONS

- **Dealing on own account**
  - Currently covers a person who deals on own account in commodities or commodity derivatives
  - Does not apply if person is part of a group whose main business is the provision of investment or banking services
  - Further exemption for those providing investment services in commodity derivatives to clients of the main business, provided the main business is not investment or banking services

- **Commodity derivatives dealers who deal on own account, including market makers, will continue to be exempt provided that:**
  - Activity is ancillary to their main business when considered on a group basis
  - The main business is not the provision of investment or banking services or acting as a market maker in commodity derivatives, and
  - Dealer must not apply a high frequency algorithmic trading technique
MEANING OF “DERIVATIVE”

- Financial derivatives settled physically or in cash
- Commodity derivatives that must or may be cash settled
- Physically settled commodity derivatives that are traded on a regulated market or a multilateral trading facility
- Physically settled commodity derivatives that have characteristics of other derivative financial instruments
FINANCIAL INSTRUMENTS

- Emission allowances will become “financial instruments” for the purposes of the MiFID II
  - Emission allowances consisting of any units recognised for compliance with the Emissions Trading Scheme Directive (2003/87/EC), and
  - Options, futures, swaps, forward rate agreements and any other derivative contracts relating to emissions allowances

- Physically settled commodity derivatives covered in Section C(6) of Annex 1 of MiFID will be extended to those traded on an OTF subject to an exception for wholesale energy products (as defined in the EU’s Regulation on Energy Market Integrity and Transparency) that are traded on an OTF and which must be physically settled
FX CONTRACTS

- Not a MiFID II “financial instrument” if it is a spot contract or a means of payment that fulfils specific conditions
- Spot contract is a contract for the exchange of one currency against another currency, where delivery is scheduled to be made:
  - Within two trading days in respect of any pair of major currencies;
  - For currencies that are not major currencies, the longer of two trading days and the period generally accepted in the market for that currency as the standard delivery period;
  - Where the contract is used for the sole or main purpose of the sale or purchase of a transferable security, within the shorter of: (a) the period generally accepted in the market for the settlement of that transferable security as the standard delivery period; and (b) 5 trading days
- Irrespective of the time for which delivery is scheduled, a contract will not be a spot contract if there is an understanding between the parties that delivery of the currency will not be performed within the period specified and will be postponed
POSITION LIMITS

- IOSCO’s Principles for the Regulation and Supervision of Commodity Derivatives Markets (endorsed 2011) and RTS 21
- National Competent Authorities can set limits
  - Baseline of 25% of deliverable supply for spot months or open interest for other months (can be adjusted)
  - Can be varied to between 2.5% and 50% (22.5% or 25% up or down)
- Applies to net position (held directly or indirectly) and economically equivalent contracts
  - Identical contract terms excluding lot size specs, delivery dates within 1 day and post-trade risk management terms
  - Parent company to aggregate its positions with others in its group
- NFCs can generally exclude hedges for commercial activity
  - Subject to NCA approval
  - 21 Day period
- MiFID firms and others holding positions on EU trading venues
ALGORITHMIC AND HIGH-FREQUENCY TRADING

- Standards for execution venues including sponsored access, co-location, tick size regimes (Article 17)
  - Additional regulatory disclosure
  - Restrictions on direct electronic access/sponsored access
  - Trading venues to implement circuit breakers and robust controls
- Effective systems and risk controls in place, including business continuity plans
- Algorithmic trading strategies will be required to be in continuous operation during trading hours of the venues used, and to post firm quotes at competitive prices in order to provide liquidity on a regular and on-going basis
- Extension of licensing requirements to investment firms that are members of RMIs or MTFs, have direct electronic access to trading venues or that apply high-frequency algorithmic trading strategies
U.S. Margin for Uncleared Swaps
GENERAL

- U.S. regulators have adopted regulations to govern swaps on uncleared margin, which require swap dealers (“SDs”) to post collateral to and collect collateral from “financial end users”
  - Financial end users include, among others, registered investment companies, business development companies, private funds, commodity pools, employee benefit plans and insurance companies

- SDs must collect initial margin (“IM”) from and post IM with financial end-users that have “material swaps exposure” (“MSE”)
  - MSE means that, when the regulations are fully phased in, the financial end-user and its affiliates have an average daily aggregate notional amount of (i) uncleared swaps, (ii) uncleared security-based swaps, (iii) foreign exchange forwards, and (iv) foreign exchange swaps with all counterparties for June, July, and August of the previous calendar year that exceeds $8 billion, where such amount is calculated only for business days

- SDs must collect variation margin (“VM”) from and post VM with all financial end users
CROSS-BORDER APPLICATION OF U.S. REGULATIONS

- There are some differences between the “U.S. person” definition for purposes of margin on uncleared swaps between the U.S. banking regulators and the CFTC, and the CFTC has also deviated from its general Guidance concerning how a “U.S. person” is defined.

- With regard to collective investment vehicles, neither the banking regulators nor the CFTC use majority ownership of the vehicle by U.S. persons as a criterion in determining whether the vehicle would be classified as a U.S. person; however, the CFTC retains the “principal place of business” criterion, which the banking regulators do not.

- Accordingly, if a fund or other collective investment vehicle is organized under the laws of a jurisdiction outside of the United States, and the SD to which it is a counterparty in a swap is similarly organized and is not a subsidiary of a U.S. entity (and any guarantees of obligations under the swap are from parties that are also organized under the laws of a jurisdiction outside of the United States), the U.S. banking regulators’ regulations governing margin on uncleared swaps would not apply to these transactions, even if (1) the vehicle is operated out of the United States, (2) the vehicle is majority-owned by U.S. persons, and (3) the SD is registered under the U.S. Commodity Exchange Act (“CEA”).

- If the SD is subject to the CFTC’s regulations governing margin on uncleared swaps, the principal place of business of the vehicle’s manager is a factor in determining if the vehicle is classified as a U.S. person.
BUSINESS DAY

- Posting and collecting margin is required on a daily basis beginning on or before the business day after the day of execution, i.e., $T+1$.

- If a swap is entered into and it is a different day at each party’s location, the day of execution is the latter of the two days. If the swap is entered into between 4 p.m. and midnight at a party’s location, or a day that is not a business day for one of the parties, the swap will be deemed to have been entered into on the next day that is a business day for both parties.

- Because the settlement period for certain assets that may be posted as collateral is longer than $T+1$, it may be necessary for fund managers to have collateral available or pre-positioned if it may need to be posted internationally, and this may require changes in operating procedures.
U.S. regulators have adopted a concept of affiliation based upon whether either party consolidates the other on financial statements, or both are consolidated with a third company, or, if the parties are not subject to accounting standards, would be so consolidated if accounting standards were applied.

The international framework that is a foundation for U.S. regulation of margin states as follows regarding investment funds: “Investment funds that are managed by an investment advisor are considered distinct entities that are treated separately when applying the threshold [for the posting of IM] as long as the funds are distinct legal entities that are not collateralised by or are otherwise guaranteed or supported by other investment funds or the investment advisor in the event of fund insolvency or bankruptcy.”

The U.S. regulators do not appear to have directly addressed whether MSE should be measured on a disaggregated basis for separately managed accounts or “investment sleeves” managed by asset managers where there is separate recourse.
PHASE-IN

- The margin requirements for uncleared swaps were set to begin being implemented in the United States on September 1, 2016 for the largest traders (parties with average daily aggregate notional amount exceeding $3 trillion)

- However, on June 9, 2016, the European Union (“EU”) surprised other international regulators by announcing that it would delay implementation of the regulations governing margin on uncleared swaps for entities subject to its jurisdiction until approximately the middle of next year

- Certain industry participants and CFTC Commissioner Giancarlo have suggested that the U.S. regulators adopt a similar delay to avoid the possibility of international arbitrage

- VM for all financial end-users for uncleared swaps was set to begin implementation on March 1, 2017, and IM would not be fully implemented until September 1, 2020; it is possible all implementation dates could be delayed nine months
U.S. Position Limits
GENERAL

- Position limits apply to any trader on U.S. markets, whether or not such person is registered under the CEA or exempt therefrom and irrespective of whether such person is a resident of the United States or organized under U.S. law.

- An account controller must aggregate trades entered for all managed accounts that it controls, any collective investment vehicles for which it makes trading decisions, and trades made for its own account to determine compliance with position limits.

  - Thus, the trades that an investment manager makes for one client may affect its ability to make certain trades for other clients.
FEDERAL SPECULATIVE LIMITS

- The CFTC currently has **speculative position limits** only for a few agricultural commodities.
- The CFTC has proposed to add speculative position limits for an additional 28 commodities, including more agricultural commodities and certain energy and metals commodities, and to incorporate within the limits economically equivalent swaps.
- There are no current or proposed federal speculative position limits for financial products.
EXCHANGE LIMITS

- In addition to the federal speculative limits adopted by the CFTC, the designated contract markets (“DCMs”), such as CME and ICE, have their own speculative limits for commodities other than those for which the CFTC has limits, and some of these include limits on financial products, particularly in the spot month.

- The DCMs may have different limits for the spot month, for any month other than the spot month, and for all-months-combined.

- Traders should be aware that the beginning of the spot month period for particular commodities may actually occur near the end of the preceding calendar month; traders that want to avoid holding positions into the spot month and instead roll positions forward to more distant trading months should pay attention to the spot month periods for commodities in which they trade to avoid inadvertently holding positions into the spot month, when trading limits may first become effective or decrease sharply as compared to trading in other than the spot month.
EXEMPTIONS

- DCM rules provide that a trader may apply for an exemption to exceed position limits prior to doing so. Exemptions are available for *bona fide* hedging positions as defined in CFTC Regulation §1.3(z)(1), risk management positions or arbitrage/spread positions, and must be renewed annually.

- Because position limits have historically applied to physical commodities and not financial products at the federal level, the concept of *bona fide* hedging is better developed for physical commodities as compared to financial products.

- The CFTC has issued interpretative guidance to DCMs dating back to 1987 with respect to how they may interpret “risk management” in connection with financial products and the CFTC is now proposing to codify that guidance within the revised definition of *bona fide* hedging and recognize balance sheet hedging, including foreign currency translation and portfolio duration matching, unleveraged synthetic positions, and temporary asset allocations as positions exempt from limits.
INDEPENDENT ACCOUNT CONTROLLER (“IAC”)  

- An entity such as a collective investment vehicle or employee benefit plan may disaggregate trades made on its behalf by IACs
  - An “eligible entity” that could use an IAC does **not** include certain institutions such as charitable organizations or governmental entities (other than government employee benefit plans), even though such entities may meet the criteria of a “Qualified Eligible Person” (“QEP”) under CFTC Regulation 4.7.
- IACs must be (a) a **registered** (i) futures commission merchant (“FCM”), (ii) introducing broker, (iii) commodity trading advisor (“CTA”), or (iv) associated person of any of the foregoing; or (b) a general partner of a commodity pool whose operator is exempt from registration under CFTC Regulation 4.13
  - The CFTC has proposed to expand the list of eligible IACs to include (i) general partners, managing members or managers of employee benefit plans excluded from the pool definition under CFTC Regulation 4.5(a)(4), and (ii) managing members or managers of a commodity pool whose operator is exempt from registration under CFTC Regulation 4.13
- The IAC must (i) trade independently of the eligible entity and of any other IAC trading for the eligible entity, and (ii) not have knowledge of trading decisions by any other IAC
- If the IAC is affiliated with the eligible entity or another IAC, additional procedures to assure independence, such as separate physical locations, must be implemented
  - A person intending to act as an IAC should obtain a representation from its client that the client does not engage an affiliate of the person if the person wants to avoid having to comply with these additional procedures
PENALTIES

- If a person exceeds exchange speculative position limits, the person is subject to exchange disciplinary action. The exact amount of a penalty for such infractions may depend upon the amount by which the person exceeds the limits, past trading history and any profits made on the excess positions. Generally, these fines will amount to tens of thousands of dollars.

- In addition to exchange disciplinary action, CEA Section 4a(e) makes it a violation of the CEA to violate an exchange position limit. The CFTC has taken enforcement action based upon violations of exchange limits even in markets for which there is no CFTC speculative limit. The CFTC is more likely to consider bringing its own enforcement action where it views the violation to be more serious and of longer duration. A civil monetary penalty under the CEA for violation of CFTC limits or a DCM limit may be assessed in an amount up to the greater of $140,000 or triple the monetary gain to such person for each violation, and each day a limit is breached may be considered a separate violation. The CFTC also has the authority to ban the person from trading for a period of time.
POSITION LIMITS IN EUROPE

- Under MiFID II, European regulatory authorities will, for the first time, have the power to set speculative position limits in all commodities. While MiFID II establishes the legal authority for the new framework, the actual implementation is still several years away and the details are far from finished.

- The next step will be a lengthy period of consultation with the European Securities and Markets Authority ("ESMA"), which will flesh out the framework, determine a methodology for setting position limits, and implement the new regime.
U.S. Clearing Mandates
RECENT CFTC PROPOSAL

- After a hiatus of a few years, the CFTC last month proposed to require clearing for additional interest rate swaps ("IRS") subject to its jurisdiction.

- Currently, IRS in four different classes (fixed-to-floating, basis, forward rate agreement, and overnight index) are approved for four different currencies (U.S. dollar, Euro, British pound and (except for the overnight index), Japanese yen))

- The proposal would apply to IRS in nine additional currencies for fixed-to-floating swaps, and various subsets of those nine currencies in the other classes.
  - The CFTC is not proposing any change in the three general conditions for IRS subject to a clearing mandate — that there be no optionality, use of dual currencies, or conditional notional amounts involved.

- The CFTC stated that its proposed additional IRS clearing mandates are consistent with those proposed or finalized in 2015 or 2016 by the CFTC’s regulatory authority counterparts in Australia, Canada, the EU, Hong Kong, Mexico, and Singapore.
TIMING

- The impact of these new U.S. clearing mandates, if adopted, will likely not affect the buy side until 2017, unless the buy side party is an “active fund”
  - An “active fund” is defined as a private fund that is not a third-party subaccount (that is, an account managed by an investment manager that is independent of and unaffiliated with the account’s beneficial owner and sponsor, and is responsible for the documentation necessary to clear swaps) and that executes 200 or more swaps per month measured on a monthly average over the 12 months preceding the adoption of the clearing mandate
- Any clearing mandate is phased in on a 90-180-270 day cycle following publication in the Federal Register of its adoption
  - Phase One, the 90-day implementation period, requires that the parties be SDs or active funds
  - Phase Two, the 180-day implementation period, brings in transactions involving commodity pools, private funds and other financial end-users, so long as a third-party subaccount is not involved
  - All other parties that are subject to clearing requirements would be required to comply by 270 days from the mandate’s publication
- We do not expect the CFTC to propose additional clearing mandates during the remainder of this calendar year
LARGE TRADER REPORTING

- The CFTC has long maintained and operated a Large Trader Reporting System ("LTRS") as part of its market surveillance program.
- A person may be considered to be a "large" trader at fairly modest position levels — such as 50 platinum contracts or 200 contracts in a broad-based securities index other than the S&P 500 Stock Index.
- These position levels are measured in any single futures or option expiration month as of the daily market close.
OCR RULES

- The CFTC adopted changes to the LTRS in November 2013, known as the Ownership and Control Report or “OCR” rules.
- After several delays, the reporting aspects of these rules are scheduled to begin to take effect later this year on September 28, 2016.
- The new rules will require greater amounts of data to be reported to the CFTC, including data on swaps and intraday trading, as well as changes in the manner in which commodity interest market participants must report information.
NEW OCR REQUIREMENTS

- The OCR rules will require the reporting of trading by a “volume threshold account” on an intraday basis and a more granular identification of omnibus accounts; these reports are in addition to the traditional end-of-day position reporting for accounts with positions at or above certain levels.

- The CFTC currently requires FCMs to identify large traders by filing CFTC Form 102, which may then trigger a request by the CFTC to the large trader itself to file CFTC Form 40.

- The OCR rules will now require FCMs to identify and report large traders based upon positions using Form 102A for futures and options on futures (an updated version of current Form 102) and Form 102S for swaps, and a new Form 102B for volume threshold accounts.

- These reports may trigger the CFTC, in its discretion, to issue special calls to traders to file a Form 40 (futures and options on futures), Form 40S (swaps), or new Form 71 for omnibus accounts.

- These forms will be required to be filed electronically rather than by using the existing paper-based system and must be reviewed annually.
WHAT’S AHEAD

- Commodity pool operators (“CPOs”) and CTAs can expect to receive requests for OCR data from their FCMs over the next several months. To assist FCMs in managing the data required for compliance with the OCR rules, FIA Tech, an affiliate of the Futures Industry Association, has established an OCR Portal to collect profile information on customers and counterparties.

- FCMs may request that their customers (1) establish an OCR profile for their account owners and controllers with FIA Tech by completing a spreadsheet, and (2) grant the relevant FCMs permission to view and link accounts to those profiles.

  - FIA Tech and many FCMs provide guidance for how to complete these profiles for accounts of funds and managed accounts.
Proposed Regulation AT
AT PERSON

- An AT Person includes existing categories of registrants, such as CPOs and CTAs, that engage in algorithmic trading, which is the use of computer systems or algorithms to develop orders, and such orders, modifications or order cancellations are electronically submitted for processing on or subject to the rules of a DCM.

- An AT Person must institute pre-trade risk controls and other measures reasonably designed to prevent trading disruption.
  
  **Pre-Trade Risk Controls**
  - Message and execution throttles
  - Order price parameters and maximum order size limits
  - Natural person monitoring

  **Other Measures**
  - Order cancellation systems
  - Connectivity systems
  - Algorithmic trading notifications to DCMs and FCMs
  - Self-trade prevention tools
  - Periodic reviews of such controls
POLICIES AND PROCEDURES — DEVELOPMENT AND TESTING

- These written policies and procedures must at a minimum provide for:
  - A development environment that is separate from the production environment
  - Testing of all algorithmic trading code and related systems (including any changes) prior to their implementation
  - Regular back-testing of algorithmic trading using historical data
  - Regular stress tests
  - Documenting the strategy and design of proprietary algorithmic trading software, including changes and
  - Periodic review of the effectiveness of these policies and procedures
POLICIES AND PROCEDURES — MONITORING

- These written policies and procedures must at a minimum provide for continuous real-time monitoring of algorithmic trading systems through:
  - Continuous real-time monitoring of the algorithmic trading system by knowledgeable and qualified staff
  - Automated alerts when the algorithmic trading system breaches design parameters, loses network connectivity, or market conditions exceed its operating boundaries
  - Monitoring staff having the ability to disengage an algorithmic trading system and to cancel resting orders when market conditions so require and
  - Periodic review of the effectiveness of these policies and procedures
POLICIES AND PROCEDURES — COMPLIANCE

- These written policies and procedures must be reasonably designed to assure compliance with the CEA and CFTC regulations, including:
  - Review of algorithmic trading systems to detect potential algorithmic trading compliance issues;
  - A plan of internal communication and coordination between compliance staff and trading staff to detect and prevent algorithmic trading compliance issues and
  - Periodic review of the effectiveness of these policies and procedures
POLICIES AND PROCEDURES — TRAINING

These written policies and procedures must provide for designating and training of staff, including:

- Procedures for designating and training all staff involved in the design, testing, and monitoring of algorithmic trading, and documenting training events — training must cover design and testing standards, and communication procedures in the event of an algorithmic trading problem
- Training policies that are reasonably designed to assure that natural person monitors are adequately trained
- Procedures to inform senior staff as soon as an algorithmic trading problem is identified and
- Periodic review of the effectiveness of these policies and procedures
ANNUAL REPORTS

- Each AT Person must submit an annual report that must include:
  - Descriptions of pre-trade risk controls
  - Copies of the written policies and procedures providing for development and testing and for compliance with the CEA and
  - CEO/COO certification that the report is accurate and complete
- The reports are required to be submitted to DCMs annually by June 30th
SOURCE CODE REPOSITORIES

- Each AT Person must maintain “a source code repository to manage source code access, persistence, copies of all code used in the production environment, and changes to such code”
- Must be maintained in accordance with the current recordkeeping obligations under CFTC Regulation 1.31
- Under CFTC Regulation 1.31, an AT person would be required to make all of the information in the source code repository available to any representative of the CFTC or the U.S. Department of Justice upon request
- This provision has generated considerable controversy and at a public roundtable on June 10 and in our separate conversations with CFTC staff, there are indications that the CFTC is rethinking this provision — other provisions may also be reconsidered (comment period was reopened through June 24)