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CFTC OKs Electronic Trading Rules, Revises Bankruptcy Code

By **Tom Zanki**

Law360 (December 8, 2020, 8:53 PM EST) -- The U.S. Commodity Futures Trading Commission on Tuesday approved rules to mitigate market disruptions caused by electronic trading anomalies and enacted its first update to bankruptcy regulations in 37 years, both actions that seek to resolve long-standing priorities.

Regarding electronic trading, the CFTC by a 4-1 vote approved rules requiring exchanges to maintain risk controls and report unusual events to the CFTC. The rules otherwise grant the exchanges discretion to police unusual activity caused by electronic trading, which has mostly replaced the floor-trading systems of yesteryear when participants shouted buy and sell orders.

The boom in electronic trading is touted for its efficiency, but it can result in glitches leading to marketwide disruptions when systems go wrong. Perhaps the most notable anomaly occurred in the stock market with the "flash crash" in May 2010, a brief but deep plunge that quickly caused the loss of about $1 trillion in wealth before the market recovered in 36 minutes.

The CFTC polices derivatives and futures markets, which have also seen volatility involving automated trading, including a surge in digital messages that upset eurodollar futures in September and October 2019, a point made by Democratic CFTC Commissioner Rostin Behnam.

Tuesday's vote addressing electronic trading rules was supported by the CFTC's three Republican commissioners and Democrat Dan Berkovitz. CFTC commissioners said the new rules largely codify existing market practices, while providing the exchanges flexibility to respond to changing market conditions by developing new rules as necessary.

"This is an area where the exchanges are likely to possess the best understanding of the risks presented and have control over how their own systems operate," CFTC Chairman Heath Tarbert said. "As a result, exchanges have the incentive and the ability to address the risks arising from electronic trading."

Tuesday's rule came months after the CFTC withdrew a stricter attempt to rein in electronic trading anomalies known as Regulation Automated Trading, which would have required automated trading firms to register with the agency and produce their trading source code to regulators upon request. But Republican commissioners pulled the proposal in June on grounds that it was too prescriptive and left the exchanges little room to adapt to market changes.

Though he voted in support, Berkovitz said Tuesday's rule was also imperfect and noted that future circumstances may require a more prescriptive approach to provide stronger clarity to markets.

"Nevertheless I think something, after a decade, is better than nothing," Berkovitz added, referring to the 2010 "flash crash" and numerous instances of electronic trading anomalies since then.

Behnam argued the CFTC should have required stronger risk controls to prepare for future disruptions, especially instability related to climate change. He also pointed to the market-shaking events of April 20, when crude-oil prices plunged to negative $40 a barrel upon falling demand at the start of the pandemic, as a reason that regulators should be on guard.

"Under stressed market conditions, automated trading has the potential to quickly make an already volatile situation even worse," said Behnam, who cast the dissenting vote.

Separately, the CFTC unanimously agreed to amend Part 190 of its bankruptcy code, which regulates bankruptcies involving commodity brokers. This action mostly codified market practices that have evolved since the agency's bankruptcy rules were last revised in 1983.

Among other things, the CFTC outlined rules governing the bankruptcies of clearinghouses, also known as a derivatives clearing organizations. Part 190 did not previously specify what should happen in the event of a clearinghouse bankruptcy, leaving matters to be dealt with case by case.

The proposal would provide legal certainty and allow a bankruptcy trustee to work off an established "playbook" rather than quickly form a resolution plan amid a crisis, officials said.

Combined, both sets of rules approved Tuesday could provide market participants more clarity after years of uncertainty.

"The electronic trading rule has been a long controversial one and one the industry is waiting for finality on," said Covington & Burling LLP counsel Anne Termine, a former chief trial attorney in the CFTC's enforcement division. "The bankruptcy rule is noteworthy because it is the first overhaul in an extremely long time."

Tuesday's actions mark the latest in a busy year of rulemaking under Republican Tarbert before the five-member CFTC turns to Democratic control in 2021. The agency in October approved long-awaited position limits rules intended to curb speculators' ability to distort commodity prices, though both Democratic commissioners dissented, preferring tougher rules.

Prior to Tuesday's meeting, the CFTC also approved several amendments to rules relating to margin requirements for uncleared swaps, which become effective 30 days after publication in the Federal Register. The CFTC also withdrew several unimplemented portions of a 2018 proposal on swap execution facilities and trade execution requirements.

--Editing by Ellen Johnson.