

## The Risks of Automated Trading: FIA Responds to CFTC Questions

By Joanne Morrison

On Dec. 11 FIA submitted an extensive response to the Commodity Futures Trading Commission's "Concept Release on Risk Controls and System Safeguards for Automated Trading," which was issued in September as part of a broad examination of the impact of technology on U.S. futures markets.

The FIA response described the many risk controls and system safeguards that are currently in use in the futures industry, and outlined several principles for the CFTC to consider as it examines ways to further strengthen those controls and safeguards. The response also contained detailed responses to specific questions posed by the CFTC in its concept release, and drew on the collective expertise of nearly 100 individuals from members of FIA and the FIA Principal Traders Group.

"FIA has a long track record in identifying best practices for managing the risks of trading, and we appreciate the fact that the CFTC has relied on our work in this area in developing its policies towards

automated trading," commented FIA President and Chief Executive Officer Walt Lukken. "We hope that our response will provide policymakers with useful insights on the current state of the art in risk management."

FIA recommended that the CFTC consider the following principles as it examines the risks of automated trading:

- The risks of automated trading are not limited to any one set of market participants, and risk controls and system safeguards should apply to all participants that use automated trading systems as well as technology providers.
- All market participants have a responsibility to implement risk controls appropriate to their role in the life of an order, whether that role is initiating the trade, routing the trade, executing the trade or clearing the trade.
- Risk control requirements should be principles-based so that they remain effective as markets, technology and trading strategies evolve.
- Regulators should encourage industry efforts to protect markets through further innovation in risk controls and system safeguards.

### FIA Surveys on Risk Controls

FIA conducted two surveys in support of the response: one asking about risk controls used by trading firm members of FIA PTG, with 26 firms responding, and the other asking about risk controls used by futures commission merchant members of FIA, with nine FCMs responding.

The survey results showed that best practice risk controls are widely used by member firms. All responding FIA PTG firms indicated that they used some form of pre-trade maximum order size screens, data reasonability checks, repeated automated execution throttles, and self-trading controls.

In addition, all responding firms indicated they were either using, or considering using, some form of drop copy functionality as a risk control. The survey results also showed that all responding FCMs use the following controls either administered internally or at the exchange level: message and execution throttles; price collars; maximum order sizes; order, trade and position drop copy; and order cancellation capabilities. In addition, all responding FCMs use some form of a kill switch or other means to stop order submission when necessary. ■

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Joanne Morrison is deputy editor of *Futures Industry*.

### EYE ON RISK

The agency's concept release was a key topic at a September meeting of the agency's Technology Advisory Committee, which was chaired by CFTC Commissioner Scott O'Malia.

*Pictured left to right: CFTC Chairman Gary Gensler, CFTC Commissioner Scott O'Malia, and CFTC Commissioner Mark Wetjen.*

