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By Electronic Mail

July 29, 2016

Mr. Christopher J. Kirkpatrick
Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington DC 20158

Re: ICE Futures U.S. – Amendment to Block Trade FAQ

Dear Mr. Kirkpatrick:

The Futures Industry Association (“**FIA**”)¹ is pleased to submit this letter in connection with the Commodity Futures Trading Commission’s (“**Commission**”) review of the proposed amendment to the Block Trade FAQ that ICE Futures U.S. (“**IFUS**”) has certified to the Commission.² IFUS has proposed to amend the FAQ to add a new FAQ 24 to confirm that certain parties to a permitted block trade under IFUS Rule 4.07 may engage in market transactions to hedge positions prior to the execution of the block trade (“**pre-hedging transactions**”), *provided*, they believe in good faith that such positions will result from a block trade that is under negotiation (“**FAQ 24**”).

FIA supports the certification of FAQ 24. However, as explained below, we believe that FAQ 24 unnecessarily precludes certain parties that would otherwise wish to participate in a block trade from participating in pre-hedging transactions, thereby reducing competition for the block trade to the potential detriment of the customer. Specifically, whenever an FCM is acting in the capacity of an

¹ FIA is the leading trade organization for the global futures, options and over-the-counter cleared derivatives markets. Its mission is to support open, transparent and competitive markets, protect and enhance the integrity of the financial system and to promote high standards of professional conduct. FIA’s core constituency consists of futures commission merchants (“**FCMs**”), and the primary focus of the association is the global use of exchanges, trading systems and clearinghouses for derivatives transactions. FIA’s regular members, which act as the majority clearing members of US exchanges, handle more than 90 percent of the customer funds held for trading on US futures exchanges. They provide the majority of the funds that support these clearinghouses and commit a substantial amount of their own capital to guarantee customer transactions.

² The Division of Market Oversight (“**Division**”), pursuant to delegated authority under Commission Rule 40.7(a)(2)(iii), determined that the proposal “presents novel or complex issues that require additional time to analyze and may be inconsistent with” the Commodity Exchange Act or Commission rules. The Division, therefore, stayed certification of the proposal in accordance with Commission Rule 40.6(c) and requested public comment thereon.

intermediary with respect to a block trade, FAQ 24 would prohibit (i) the separately managed and supervised trading desk of the FCM and (ii) the FCM's affiliates from participating in pre-hedging transactions. For the reasons explained below, we encourage IFUS to amend FAQ 24 to remove the prohibition on intermediaries, and their affiliates, from participating in pre-hedging transactions and urge the Commission to approve such an amendment.³

Proposed FAQ 24 recognizes that pre-hedging transactions facilitate the execution of block trades, especially in less liquid markets. In circumstances in which a counterparty is unable to hedge its risk in entering into a block trade until the trade has been executed, as is currently the case on IFUS, the price at which a counterparty is willing to enter into the block trade will necessarily include a premium to compensate the counterparty for assuming that risk. If, on the other hand, a counterparty is better able to assess its risk by entering into a pre-hedging transaction, including in a related market, prior to executing the block trade, the risk premium will be reduced. If a counterparty is permitted to enter into a pre-hedging transaction, therefore, the benefit will flow to the customer.

Notwithstanding this benefit, whenever a customer's FCM is acting as the customer's intermediary with respect to a block trade, proposed FAQ 24 would effectively prohibit (i) the separately managed and supervised trading desk of the FCM and (ii) the FCM's affiliates from participating in pre-hedging transactions. Specifically FAQ 24 prohibits an FCM when acting in its capacity as the customer's intermediary from entering into pre-hedging transactions "in any account which is owned or controlled, or in which an ownership interest is held by the [FCM], or for the proprietary account of the employer of such [FCM]."

We believe this prohibition is misguided. The trading desk of an FCM and the FCM's affiliates would have no reason to participate in negotiating a block trade when other potential counterparties are provided a critical tool for assessing market risk, which the FCM and its affiliates are denied. Prohibiting the trading desk of the customer's FCM, or such FCM's affiliates, from entering into pre-hedging transactions, therefore, (i) unnecessarily denies the customer access to an important block trade counterparty and a potentially better price, and (ii) places the FCM and its affiliates at a competitive disadvantage to other potential counterparties.

We appreciate that the authority to enter into pre-hedging transactions may expose an FCM to potential conflicts of interest. However, since any counterparty to a block trade must be an eligible contract participant and, therefore, is deemed knowledgeable, we believe any potential conflicts of interest can be addressed through disclosure to the customer and the customer's consent (including negative consent) to such pre-hedging transactions.

Such disclosure is consistent with the approach that the Financial Industry Regulatory Authority ("FINRA") adopted in FINRA Rule 5270, prohibiting front running of block transactions. Notwithstanding the general prohibition on front running, the supplementary information published concurrently with the adoption of Rule 5270 makes clear that the rule does not preclude a broker-dealer, including a customer's intermediary, from entering into transactions "for the purpose of fulfilling, or facilitating the execution of, the customer block order." Importantly, however, the

³ A marked copy of FAQ 24 highlighting our suggested revisions is enclosed as Exhibit A.

broker-dealer must clearly disclose to its customer the terms and conditions for handling the customer's orders. If the customer does not object, then the broker-dealer may reasonably conclude that the customer has consented.⁴

The supplementary information further provides that the broker-dealer should be able to demonstrate that any pre-hedging transactions that otherwise would appear to violate the prohibition on front running transactions were undertaken to fulfill or facilitate the execution of the customer's block trade. It also emphasizes that the broker-dealer "must minimize any potential disadvantage or harm in the execution of the customer's order, [and] must not place the [broker-dealer's] financial interests ahead of those of its customer."

Along these same lines, we note that, as provided in FAQ 24, any party that enters into pre-hedging transactions, including an FCM and any affiliate of the FCM, must at all times be acting in good faith. Moreover, such remains subject to all other IFUS rules designed to protect customers, including, *e.g.*, (i) Rule 4.02(h), the prohibition on front running, (ii) Rule 4.02(i), the prohibition on disclosing a customer's order except in furtherance of the execution of the order, and (iii) Rule 4.04, the prohibition on engaging in conduct or practices inconsistent with just and equitable principles of trade or conduct detrimental to the best interests of IFUS. We submit that these rules are sufficient to protect an FCM's block trade customers from potential abuse. Certainly, IFUS's ability to audit for potential violations of these rules is no less difficult than auditing non-members for potential violation of such rules.⁵

Separately, we ask IFUS to further amend FAQ 24 to clarify that parties solicited to provide a two-sided block market are not deemed to be in possession of an impending block trade, *provided* that the side of the market in which the customer has an interest is not disclosed in connection with the solicitation. We do not believe that a request for a two-sided market provides a party with sufficient knowledge of a customer's intent to implicate a potential violation of the IFUS rules cited above.⁶

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⁴ FINRA Rule 5270 may be accessed at http://finra.complinet.com/en/display/display.html?rbid=2403&record_id=14821&element_id=10860&highlight=5270#r14821. We also note that OneChicago Exchange previously certified an interpretation to the Commission, Regulatory Release 2011-8, that provides guidance to OneChicago members with respect to pre-hedging transactions in connection with block trades under OneChicago Exchange Rule 417.

http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul050611onec_hicago001.pdf.

⁵ As with FINRA Rule 5270, we recognize that any party that enters into a pre-hedging transaction would bear the burden of establishing that the transaction was entered into to facilitate the customer's block trade and that its conduct did not otherwise violate applicable IFUS rules.

⁶ CME Block Trade FAQ 12 is similar. See <http://www.cmegroup.com/rulebook/files/RA1604-5.pdf>.

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FIA appreciates the Commission's consideration of these comments. If any member of the Commission or the Commission's staff have any questions or need any additional information with respect to the matters discussed herein, please contact Allison P. Lurton, FIA's General Counsel, at 202.466.5460 or alurton@fia.org.

Sincerely,



Allison Lurton

SVP and General Counsel

cc: Division of Market Oversight
Vince A. McGonagle, Director
David Van Wagner, Chief Counsel
Steven Sherrod, Senior Economist

ICE Futures U.S.
Trabue Bland, President
Conor Weber, Compliance Counsel
Erik Haas, Director – Market Regulation
Kara Dutta, Assistant General Counsel

EXHIBIT A

24. Is pre-hedging or anticipatory hedging of a block trade permitted?

Parties to a block trade may engage in pre-hedging or anticipatory hedging of the position that they believe in good faith will result from the consummation of the block trade, ~~except for an intermediary that takes the opposite side of its own Customer order. In such instances, prior to the consummation of~~ provided, however, that where an agency desk within a futures commission merchant (“FCM”) or an individual is engaged as an intermediary to identify potential counterparties to a block trade (such agency desk or individual hereafter referred to as the “Intermediary”), and that Intermediary acts as a counterparty to the block trade, the intermediary ~~Intermediary is prohibited from offsetting the position established by the block trade in any account which is owned or controlled, or in which an ownership interest is held by the intermediary, or for the proprietary account of the employer of such intermediary in the same~~ product or a closely-related product prior to the consummation of the block trade. The intermediary may enter into transactions to offset the position only after the block has been consummated, which includes the period prior to it being publicly reported by the Exchange.

For the avoidance of doubt, where an Intermediary is engaged by a customer to identify potential counterparties to a block trade, and (i) a separately supervised and controlled trading desk of such Intermediary or (ii) an affiliate of such Intermediary (together an “Affiliate Counterparty”) becomes the counterparty to such block trade, such Affiliate Counterparty shall not be prohibited from offsetting the position that the Affiliate Counterparty believes in good faith will result from the consummation of the block trade prior to the consummation of the block trade.

It shall be a violation of Exchange Rule 4.02(h) for a Person to engage in the front running of a block trade when acting on material non-public information regarding an impending transaction by another person, acting on non-public information obtained through a confidential employee/employer relationship, broker/customer relationship, or in breach of a fiduciary responsibility.

The Exchange may proceed with enforcement action when the facts and circumstances of pre-hedging suggest deceptive or manipulative conduct by any of the involved parties, including when an intermediary handling a Customer order acts against its Customer’s best interests.

Parties solicited to provide a two-sided block market are not deemed to be in possession of non-public information provided that side of market interest is not disclosed in the context of the solicitation.