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CFTC Publishes a Proposed Interpretive Order on Disruptive Trading Practices under Dodd-Frank

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The Dodd-Frank Wall Street Reform and Consumer Protection Act added a new Section 4c(a)(5) to the Commodity Exchange Act (CEA) regarding disruptive trading practices, which prohibits any trading, practice or conduct on or subject to the rules of a "registered entity" that (a) violates bids or offers; (b) demonstrates intentional or reckless disregard for the orderly execution of transactions during the closing period; or (c) is, is of the character of, or is commonly known to the trade as, "spoofing" (bidding or offering with the intent to cancel the bid or offer before execution).

On March 18, the Commodity Futures Trading Commission published a proposed interpretive order regarding these disruptive trading practices under the Dodd-Frank Act (and simultaneously terminated a previously issued advance notice of proposed rulemaking on the same subject). The proposed interpretive order provides market participants with guidance regarding CEA Section 4c(a)(5) and addresses concerns by market participants in response to the advanced notice of proposed rulemaking. Items clarified by the proposed interpretive order include the scope of Section 4c(a)(5), what specific conduct and trading practices would violate the statute, what it means to "violate" bids or offers, and certain other terms set forth in the statute.

Specifically, the CFTC's proposed interpretation of CEA Section 4c(a)(5) provides for this purpose that:

- a "registered entity" includes a designated contract market (DCM) or swap execution facility (SEF), but not a swap data repository;
- CEA Section 4c(a)(5) does not apply to block trades or exchanges for related positions, even if transacted on a DCM or SEF;
- "closing period" means "the period in the contract or trade when the daily settlement price is determined under the rules of that trading facility" (although activity outside the closing period may be included in an investigation under CEA Section 4c(a)(5)(B)); and
- "spoofing" includes submitting or cancelling bids or offers to (1) overload the quotation system of a registered entity, (2) delay another person's execution of trades, or (3) create the appearance of market depth (subject to a good faith exclusion).

Further, the CFTC's proposed interpretation provides guidance on how the CFTC proposes to construe each of the three clauses of Section 4c(a)(5):

- Section 4c(a)(5)(A) forbids "buying a contract at a price that is higher than the lowest available offer price and/or selling a contract at a price that is lower than the highest available bid price." The CFTC's proposed interpretation would deem such a purchase or sale to be in violation of Section 4c(a)(5)(A), regardless of the intent of the buyer or seller.
- In determining whether a violation has occurred under Section 4c(a)(5)(B), the CFTC will evaluate the facts and circumstances at the time of the relevant trading, practice or conduct. The CFTC's proposed interpretation, therefore, directs market participants to "assess market conditions and consider how their trading practices and conduct affect the orderly execution of transactions during the closing period."
- A violation under Section 4c(a)(5)(C) requires that a market participant have the intention to cancel a bid or offer before execution (as opposed to merely acting recklessly). An investigation of a violation of this provision will involve "evaluating all of the facts and circumstances of each particular case, including a person's trading practices and patterns."

Comments on the proposed interpretive order must be received by May 17. The *Federal Register* release is available here.

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