



## Rule Self-Certification

April 6, 2015

### VIA ELECTRONIC PORTAL

Christopher J. Kirkpatrick  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21<sup>st</sup> Street, N.W.  
Washington, DC 20581

Re: **Regulation §40.6 Submission Certification**  
**Disruptive Trading Practices**  
**Reference File: SR-NFX-2015-16**

Dear Mr. Kirkpatrick:

Pursuant to Section 5c(c)(1) of the Commodity Exchange Act, as amended (“Act”), and Section 40.6(a) of the regulations promulgated by the Commodity Futures Trading Commission under the Act, NASDAQ Futures, Inc. (“NFX” or “Exchange”) amends Chapter III, Section 24, entitled “General Trading Standards and Prohibited Practice” and adopts Disruptive Trading Practices Guidance in the form of a Futures Regulatory Alert. The amendment to Chapter III, Section 24 and the Disruptive Trading Practices Guidance will be implemented on April 21, 2015. The text of Chapter III, Section 24 is set forth in Exhibit A. The Futures Regulatory Alert containing the Disruptive Trading Practices Guidance is set forth in Exhibit B. The Futures Regulatory Alert would be issued on April 21, 2015, the date of implementation.

The Exchange amends Chapter III, Section 24, entitled “General Trading Standards and Prohibited Practice” to specify that knowingly entering any bid or offer for the purposes of making a market price which does not reflect the true state of the market, or knowingly entering, or causing to be entered bid or offers other than in good faith for the purposes of executing a bona fide transaction. The Exchange offers specific examples of conduct which is prohibited on NFX with respect to entering Orders into the Trading System.

The Exchange will issue a Futures Regulatory Alert clarifying the types of practices that are prohibited pursuant to Chapter III, Section 24. The Exchange’s alert contains an FAQ which addresses, among other things, the factors that may

be considered in assessing a potential violation of this Rule, order exposure time frames and modify and cancelling orders. The Exchange desires to provide guidance with market participants with respect to prohibited activities on NFX.

With respect to the designated contract market core principles (“Core Principles”) as set forth in the Act:

- *Compliance with Rules:* Today the Exchange has in place Rules which describe the manner in which Futures Participants may access and trade on NFX. Chapter II, Section I provides for the qualifications and rules of participation applicable to Futures Participants as well as Authorized Traders. Chapter V, Section 18 describes prohibited activities with respect to the Trading System. Trading is subject to the Rules at Chapter III of the Exchange’s Rulebook, which include prohibitions against fraudulent, noncompetitive, unfair and abusive practices. Additionally, trading is subject to the trading procedures and standards in Chapter V of the Rulebook. The Exchange’s disciplinary Rules are contained in Chapter VI of the Rulebook.
- *Prevention of Market Disruption:* The Exchange’s Regulatory Department, which handles real-time surveillance, monitors trading activity on the Exchange with a SMARTS Surveillance Application through which the Exchange can track activity of specific Authorized Traders, monitor price and volume information and receive alerts regarding market messages. The Exchange’s Regulatory Department, which handles real-time surveillance in conjunction with staff that handles T+1 surveillance, utilizes data collected by the SMARTS Surveillance Application to monitor price movements, as well as market conditions and volumes to detect suspicious activity such as manipulation, disruptive trading and other abnormal market activity.
- *Availability of Contract Information.* The Exchange has indicated within its trading Rules where specific information relates to a particular Contract. The Exchange will post the terms and conditions of Exchange Contracts in its Rulebook along with trading Rules.
- *Protection of market participants.* Chapter III of the Exchange’s Rulebook contains prohibitions precluding intermediaries from disadvantaging their customers. These rules apply to trading in all Contracts.

There were no opposing views among the Exchange’s Board of Directors, members or market participants. The Exchange hereby certifies that the amendments to Chapter III, Section 24, entitled “General Trading Standards and

Prohibited Practice” and Disruptive Trading Practices Guidance in the form of a Futures Regulatory Alert comply with the Commodity Exchange Act and regulations thereunder. The Exchange also certifies that a notice of pending certification with the Commission and a copy of this submission have been concurrently posted on the Exchange’s website at <http://www.nasdaqomx.com/transactions/markets/nasdaq-futures>.

If you require any additional information regarding the submission, please contact Angela S. Dunn at +1 215 496 5692 or via e-mail at [angela.dunn@nasdaq.com](mailto:angela.dunn@nasdaq.com). Please reference SR-NFX-2015-16 in any related correspondence.

Regards,

A handwritten signature in black ink that reads "Daniel R. Carrigan". The signature is written in a cursive, flowing style.

Daniel R. Carrigan  
President

cc: National Futures Association

**Exhibit A**

*New text is underlined; deleted text is in brackets.*

**Chapter III Obligations of Futures Participants and Authorized Traders**

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**Section 24 General Trading Standards and Prohibited Practices**

(a) – (f) No change.

(g) Futures Participants and Authorized Traders shall not:

(1) Engage in practices that may cause degradation of the Exchange's services or facilities, or that may cause a disorderly market, including but not limited to, unwarranted use of cancelling and resubmitting Orders;

(2) Engage in pre-arranged transactions other than transactions executed in compliance with Chapter IV, Sections 11 (Block Trades) and 12 (Exchange for Related Positions) and Chapter V, Section 11 (Pre-Negotiated Business and Cross Transactions); or

(3) Engage in acts, practices, or conduct contrary to the purposes of the Exchange or likely to bring the Exchange into disrepute. These prohibited practices include, but are not limited to:

(i) effecting a transaction in, or inducing the purchase or sale of, any Contract through any manipulative, deceptive, or fraudulent device or contrivance;

(ii) engaging in price manipulation or cornering of the market;

(iii) engaging in wash transactions (or other activities that may or may not involve the making of a Contract) that creates a misleading appearance of activity occurring on the Trading System and/or causes the reporting of a misleading price level;

(iv) engaging in accommodation transactions, by which one party enters into a Contract with another party knowing or having reason to know that such transaction was an attempt to conceal a trading abuse;

(v) engaging in "front-running" or "trading-ahead," where a party knowingly places an Order or executes a trade for a Contract while in possession of material nonpublic information concerning an imminent Block Trade or Customer Order;

(vi) engaging in "cherry picking," where a party assigns a trade for a Customer to the account of another Customer or party (for any reason, even if only temporarily, where the situation is not remedied) and the trade assigned to the other Customer or party is at a superior price than the trade price received by the Customer;

(vii) withdrawing, withholding, disclosing, or taking advantage of a Customer Order in whole or in part for the benefit of any other Person;

(viii) engaging in compensation trades, where one or more parties executes non-competitive trades to transfer money between accounts; and

(ix) engaging in conduct or practices detrimental to the best interests of the Exchange.

(x) engaging in any other manipulative or disruptive trade practices prohibited by the Commodity Exchange Act, as amended, or Commission regulations, including but not limited to, "spoofing," "improper cross trading," "money passes," and trading against a Customer Order

(4) Knowingly enter any bid or offer for the purposes of making a market price which does not reflect the true state of the market, or knowingly entering, or causing to be entered bid or offers other than in good faith for the purposes of executing a bona fide transaction. Additionally, all non-actionable Orders must be entered in good faith for legitimate purposes.

(i) No Futures Participant shall enter or cause to be entered an Order with the intent, at the time of order entry, to cancel the Order before execution or to modify the Order to avoid execution;

(ii) No Futures Participant shall enter or cause to be entered an actionable or non-actionable message or messages with intent to mislead other market participants;

(iii) No Futures Participant shall enter or cause to be entered an actionable or non-actionable message or messages with intent to overload, delay, or disrupt the systems of the Exchange or other market participants; and

(iv) No Futures Participant shall enter or cause to be entered an actionable or non-actionable message with intent to disrupt, or with reckless disregard for the adverse impact on, the orderly conduct of trading or the fair execution of transactions.

\* \* \* \* \*

## Exhibit B

### Futures Regulatory Alert #2015 - XX Disruptive Trading Practices Rule and FAQ

#### Markets Impacted:

- [NASDAQ Futures, Inc.](#)

#### Contact Information:

- John Pickford at [FuturesReg@nasdaq.com](mailto:FuturesReg@nasdaq.com)

#### What you need to know:

- Effective May 1, 2015, NASDAQ Futures, Inc. (NFX) will implement amendments to Chapter III, Section 24 which consolidate the rules prohibiting disruptive trading practices into new subparagraph (g) (4) and adds language to provide additional clarification as to the types of practices that are prohibited.
- Disruptive trading practices are also prohibited pursuant to other sections of Chapter III Section 24 (g)(1), Chapter III Section 24 (g)(3)(i), and Chapter III Section 21.

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### The Exchange has amended its Rules at Chapter III, Section 24 to add a new section (g) which prohibits certain disruptive trade practices.

New Chapter III, Section 24(g)(4) provides that Futures Participants and Authorized Traders shall not:

**(4) Knowingly enter any bid or offer for the purposes of making a market price which does not reflect the true state of the market, or knowingly entering, or causing to be entered bid or offers other than in good faith for the purposes of executing a bona fide transaction. Additionally, all non-actionable Orders must be entered in good faith for legitimate purposes.**

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**(ii) No Futures Participant shall enter or cause to be entered an actionable or non-actionable message or messages with intent to mislead other market participants;**

**(iii) No Futures Participant shall enter or cause to be entered an actionable or non-actionable message or messages with intent to overload, delay, or disrupt the systems of the Exchange or other market participants; and**

**(iv) No Futures Participant shall enter or cause to be entered an actionable or non-actionable message with intent to disrupt, or with reckless disregard for the adverse impact on, the orderly conduct of trading or the fair execution of transactions.**

### FAQs related to Chapter III Section 24(g)(4)

1. **What factors may be considered in assessing a potential violation of the Chapter III, Section 24(g)(4) regarding disruptive trading practices, including spoofing?**

NFX Regulation may consider a variety of factors in assessing whether conduct violates the Rules, including, but not limited to:

- whether the market participant's intent was to induce others to trade when they otherwise would not;
- whether the market participant's intent was to affect a price rather than to change his position;

- whether the market participant's intent was to create misleading market conditions;
- market conditions in the impacted market(s) and related markets;
- the effect on other market participants;
- the market participant's historical pattern of activity;
- the market participant's Order entry and cancellation activity;
- the size of the Order(s) relative to market conditions at the time the Order(s) was placed;
- the size of the Order(s) relative to the market participant's position and/or capitalization;
- the number of Orders;
- the ability of the market participant to manage the risk associated with the Order(s) if fully executed;
- the duration for which the Order(s) is exposed to the market;
- the duration between, and frequency of, non-actionable messages;
- the queue position or priority of the Order in the Order Book;
- the prices of preceding and succeeding bids, offers, and trades;
- the change in the best offer price, best bid price, last sale price, or other price that results from the entry of the Order; and
- the market participant's activity in related markets.

**2. What does "mislead" mean in the context of the Chapter III, Section 24(g)(4)?**

The language is intended to be a more specific statement of the general requirement that market participants are not permitted to act in violation of just and equitable principles of trade. This section of the Rule prohibits a market participant from entering Orders or Quotes messages with the intent of creating the false impression of market depth or market interest. NFX Regulation generally will find the requisite intent where the purpose of the participant's conduct was, for example, to induce another market participant to engage in market activity.

**3. Is there a specific amount of time an Order should be exposed to the market to demonstrate that it does not constitute a disruptive practice?**

Although the amount of time an Order or Quote is exposed to the market may be a factor that is considered when determining whether the Order or Quote constituted a disruptive trading practice, there is no prescribed safe harbor. NFX Regulation will consider a variety of factors, including exposure time, to determine whether an Order or Orders constitute a disruptive practice.

**4. Is it a violation of the Chapter III, Section 24(g)(4) to modify or cancel an Order once it has been entered?**

An Order or Quote, entered with the intent to execute a bona fide transaction that is subsequently modified or cancelled due to a perceived change in circumstances does not constitute a violation of the Rules.

**5. Will Orders that are entered by mistake constitute a violation of Exchange Rules?**

An unintentional, accidental, or "fat-finger" Order will not constitute a violation of the Rules, but such activity may be a violation of other Exchange Rules, including, but not limited to Rules pertaining to acts that are detrimental to the best interests of the Exchange. Market participants are expected to take steps to mitigate the occurrence of errors, and their impact on the market. This is particularly true for entities that run algorithmic trading applications, or otherwise submit large numbers of automated orders to the market.

**6. Does a partial fill of an Order or Quotes demonstrate that the Order did not violate the Rules?**

While execution of an Order, in part or in full, may be one indication that an Order was entered in good faith, an execution does not automatically cause the Order to be considered compliant with the Chapter III, Section 24(g)(4). Orders must be entered in an attempt to consummate a trade. A variety of factors may lead to a violative Order ultimately achieving an execution. NFX Regulation will consider a multitude of factors in assessing whether the Rules has been violated.

**7. Under this new Rule, is a market participant prohibited from making a two-sided market with unequal quantities (e.g., 100 bid at 10 offered)?**

No. Market participants are not precluded from making unequal markets as long as the Orders or Quotes are entered for the purpose of executing bona fide transactions. If either (or both) Order(s) or Quotes are entered with prohibited intent, including recklessness, such activity will constitute a violation of the Rules.

**8. Is the use of Iceberg Orders or Quotes considered misleading under the Chapter III, Section 24(g)(4)?**

No. The use of Iceberg Orders, in and of itself, is not considered a violation of the Rules. However, a violation may exist if an Iceberg Order is used as part of a scheme to mislead other market participants; for example, if a market participant pre-positions an Iceberg on the bid and then layers larger displayed quantities on the offer to create artificial downward pressure that results in the Iceberg Order being partially or completely filled.

**9. Is a market participant allowed to enter Order(s) at various price levels throughout the Order Book in order to gain queue position, but subsequently cancel those Orders as the market changes?**

It is understood that market participants may want to achieve queue position at certain price levels, and given changing market conditions may wish to modify or cancel those Orders. In the absence of other indicia that the Orders were entered for disruptive purposes, they would not constitute a violation of Chapter III, Section 24(g)(4).

**10. How does NFX Regulation define “orderly conduct of trading or the fair execution of transactions?”**

Whether a market participant intends to disrupt the orderly conduct of trading or the fair execution of transactions or demonstrates a reckless disregard for the orderly conduct of trading or the fair execution of transactions may be evaluated only in the context of the specific instrument, market conditions, and other circumstances present at the time in question. Some of the factors that may be considered in determining whether there was orderly conduct or the fair execution of transactions were described by the CFTC as follows: “[A]n orderly market may be characterized by, among other things, parameters such as a rational relationship between consecutive prices, a strong correlation between price changes and the volume of trades, levels of volatility that do not dramatically reduce liquidity, accurate relationships between the price of a derivative and the underlying such as a physical commodity or financial instrument, and reasonable spreads between contracts for near months and for remote months.” See Anti-disruptive Practices Authority, 78 Fed. Reg. at 31,895-96. Volatility alone, however, will not be presumptively interpreted as disorderly or disruptive as market volatility can be consistent with markets performing their price discovery function.

**11. What factors will NFX Regulation consider in determining if an act was done with the prohibited intent or reckless disregard of the consequences?**

Proof of intent is not limited to instances in which a market participant admits its state of mind. Where the conduct was such that it more likely than not was intended to produce a prohibited disruptive consequence, intent may be found. Claims of ignorance, or lack of knowledge, are not acceptable defenses to intentional or reckless conduct. Recklessness has been commonly defined as conduct that “departs so far from the standards of ordinary



care that it is very difficult to believe the actor was not aware of what he or she was doing.” See Drexel Burnham Lambert, Inc. v. CFTC, 850 F.2d 742, 748 (D.C. Cir. 1988).

**12. Are Orders or Quotes entered for the purpose of igniting momentum in the market prohibited by Chapter III, Section 24(g)(4)?**

A “momentum ignition” strategy occurs when a market participant initiates a series of Orders or transactions in an attempt to ignite a price movement in that market or a related market. This conduct may be deemed to violate the Rules if it is determined the intent was to disrupt the orderly conduct of trading or the fair execution of transactions, if the conduct was reckless, or if the conduct distorted the integrity of the determination of settlement prices. Further, this activity may violate the Rules; if the momentum igniting Orders were intended to be canceled before execution, or if the Orders were intended to mislead others. If the conduct was intended to create artificially high or low prices, this may also constitute a violation of the Rules

**13. Is changing from buying to selling with respect to an Order prohibited by Chapter III, Section 24(g)(4)?**

NFX Market Regulation recognizes there are many variables that can cause a market participant to change their perspective of the market. The Rules do not prohibit a market participant from changing his bias from short (long) to long (short). However, certain activity may be considered disruptive to the marketplace. For example, repeated instances of a market participant cancelling Orders on one side of the market and then entering Orders in the other direction that are large enough to turn the market (i.e., being of a sufficient quantity to sweep the entire quantity on the Order Book at the particular price level and create a new best bid or best offer price) can be disruptive to the orderly conduct of trading or the fair execution of transactions.

**14. Does NFX Regulation consider cancelling an Order utilizing NFX’s Self-Match Trade Prevention Functionality (“STPF”) or other self-match prevention technology indicative of an Order being in violation of the Rules?**

The means by which an Order is cancelled, in and of itself, is not an indicator of whether an Order violates the Rules. The use of STPF in a manner that causes a disruption to the market may constitute a violation of the Rules. Further, if the resting Order that was cancelled was non-bona fide, ab initio, it would be considered to have been entered in violation of the Rules.

**15. What type of pre-open activity is prohibited by the Rules?**

As described in question 1, any activity that influences a market price may be considered when reviewing disruptive trading practices. This includes Order activity during the Pre-Open Session that influences a price visible to the market, such as the indicative opening price, if the purpose of that Order activity is not to execute a bona fide transaction. Other activity related to the Pre-Open Session may also be considered disruptive, including but not limited to the entry of Orders prior to the beginning of the Pre-Open Session in an attempt to “time” the FIFO priority queue for Trade-At-Settlement (“TAS”) transactions, or other similar purposes.

**16. Is the creation or execution of User Defined Strategies (“UDS”) for the purposes of deceiving or disadvantaging other market participants a violation of the Rules?**

Yes. UDS functionality requires users to exercise diligence and care in the creation of Option spread instruments, including the creation of covered Option strategies. Market participants are reminded that knowingly creating and/or trading UDS instruments in a manner intended to deceive or unfairly disadvantage other market participants is considered a violation of the Rules. Additionally, NFX Regulation may price adjust or cancel trades that are deemed to negatively impact the integrity of the market pursuant to Chapter V, Section 5.

**17. Are Stop Orders entered for purposes of protecting a position prohibited by Chapter III, Section 24(g)(4)?**

Market participants may enter Stop Orders as a means of minimizing potential losses with the hope that the Order will not be triggered. However, it must be the intent of the market participant that the Order will be executed if the specified condition is met. Such an Order entry is not prohibited by this Rule.

**18. Is it prohibited to enter an Order for a quantity larger than a market participant expects to trade in electronic markets subject to a Size Pro-Rata matching algorithm?**

Orders entered for the purpose of achieving an execution are permitted. Accordingly, Orders entered into markets subject to a Size Pro-Rata execution algorithm, which are intended to maximize execution of those Orders, are permitted. However, it is considered an act detrimental to the welfare of NFX and may be a violation of other Exchange Rules for a market participant to enter an Order without the ability to satisfy, by any means, the financial obligations attendant to the transaction that would result from full execution of the Order. Participants should be prepared to, and capable of, handling the financial obligations attendant to the full execution of their Orders.

**19. What are “actionable” and “non-actionable” messages in relation to Chapter III, Section 24(g)(4)(ii), (iii), and (iv)?**

Actionable Orders and Quotes are messages that can be accepted by another party or otherwise lead to the execution of a trade.

**20. Is a market participant precluded from entering Orders that may be considered large for a particular market, and thus may have a potential impact on the market?**

The size of an Order or cumulative Orders may be deemed to violate Chapter III, Section 24(g)(4) if the entry results in disorderliness in the markets, including, but not limited to, price or volume aberrations. Market participants should further be aware that the size of an Order may be deemed to violate Chapter III, Section 24(g)(4) if that Order distorts the integrity of the settlement prices. Accordingly, market participants should be cognizant of the market characteristics of the products they trade and ensure that their Order entry activity does not result in market disruptions. Exigent circumstances may be considered in determining whether a violation of Chapter III, Section 24(g)(4) has occurred and, if so, what the appropriate sanction should be for such violation.