Received CFTC
Records Section

00-14
NC 1

RECEIVED
C.F.T.C.

CHICAGO MERCANTILE EXCHANGE

'00 FEB 28 AM 9 05

OFFICE OF THE SECRETARIAT

Richard J. McDonald
Senior Vice President, Research
and Chief Economist
312/930-4574
FAX: 312/930-4517
dmcdonal@cme.com

Post-it® Fax Note 7671	Date 25 FEB	# of pages ▶ 7
To Ms Jean A Webb	From Dick McDonald	
Co./Dept. CFTC	Co. CME	
Phone #	Phone # 312 930 4574	
Fax # 202 418 5521	Fax #	

February 25, 2000

RECEIVED
C.F.T.C.
'00 APR 13 AM 7 48

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: Section 5a(a)(12)(A), Regulation §1.41(c) Submission. Rule 526. – **Block Transactions.** CME Submission #00-21.

VIA FACSIMILE

Dear Ms. Webb:

I. SUBMISSION

The Chicago Mercantile Exchange ("CME" or "Exchange") hereby submits for Commission review and approval, in accordance with Section 5a(a)(12)(A) of the Act and Regulation §1.41(c), new Rule 526. – **Block Transactions**.

II. TEXT OF THE PROPOSED RULE

The proposed rule (underlined) follows. A clean copy is attached as Appendix A.

526. Block Transactions: Notwithstanding Rule 520. – TRADING CONFINED TO EXCHANGE FACILITIES –, the Board or a Committee appointed by the Board shall, from time to time, determine the minimum thresholds for and the commodities in which Block Transactions (privately negotiated transactions) shall be permitted. The following shall govern Block Transactions:

A. A member may execute a Block Transaction for a specified quantity at or in excess of the applicable minimum threshold designated by the Board.

B. Each party to a Block Transaction must be an Eligible Participant as that term is defined in Commission Regulation § 36.1.

C. A member shall not execute any order by means of a Block Transaction unless that order meets the applicable minimum threshold and includes specific instructions to execute a Block Transaction.

D. The price at which a Block Transaction is executed must be "fair and reasonable" in light of (i) the size of such Block Transaction, (ii) the prices and sizes of other transactions in the same contract at the relevant time, (iii) and the prices and sizes of transactions in the corresponding cash market at the relevant time.

E. Block Transactions shall not set off conditional orders (e.g., Stop Orders, MIT Orders, etc.) or otherwise affect orders in the regular market.

F. All Block Transactions must be reported to a designated Exchange official within five minutes of the time of execution. The report must include the contract, contract month, price, and quantity of the transaction. The Exchange shall immediately publish such information separately from the reports of transactions in the regular market.

G. Clearing firms must report Block Transactions to the Exchange Clearing House, including the time of execution, in accordance with the Clearing House Manual of Operations.

H. Brokers executing Block Transactions must maintain a record of said transaction, in accordance with Rule 536. – RECORDS FOR ORDERS AND PERSONAL TRANSACTIONS DURING REGULAR TRADING HOURS.

I. In the application of paragraphs A., B., and C. of this Rule to a commodity trading advisor ("CTA") registered under the Act, including without limitation any investment advisor registered as such with the Securities and Exchange Commission that is exempt from regulation under the Act or Commission Regulations thereunder, with total assets under management exceeding $50 million, the CTA, and not the CTA's customers, shall be the applicable entity for purposes of said paragraphs A., B., and C.

III. EFFECTIVE DATE AND RULE PROMUGATING AUTHORITY

On Friday, February 25, 2000, the Board of Directors, which acts pursuant to Rule 230.j., approved by poll the proposed rule applied for herein. As with previous submissions to the Commission, the rule will become effective upon CFTC approval and notification of the membership.

IV. OPERATION, PURPOSE, AND EFFECT OF THE PROPOSED RULE

In June 1999 the Commission issued an Advisory on Alternative Execution, or Block Trading, Procedures for the Futures Industry, in which the Commission indicated its receptiveness to reviewing block trading proposals. On February 14, 2000 the Commission announced that it had approved a block-trading rule submitted by the Cantor Financial Futures Exchange ("Cantor") as a one-year pilot program. In its press release the Commission noted that Cantor's rule provided that:

(i) A block transaction must have a minimum size of 100 contracts ($10 million);
(ii) Transactions must be reported to the exchange within 5-10 minutes;
(iii) Cantor will be required to publish block trading information immediately upon receipt; and
(iv) Participation will be limited to sophisticated traders who would be "eligible participants" under Part 36 of the Commission's regulations.

The CME's proposed Block Transaction procedures are substantially identically to the procedures approved by the Commission for Cantor:[1]

(i) The Board has approved a one-year pilot program to allow Block Transactions in 5-Year and 10-Year Agency Note futures contracts, with a minimum size of 100 contracts.[2] As with the CME's All-or-None trading rule, the size threshold is not incorporated in the rule itself, but will be

---

[1] Two sources of necessary differences are that Cantor's rule is intertwined with a market-making program that has no counterpart at the CME and that Cantor is an all-electronic exchange while the CME rule is intended to be applicable to contracts trading both by open outcry and on its GLOBEX® electronic trading system.

[2] These submissions were submitted to the CFTC on January 27, 2000 as 45-day Fast-Track submissions. The 45-day period will terminate on March 13, 2000. The CME's Board of Directors has approved a futures-contract launch date of Tuesday, March 14, 2000, pending CFTC approval.

determined and modified by the Board of Directors, subject to CFTC approval.

(ii) The proposed rule provides that the contract, contract month, price and quantity of all block transactions must be reported to the Exchange within 5 minutes of the time of execution.

(iii) The Exchange plans to publish such reports immediately upon receipt. Such reports will be published separately from the prices of transactions in the affected regular market, in order to avoid confusion.

(iv) The proposed rule restricts participants in Block Transactions to Eligible Participants as defined in Commission Regulation §36.1.

In addition, the CME's proposed rule provides – like the previously-approved Cantor rule – that in order to be executed as a Block Transaction, an order must explicitly be so designated and that the price at which a Block Transaction is executed must be "fair and reasonable" in the light of the size of the transaction and current market conditions. Other aspects of the proposed rule assure conformance with normal record-keeping practices and trade-submission procedures. Finally, like the Cantor rule, the proposed rule clarifies that a CTA or like entity is subject to Paragraphs A., B., and C. of the proposed rule, and not the CTA's customers. That is, those customers do not have to be Eligible Participants themselves, their shares of a Block Transaction do not have to meet or exceed the minimum size requirement, and they do not have to give explicit permission to participate in Block Transactions executed for their CTA.

The CME believes that proposed Rule 526. – **Block Transactions** – will bring important benefits to the sophisticated institutional users of the CME's proposed 5-Year and 10-Year Agency Note futures contracts. The CME hopes that the Commission can give this proposal expeditious treatment so that the marketplace can benefit from the rule during the early stages of liquidity development.

V. <u>OPPOSING VIEWS</u>

One member of the Board of Directors, a local trader, opposed the proposed rule. No reason was expressed.

VI. RELEVANT PROVISIONS OF THE CEA OR COMMISSION REGULATIONS

The CME believes that no amendment to the Commodity Exchange Act or CFTC regulations is necessitated by this submission.

If my staff or I may assist you, please do not hesitate to call. Please reference our CME Submission #00-21 on all future correspondence for this submission.

Sincerely,

Richard J. McDonald
Senior Vice President, Research
and Chief Economist

cc: Mr. John Lawton, Mr. David Van Wagner
CFTC Division of Trading and Markets

APPENDIX A

527. Block Transactions: Notwithstanding Rule 520. – TRADING CONFINED TO EXCHANGE FACILITIES –, the Board or a Committee appointed by the Board shall, from time to time, determine the minimum thresholds for and the commodities in which Block Transactions (privately negotiated transactions) shall be permitted. The following shall govern Block Transactions:

A. A member may execute a Block Transaction for a specified quantity at or in excess of the applicable minimum threshold designated by the Board.

B. Each party to a Block Transaction must be an Eligible Participant as that term is defined in Commission Regulation § 36.1.

C. A member shall not execute any order by means of a Block Transaction unless that order meets the applicable minimum threshold and includes specific instructions to execute a Block Transaction.

D. The price at which a Block Transaction is executed must be "fair and reasonable" in light of (i) the size of such Block Transaction, (ii) the prices and sizes of other transactions in the same contract at the relevant time, (iii) and the prices and sizes of transactions in the corresponding cash market at the relevant time.

E. Block Transactions shall not set off conditional orders (e.g., Stop Orders, MIT Orders, etc.) or otherwise affect orders in the regular market.

F. All Block Transactions must be reported to a designated Exchange official within five minutes of the time of execution. The report must include the contract, contract month, price, and quantity of the transaction. The Exchange shall immediately publish such information separately from the reports of transactions in the regular market.

G. Clearing firms must report Block Transactions to the Exchange Clearing House, including the time of execution, in accordance with the Clearing House Manual of Operations.

H. Brokers executing Block Transactions must maintain a record of said transaction, in accordance with Rule 536. – RECORDS FOR ORDERS AND PERSONAL TRANSACTIONS DURING REGULAR TRADING HOURS.

I. In the application of paragraphs A., B., and C. of this Rule to a commodity trading advisor ("CTA") registered under the Act, including without limitation any investment advisor registered as such with the Securities and Exchange Commission that is exempt from regulation under the Act or Commission Regulations thereunder, with total assets under management exceeding $50 million, the CTA, and not the CTA's customers, shall be the applicable entity for purposes of said paragraphs A., B., and C.

CHICAGO MERCANTILE EXCHANGE

Richard J. McDonald
Senior Vice President, Research
and Chief Economist
312/930-4574
FAX: 312/930-4517
dmcdonal@cme.com

RECEIVED
C.F.T.C.
'00 MAR 13 PM 3 18
OFFICE OF THE SECRETARIAT

March 9, 2000

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

RE: Supplement to CME Submission #00-21, Section 5a(a)(12)(A), Regulation §1.41(c) Submission. Rule 526. – Block Transactions.

Dear Ms. Webb:

On February 25, 2000, the Chicago Mercantile Exchange ("CME" or "Exchange") submitted for Commission review and approval, per Section 5a(a)(12)(A) of the CEAct and Regulation §1.41(c) thereunder, a proposal to implement a new Rule 526. This Rule provides a framework under which Block Transactions could be executed on the Exchange. Under the auspices of Rule 526, the CME Board has approved a one-year pilot program to permit Block Transactions in the context of Five- and Ten-Year Agency Note futures with a minimum of 100 contracts. *

By letter dated March 2, 2000, the Commission has made several inquiries regarding the Exchange's proposal. This correspondence is intended to address these inquiries and to amend our proposed Rule in response to the Commission's concerns.

* The Exchange submitted applications for contract market designation in Five- and Ten-Year Agency Note futures and options on January 27, 2000 (see CME submissions #00-10 and #00-11, respectively). These submissions were filed as 45-day Fast Track submissions and are currently pending CFTC approval. The 45-day window concludes on March 13, 2000. Accordingly, the Exchange intends to launch futures on Five- and Ten-Year Agency notes on Tuesday, March 14, 2000, subject to CFTC approval.

In particular, these inquiries were directed at (1) the basis upon which the Exchange proposes to establish a 100 contract minimum for Block Transactions in the context of Five- and Ten-Year Agency note futures; (2) the criteria by which the Exchange would assess whether a block trade is "fair and reasonable"; and (3) the reporting mechanism proposed by the Exchange for Block Transactions.

One Hundred Contract Minimum – The Exchange proposes a one hundred (100) contract minimum lot size ($10 million face value) for Block Transactions in the context of Five- and Ten-Year Agency Note futures. This proposed minimum size was chosen after consideration of the unique characteristics of the cash Agencies - an active yet immature market. This characterization is particularly evident in light of a comparison to the cash Treasury market – perhaps the most liquid securities market in the world. Recall that Fannie Mae Benchmark and Freddie Mac Reference Notes are rather novel instruments that have been available for less than two years.

As evidence of this immaturity, consider that bids and offers are most frequently quoted – not in stand-alone terms – but as a yield spread vs. comparable maturity Treasuries. *I.e.*, a 10-year Agency might be quoted as 50 basis points over the 10-year on-the-run Treasury note. This constitutes strong evidence of the dependence and subordinance of the Agency to the Treasury market.

The secondary markets for Agencies and Treasuries may be characterized as a dealer market – with brokers facilitating inter-dealer transactions. Electronic trading has had less of an impact on the Agency than the Treasury market. A study published by the Bond Market Association in November 1999 titled "eCommerce in the U.S. Fixed Income Markets" listed thirty electronic secondary markets for domestic fixed income securities, twenty-six (26) of which trade Treasury securities while only fifteen (15) trade Agency securities. Accordingly, the degree of pricing transparency in Agency securities is less than that of Treasury securities. Agency pricing data is less readily available than Treasury pricing data – whether from quotation vendors or official statistical sources.

An informal poll of thirteen (13) Agency dealers conducted by the Exchange on March 2nd and 3rd suggests that the bulk of current transactions fall into the $10-25 million range. Estimates of what would be considered a "large" transaction ranged from $50+ to $500+ million. The sample was drawn from the most significant New York City based broker/dealers who largely transact business with equally significant institutional customers. We would expect that a comprehensive survey of all transactions in Agency notes would yield a much smaller "typical" transaction size. (Transactions in Agency notes may be as small as $1,000 face value.)

Three brokers dominate the inter-dealer market – Garban, Liberty and to a lessor extent, Cantor. The minimum size in the inter-dealer brokered market is perhaps $5 million. An employee of one broker opined that their typical transaction size is $5-25 million, indicating that they conduct perhaps 125 transactions daily.

The clientele for Benchmark and Reference notes is largely institutional. Given the brief history of the market, we believe that the largest, most sophisticated of investors – the "early adopters" - account for the largest portion of trading volume.

Thus, we can identify a paradox – increased liquidity can be expected to reduce observed transaction sizes, since the bulk of growth could come from smaller institutions and retail customers. In other words, we anticipate that reported Agency transaction sizes will diminish as the market matures and penetrates to smaller institutions and retail customers.

Currently, there are no futures markets for Agency debt. Once commenced, however, we anticipate that typical Agency futures transaction sizes will be much lower than typical transaction sizes in comparable maturity Treasury futures. Agency futures liquidity will likely be inferior to Treasury futures liquidity. We believe that this assessment is fair in light of the maturity and widespread acceptance of the extant Treasury futures.

To the extent that block trading provisions attract participants to the Agency futures markets, we believe that typical transaction sizes will grow and liquidity will be enhanced. Note that, per the Exchange's original block transaction submission dated February 25, 2000, we propose to offer block trading in the context of a one-year pilot program. As such, we fully anticipate a complete review and, if appropriate, amendment to the specifications of the block trading program.

The pivotal question remains: "what size moves the market?" We note that the Commission has approved the Cantor Exchange's 100 contract ($10 million face value) block trade minimum in the context of its 30-year and 10-year Treasury futures. As such, the Commission recognizes the potential for a 100 contract ($10 million face value) lot to move the Treasury market.

Accordingly, the CME has conservatively selected a 100 contract ($10 million face value) block transaction minimum per the rationale that – in light of the superior liquidity in the Treasury markets - the transaction size required to move Agency futures can be no more than that required to move Treasury futures.

'Fair and Reasonable' Criteria – The Commission suggests that a "fair and reasonable" criteria by which to assess the price of a block trade should include reference to other relevant markets in addition to CME markets and the underlying cash markets; and, by reference to the circumstances of parties to such block trade. The Exchange agrees and revises its original submission accordingly.

A revised Rule 526 is included below. Additions to the original proposal of February 25, 2000 are underlined, deletions to the original proposal are bracketed and overstruck. A clean copy is attached in the Appendix to this document.

526. Block Transactions: Notwithstanding Rule 520. – TRADING CONFINED TO EXCHANGE FACILITIES –, the Board or a Committee appointed by the Board shall, from time to time, determine the minimum thresholds for and the commodities in which Block Transactions (privately negotiated transactions) shall be permitted. The following shall govern Block Transactions:

A. A member may execute a Block Transaction for a specified quantity at or in excess of the applicable minimum threshold designated by the Board.

B. Each party to a Block Transaction must be an Eligible Participant as that term is defined in Commission Regulation § 36.1.

C. A member shall not execute any order by means of a Block Transaction unless that order meets the applicable minimum threshold and includes specific instructions to execute a Block Transaction.

D. The price at which a Block Transaction is executed must be "fair and reasonable" in light of (i) the size of such Block Transaction, (ii) the prices and sizes of other transactions in the same contract at the relevant time, (iii) and the prices and sizes of transactions in [~~the corresponding cash market~~] other relevant markets, including without limitation the underlying cash and futures markets, at the relevant time, and (iv) the circumstances of the parties to such Block Transaction.

E. Block Transactions shall not set off conditional orders (e.g., Stop Orders, MIT Orders, etc.) or otherwise affect orders in the regular market.

F. All Block Transactions must be reported to a designated Exchange official within five minutes of the time of execution. The report must include the contract, contract month, price, and quantity of the transaction. The Exchange shall immediately publish such information separately from the reports of transactions in the regular market.

G. Clearing firms must report Block Transactions to the Exchange Clearing House, including the time of execution, in accordance with the Clearing House Manual of Operations.

H. Brokers executing Block Transactions must maintain a record of said transaction, in accordance with Rule 536. – RECORDS FOR ORDERS AND PERSONAL TRANSACTIONS DURING REGULAR TRADING HOURS.

I. In the application of paragraphs A., B., and C. of this Rule to a commodity trading advisor ("CTA") registered under the Act, including without limitation any investment advisor registered as such with the Securities and Exchange Commission that is exempt from regulation under the Act or Commission Regulations thereunder, with total assets under management exceeding $50 million, the CTA, and not the CTA's customers, shall be the applicable entity for purposes of said paragraphs A., B., and C.

Reporting Mechanism – The Commission's correspondence of March 2nd inquires with respect to the mechanism by which the Exchange would accept information regarding block transactions when the Exchange is not open.

As the Commission is aware, the Exchange's GLOBEX®$_2$ system is operated virtually round-the-clock on weekdays. Accordingly, the Exchange's Globex Control Center (GCC) will accept information via telephone regarding block transactions on weekdays commencing at 5:30 p.m. on Sundays and continuing through 2:00 p.m. on Fridays. During Regular Trading Hours (RTH), block transactions may also be reported to the Exchange through select price reporting terminals available on the Exchange floor. Thus, block transactions may be reported to the Exchange within five minutes of execution and subsequently reported on the Exchange's ticker facilities immediately thereafter. During RTH, these prices will also be reported on the wallboards in the Exchange trading halls.

Please direct any inquiries regarding these matters to John W. Labuszewski at 312-466-7469. We would be appreciative if you could reference our CME Submission #00-21 on all future correspondence regarding this matter.

Sincerely,

Richard J. McDonald
Senior Vice President, Research
and Chief Economist

cc: Mr. John Lawton, Mr. David Van Wagner
CFTC Division of Trading and Markets

/jwl

Appendix: Clean Copy of Revised Rule 527

527. **Block Transactions:** Notwithstanding Rule 520. – TRADING CONFINED TO EXCHANGE FACILITIES –, the Board or a Committee appointed by the Board shall, from time to time, determine the minimum thresholds for and the commodities in which Block Transactions (privately negotiated transactions) shall be permitted. The following shall govern Block Transactions:

A. A member may execute a Block Transaction for a specified quantity at or in excess of the applicable minimum threshold designated by the Board.

B. Each party to a Block Transaction must be an Eligible Participant as that term is defined in Commission Regulation § 36.1.

C. A member shall not execute any order by means of a Block Transaction unless that order meets the applicable minimum threshold and includes specific instructions to execute a Block Transaction.

J. The price at which a Block Transaction is executed must be "fair and reasonable" in light of (i) the size of such Block Transaction, (ii) the prices and sizes of other transactions in the same contract at the relevant time, (iii) and the prices and sizes of transactions in other relevant markets, including without limitation the underlying cash and futures markets, at the relevant time, and (iv) the circumstances of the parties to such Block Transaction.

D. Block Transactions shall not set off conditional orders (e.g., Stop Orders, MIT Orders, etc.) or otherwise affect orders in the regular market.

E. All Block Transactions must be reported to a designated Exchange official within five minutes of the time of execution. The report must include the contract, contract month, price, and quantity of the transaction. The Exchange shall immediately publish such information separately from the reports of transactions in the regular market.

F. Clearing firms must report Block Transactions to the Exchange Clearing House, including the time of execution, in accordance with the Clearing House Manual of Operations.

G. Brokers executing Block Transactions must maintain a record of said transaction, in accordance with Rule 536. – RECORDS FOR ORDERS AND PERSONAL TRANSACTIONS DURING REGULAR TRADING HOURS.

H. In the application of paragraphs A., B., and C. of this Rule to a commodity trading advisor ("CTA") registered under the Act, including without limitation any investment advisor registered as such with the Securities and Exchange Commission that is exempt from regulation under the Act or Commission Regulations thereunder, with total assets under management exceeding $50 million, the CTA, and not the CTA's customers, shall be the applicable entity for purposes of said paragraphs A., B., and C.

CHICAGO MERCANTILE EXCHANGE

RECEIVED
C.F.T.C.

'00 MAR 20 PM 2 30

OFFICE OF THE SECRETARIAT

Richard J. McDonald
Senior Vice President, Research
and Chief Economist
312/930-4574
FAX: 312/930-4517
dmcdonal@cme.com

March 20, 2000

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

VIA FACSIMILE

RE: Supplement to CME Submission #00-21, Section 5a(a)(12)(A), Regulation §1.41(c) Submission. Rule 526. – Block Transactions.

Dear Ms. Webb:

On February 25, 2000, the Chicago Mercantile Exchange ("CME" or "Exchange") submitted for Commission review and approval, per Section 5a(a)(12)(A) of the CEA and Regulation §1.41(c) thereunder, a proposal to implement a new Rule 526. This Rule provides a framework under which Block Transactions could be executed on the Exchange. Under the auspices of Rule 526, the CME Board has approved a one-year pilot program to permit Block Transactions in Five- and Ten-Year Agency Note futures with a minimum of 100 contracts.

1-yr pilot program

In a telephone conversation on March 15, 2000 Commission staff requested that the Exchange formally address four issues stated in the Commission's Advisory of June 10, 1999. Specifically, the Commission had requested that proposers of alternative execution procedures discuss four factors: 1) "...the impact of its proposal on the usefulness of the contract market as a vehicle for price discovery and risk transfer," 2) "whether its proposal represents the least anti-competitive means of achieving its objective," 3) "whether the proposed transactions fulfill some need of market participants that traditional open outcry cannot fulfill as well," 4) "and whether the transactions are structured in such a way as to complement the competitive market." These four issues are addressed as follows.

1) "Price Discovery and Risk Transfer" Issue – The CME's proposed Block Transactions rule for Agency Note futures contracts will allow market participants to seek counterparties for large-sized transactions and execute the transactions at a single price. The prices of these transactions will be promptly available to the public via the CME ticker and wallboards, albeit after a somewhat longer delay than occurs for transactions in open outcry. To the extent that Block Transactions will be executed because of the belief that the orders might be too large to be filled in the open outcry arena – or that there might be too much price slippage there –, these transactions would not otherwise have been executed on the Exchange. The orders might not have been executed at all or might have been executed in a marketplace with less price transparency, such as the over-the-counter market. Therefore the reported prices of Block Transactions will provide market participants with information about market conditions for large-sized transactions that otherwise would not be available. Likewise, these Block Transactions will provide opportunities for risk transfer using the CME's Agency Note futures contracts that would otherwise not be available.

It is possible that the ability to execute Block Transactions will draw some transactions away from the open outcry venue, and that this could have a deleterious effect on liquidity and price discovery. But the minimum size requirement of 100 contracts will assure that this will occur only for relatively infrequent large-sized transactions. In addition market participants have a keen interest in obtaining the best prices possible for their transactions and therefore will tend to transact in the venue that offers the best prices. Participants may be more willing to use the pit if they know that there are alternative sources of liquidity available and may use the pit to offset positions – or parts thereof – that have been established via Block Transactions. This suggests that the proposed Block Transaction facility will augment – rather than fragment – the open outcry market.

lack of impact on open outcry

In sum, we expect that the proposed Block Transaction rule will enhance both price discovery and the opportunities for risk transfer in CME Agency Note futures contracts.

2) "Anti-Competitiveness" Issue – The Commission has raised the possibility that block trading represents an anti-competitive alternative to traditional open outcry trading. The Exchange is of the opposite opinion. The Exchange already offers several methods of trading for Agency Note futures; traditional open outcry, the GLOBEX$_2$® electronic trading platform, Exchange for Physicals transactions ("EFPs"), and All-or-None ("AON") trading. These alternative trading methods complement each other and each has specific features that can be attractive to a particular audience. The traditional open outcry venue provides continuos price discovery and liquidity.

$GLOBEX_2$ combines that with instantaneous feedback, information about the depth of the book, and fewer errors. EFPs allow private bilateral negotiation of selected transactions. AON trading provides a competitive venue for those participants with large-sized orders who value the absence of slippage more highly than securing the "best" price available in the pit and also provides price discovery for large-sized transactions. The CME's proposed Block Transactions rule combines several aspects of these existing methodologies – absence of slippage, private negotiation for sophisticated parties, price discovery for large-sized transactions, speed of execution – into a new alternative trading venue. It is designed to supplement existing CME markets by providing features that are valued by a well-defined audience of institutional market participants. As such, proposed Rule 526 will broaden the choices available to market participants; therefore this should be viewed as a *pro*-competitive proposal, not an anti-competitive one. To argue otherwise would be comparable to stating that only one exchange should be allowed to trade a given product or that – in the extreme – everyone should have to wear the same size and style of shoes.

pro-competitive impact

3) "Unfulfilled Needs" Issue – As noted above, proposed Rule 526 would provide sophisticated market participants with a combination of absence of slippage, private negotiation, and speed of execution and would bring price discovery for large-sized transactions to the general marketplace. That is, it would combine common OTC trading practices with the financial integrity of the CME. Many Exchange member firms and other institutional market participants have indicated that they very much desire the ability to execute block transactions in CME Agency Note futures contracts. The factors cited above are the chief reasons that they have given for wishing to execute such transactions.

4) "Complement the Pit" Issue – It is the belief of the CME that the proposed rule would complement existing CME trading venues for Agency Note futures contracts by bringing new participants to the Exchange's markets. New participants who may be attracted to the Exchange by the ability to do Block Transaction may also execute smaller orders in the pit and eventually trade other CME products as well. Participants may be more willing to use the pit if they know that there are alternative sources of liquidity available. In addition, as the Commission noted in its Advisory exchanges in other jurisdictions are increasingly offering block transaction facilities. In order to remain competitive and ultimately to survive, U.S. futures exchange must be able to compete on equal terms. In that sense, it is not so much a matter of complementing the pit but a matter of saving the pit.

Please refer to CME Submission #00-21 in any future correspondence regarding this matter.

Sincerely,

Richard J. McDonald

Richard J. McDonald
Senior Vice President, Research
and Chief Economist

cc: Mr. John Lawton, Mr. David Van Wagner
CFTC Division of Trading and Markets

CHICAGO MERCANTILE EXCHANGE

Richard J. McDonald
Senior Vice President, Research
and Chief Economist
312/930-4574
FAX: 312/930-4517
dmcdonal@cme.com

March 23, 2000

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

VIA FACSIMILE

RE: Supplement to CME Submission #00-21, Section 5a(a)(12)(A), Regulation §1.41(c) Submission. Rule 526. – Block Transactions.

Dear Ms. Webb:

On February 25, 2000, the Chicago Mercantile Exchange ("CME" or "Exchange") submitted for Commission review and approval, per Section 5a(a)(12)(A) of the CEA and Regulation §1.41(c) thereunder, a proposal to implement a new Rule 526. This Rule provides a framework under which Block Transactions could be executed on the Exchange. Under the auspices of Rule 526, the CME Board has approved a one-year pilot program to permit Block Transactions in Five- and Ten-Year Agency Note futures with a minimum of 100 contracts.

By a poll on Thursday, March 23, 2000, the Board of Directors approved an increase in the minimum size for Block Transactions in Agency Note futures contracts from 100 contracts to 200 contracts. One Director, a local trader, voted against the proposal. The Executive Committee subsequently discussed the issue and ratified the Board's action.

The proposed increase is based on conversations with market participants and on an analysis of transactions and of filled customer orders, as presented in the following table:

CME Agency Note Futures Activity
(March 14, 15, & 16 combined)

	Transactions	Customer Orders (CTI 4)
Average Number per Day	378	144.67
Average Size	25.75	60.25
Median Size	15	35
Maximum Size	400	500
Minimum Size	1	1
90^{th} Percentile	50	150
95^{th} Percentile	90	200
97.5^{th} Percentile	100	220
99^{th} Percentile	150	300

Based on this data, a minimum size of 200 contracts would exclude all but 5 per cent of filled orders and less than one per cent of executed transactions. Clearly 200 contracts must be considered a large-sized transaction in this market.

Please refer to CME Submission #00-21 in any future correspondence regarding this matter.

Sincerely,

Richard J. McDonald

Richard J. McDonald
Senior Vice President, Research
and Chief Economist

cc: Mr. John Lawton, Mr. David Van Wagner
CFTC Division of Trading and Markets