FIA LAW & COMPLIANCE DIVISION

Received CFTC
Records Section

00-14
1

OFFICE OF THE SECRETARIAT
'00 APR 24 PM 4 55
RECEIVED C.F.T.C.

President
RONALD H. FILLER
Lehman Brothers Inc.
3 World Financial Center
American Express Tower
8th Floor
New York, NY 10285
(212) 526-0236
rfiller@lehman.com

Vice President
EILEEN T. FLAHERTY
Aubrey G. Lanston & Co., Inc.
One Chase Manhattan Plaza
53rd Floor
New York, NY 10005
(212) 612-1702
eileen.flaherty@lanston.com

Treasurer
THOMAS N. MURPHY
R.J. O'Brien & Associates Inc.
555 West Jackson Boulevard
Chicago, IL 60661-5700
(312) 408-4174
(312) 408-4195 Fax
tnmurphy@rjobrien.com

Secretary
BARBARA W. BISHOP
Bear, Stearns & Co. Inc.
245 Park Avenue
Third Floor
New York, NY 10167
212-272-2545
212-272-5917 Fax
bbishop@bear.com

RECEIVED C.F.T.C.
'00 APR 25 AM 11 53

FIA Contact
BARBARA WIERZYNSKI
General Counsel
legal@fiafii.org

FUTURES INDUSTRY ASSOCIATION
2001 Pennsylvania Avenue N.W.
Suite 600
Washington, DC 20006-1807
(202) 466-5460
(202) 296-3184 Fax

www.fiafii.org

April 24, 2000 COMMENT

Ms. Jean A. Webb
Secretary to the Commission
Commodity Futures Trading Commission
1155 21st Street NW
Washington, D.C. 20581

Re: **Chicago Mercantile Exchange - Proposed new Rule 526 to Establish Block Trading Procedures - Submitted Pursuant to Commission Regulations §§1.41(c) and <u>1.38, Fed. Reg. – (April 7, 2000)</u>**

Dear Ms. Webb:

The Futures Industry Association ("FIA") is pleased to submit the following comments on the proposed new Rule 526 of the Chicago Mercantile Exchange ("CME"). Rule 526was submitted for the Commission's approval pursuant to Section 5(a)(12)(A) of the Commodity Exchange Act, as amended (the "Act"), and Commission Regulation §§1.41(c) and 1.38, in order to permit the execution of Block Trades (as defined below) subject to the terms and conditions described in the proposed rule. FIA, a not-for-profit corporation, is a principal spokesman for the futures industry. Its members include approximately sixty of the largest futures commission merchants ("FCMs") in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

FIA supports the proposed CME Rule 526 subject to the following comments. In submitting the following comments, FIA does not wish our comments to be construed as objections to, or to have the effect of delaying the Commission's approval of, the proposed Rule 526. Rather, FIA submits these comments with the desire that they be considered by the Commission, CME and any other contract markets contemplating the adoption of similar alternative execution procedures, to enable them to understand how FIA believes such procedures can be best designed to maximize their utility and benefits. We strongly encourage other exchanges to propose similar rules for upstairs trading.

As indicated in the notice relating to the proposed Rule 526, issued by the Commission on April 3, 2000, the proposed rule is designed to allow qualified market participants to negotiate and arrange futures transactions of a minimum size bilaterally away from the CME's open outcry trading platform or its GLOBEX2 electronic trading system. Once the specific terms of the block transaction have been agreed to, the counterparties would report the relevant details of the transaction to a designated CME official for clearing and settlement (each such transaction, a "Block Trade").

As the Commission is aware, FIA believes that there is a compelling need for alternative procedures to facilitate the execution of large orders in all contract markets in order to enhance the ability of these markets to meet the needs of institutional participants concerning transaction size and price.[1] Due to the dramatic growth in institutional participation in the futures markets during the last twenty years and the increasing integration of the financial futures and securities markets (including government securities), market participants increasingly wish to be able to trade large numbers of futures contracts as part of larger, structured capital markets transactions. Such transactions require size and price certainty in order to be implemented smoothly, efficiently and cost effectively.

Absent rules permitting alternative execution procedures, such as block trades, market participants must submit futures transactions for execution on exchange floors or in electronic markets and are prohibited from negotiating such transactions off the floor or outside the electronic market. The sizes and prices obtained for such transactions merely reflect the liquidity available on the floor or in the trading system in a particular contract at a particular time. These sizes and prices fail to achieve desired economic objectives or to reflect accurate actual supply and demand of the market at large, thus resulting in volume and price distortions. While on-floor and electronic market trading methods are intended to achieve competitive trading and best execution, they may not always produce the intended results in such circumstances, and may result in aberrant pricing.

For the reasons set forth above, FIA supports the proposed CME Rule 526. FIA believes, however, that they impose a number of specific requirements which may have the effect of limiting the potential utility and benefits of Block Trades.

Among other things, FIA supports the provision in proposed Rule 526 which, in order to determine whether the minimum threshold of 200 contracts has been satisfied, permits the aggregation of orders from different accounts in the case of a commodity trading advisor registered under the Act, including any investment adviser registered as such with the Securities and Exchange Commission ("SEC") that is exempt from regulation under the Act or Commission regulations thereunder, with total assets under management exceeding US $50 million. Likewise, FIA supports the provision in proposed Rule 526, which states that if a Block Trade is entered into on behalf of customers by a similarly registered commodity trading advisor or investment adviser, with total assets under management exceeding US$50 million, the individual customers need not qualify as an Eligible Participant. In both cases, however, FIA believes that the provisions should be

---

[1] In this connection, FIA recently expressed its support for such alternative procedures in its letter commenting on rules proposed by the Cantor Financial Futures Exchange ("CFFE"). In addition to the CFFE, both The London International Financial Futures and Options Exchange and EUREX offer block trading facilities through their automated systems.

broadened in scope to include advisers not required to be registered as commodity trading advisors under the Act or as investment advisers with the SEC (e.g., an adviser operating outside the United States with customers outside the United States, or an adviser with less than 15 clients and that is not otherwise holding itself out as a commodity trading advisor). In addition, consideration should be given to whether there are circumstances in which a futures commission merchant should be permitted to aggregate orders for different accounts, such as in the case in which it is necessary to satisfy the requirement of the minimum threshold of 200 contracts, at least at the opening of trading.

FIA is also concerned regarding the requirement in proposed Rule 526 that the price at which a Block Trade is executed must be "fair and reasonable" in light of (1) the size of such Block Trade; (2) the price and size of other transactions in the same contract at the relevant time; (3) the prices and sizes of transactions in other relevant markets; including the underlying cash and futures markets, at the relevant time; and (4) the circumstances of the parties to the Block Trade. Although the factors in items (3) and (4) may serve to partially ameliorate the concerns expressed by FIA in its letter commenting on the block trading rules as had been proposed by the CFFE, FIA remains concerned that this revised standard is vague and unnecessary. FIA believes that such a pricing requirement is not appropriate for the proposed Rule 526 or any other alternative execution procedure.

The prices of other trades in the same contract as executed in open outcry or GLOBEX2 may not necessarily be representative of the market for the larger orders that may be executed as Block Trades. As stated in Question 5 of the CME's Questions and Answers regarding EFP Transactions, the CME recognizes that EFPs may be executed at any price agreed upon by both parties (CME Update 94-4, July 5, 1994, Question 5). Similarly, the parties should be free to negotiate and agree to enter into a Block Trade at any price. The Commission should not be concerned that such an approach might lead to fraud or market manipulation, since adequate safeguards already exist to prevent such abuse. First, Block Trades would be subject to the other requirements of the proposed Rule 526, which will have been approved by the Commission. Second, the antifraud and antimanipulation provisions of the Act would remain applicable to Block Trades. Third, the CME would remain responsible for market surveillance and rule enforcement, subject to Commission oversight. Given these safeguards, the utility and benefits of Block Trades should not be impaired by the pricing requirement in the proposed rule.

Finally, FIA wishes to comment regarding the requirement in proposed Rule 526 that information identifying the relevant contract, contract month, price, and quantity for each Block Trade must be reported to the CME and that the time of execution must be reported to the CME Clearing House within 5 minutes of execution of such Block Trade. It is clearly in the interest of the firm executing a Block Trade to present the trade for clearing as soon as reasonably practical. FIA is concerned, however, that the specific timing requirement, as proposed, may be burdensome, especially during a period of highly active trading. Moreover, the 5 minute reporting requirement is not appropriate in the case in which a trader must work a large order in several parts. FIA recommends that the reporting requirement be established at 60 minutes. The safeguards described in the previous paragraph are adequate to address any concerns the Commission may have that this approach could lead to fraud or market manipulation.

FIA appreciates the opportunity to submit these comments on CME's proposed Rule 526. If you have any questions regarding this letter, please contact me at (212) 526-0236 or Barbara Wierzynski, FIA's General Counsel at (202) 466-5460.

Sincerely,

Ronald H. Filler

Ronald H. Filler
President