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COMMENT

August 20, 2001

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

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VIA FACSIMILE AND E-MAIL

Re: Listing Standards and Conditions for Trading Security Futures Products – Fed. Reg. Vol. 66, No. 140, July 20, 2001, pp. 37932-37939.

Dear Ms. Webb:

Chicago Mercantile Exchange Inc. ("CME") is pleased to offer comments on a proposal recently published by the Commodity Futures Trading Commission ("Commission") regarding rules designed to implement listing standards and conditions for trading in Security Futures Products ("SFPs") under the Commodity Futures Modernization Act of 2000 ("CFMA").

Proposed Regulations 41.21-25 implement requirements for listing and trading SFPs contained in Section 2(a)(1)(D) of the Commodity Exchange Act ("CEA") and Section 6(h) of the Securities Exchange Act of 1934 ("Exchange Act"). The Commission's construction of those Regulations is clear and straightforward and should serve as a model for future rulemaking with respect to SFPs. CME has comments on two aspects of the proposed rules.

Intermarket Surveillance – Section 2(a)(1)(D)(i)(VIII) of the CEA requires that a board of trade listing SFPs "...has procedures in place for coordinated surveillance among such board of trade, any market on which any security underlying the security futures product is traded, and other markets on which any related security is traded to detect manipulation and insider trading...." The Commission notes in its commentary that many boards of trade have become affiliate members of the Intermarket Surveillance Group ("ISG"). All national securities exchanges and national securities associations are full members of the ISG. The Commission correctly notes that allowing boards of trade listing SFPs to become full members of the ISG would enhance their ability to comply with this statutory requirement. The Commission then states that "...the ISG should grant full memberships to all boards of trade that trade security

futures products upon a good-faith showing that such entities meet the requirements for full membership." CME agrees fully and stands ready to apply for full membership in the ISG.

The Commission, in proposed regulation 41.22(g), requires that boards of trade intending to list SFPs certify that they are full members of the ISG. This proposed requirement, however, presumes that the ISG will allow boards of trade to become full members on terms comparable to those of current full members, and will be able to do so in a timely fashion. From an operational perspective it may not be possible for the ISG to adopt procedures to consider and then to accept boards of trade as full members in the near future. If it is not possible for boards of trade to become full members of the ISG on a timely basis then – under the proposed regulation – they effectively will be eliminated from competing for SFP business when trading in those products commences. That highly plausible situation clearly would be contrary to the express intent of Congress.

CME recommends therefore, that the Commission modify proposed regulation 41.22(g) to exempt boards of trade that are affiliate members of the ISG until such time as the ISG:

- has adopted procedures to admit boards of trade as full members, and
- has done so for those affiliate members that have applied for full membership and have satisfied the membership criteria applicable to national securities exchanges.

Position Limits/Accountability – Proposed regulation 41.25(a)(3) requires that boards of trade adopt position limits or position accountability for expiring contract months in SFPs. Specifically:

- Paragraph 41.25(a)(3)(i) imposes a 1,350,000 share equivalent position limit during the last five trading days of a contract month,
- Paragraph 41.25(a)(3)(i)(A) allows a 2,250,000 share equivalent limit for futures on actively traded stocks,
- Paragraph 41.25(a)(3)(i)(B) allows position accountability above the 2,250,000 share equivalent level for futures on stocks whose trading activity meets a somewhat higher standard,
- Paragraph 41.25(a)(3)(ii) applies the preceding standards to the "least liquid" security in a narrow-based security index, and finally
- Paragraph 41.25(a)(3)(iii) provides for hedge exemptions.

In its commentary the Commission indicates that these regulations are comparable to the current position limit regulations for options on individual securities.

CME has several observations on these proposed regulations. First, CME has extensive experience with position accountability, which was first adopted for its Three-Month Eurodollar, Deutsche mark, Japanese yen, Swiss franc and pound sterling futures contracts. CME believes that position accountability has worked well and provides essentially the same prophylactic benefits as fixed position limits. CME recommends therefore, that the Commission consider allowing position accountability under wider circumstances than those currently proposed.

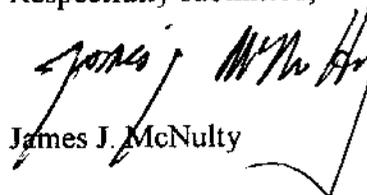
Second, CME is concerned that under the proposed rules situations may arise where an SFP trading subject to position accountability suddenly becomes subject to a strict position limit because trading activity has diminished in the underlying security. Without provision for a grace period before the hard limit comes into effect, holders of large positions may be forced to leave the market in a manner that creates congestion and price distortions – the very basis for the existence of position limits in the first place. Similar observations apply to the transition from the 2,250,000 share equivalent limit to the 1,350,000 share equivalent limit. CME recommends that the Commission provide a grace period before the tightened limit would be applicable – at a minimum, not until one contract expiration has occurred.

Third, CME wishes to comment on the Commission's proposal that for narrow-based security indexes the average trading volume standard should be applied to the "least liquid" security in the index. Since the term "least liquid" could have a variety of interpretations, CME recommends that the requirement explicitly be couched in terms of average daily trading volume. Also, since trading volumes are likely to be positively associated with index weighting (the smallest and least active securities tend to receive the smallest weights), and since the link between cash and futures markets will be tied to index weightings, it would make sense to apply the activity standard to the average security in the index.

Finally, to minimize the computational burden and to provide clarity, CME recommends that the six-month trading activity and share outstanding calculations be required at most monthly on a calendar month basis (e.g., January-June, February-July, etc.).

CME appreciates the opportunity to comment on the proposed rules.

Respectfully submitted,



James J. McNulty

cc: The Honorable James E. Newsome
The Honorable Barbara Pederson Holum
The Honorable David D. Spears
The Honorable Thomas J. Erickson