

# CHICAGO MERCANTILE EXCHANGE

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**Paul B. O'Kelly**  
Senior Vice President and  
General Counsel  
312/930-8510

## COMMENT

March 9, 1998

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

Re: **Proposed Amendments to Commodity Futures Trading Commission Regulation 1.35  
Relating To Account Identifications For Bunched Orders**

Dear Ms. Webb:

The Chicago Mercantile Exchange ("CME") appreciates the opportunity to comment on the Reproposal of Rules Regarding Account Identification for Eligible Bunched Orders ("Reproposal") published January 6, 1998 (63 Fed. Reg. 695) by the Commodity Futures Trading Commission ("CFTC" or "Commission"). The CME is encouraged by the improvements the Commission has made to its earlier release regarding this issue.

The Reproposal eliminates most of the practical difficulties created by the earlier proposal and now reflects the more informed regulatory view that sophisticated investors do not always need or desire burdensome regulations intended for their protection. The Reproposal will allow money managers to use futures markets more effectively for the benefit of their customers by permitting a practice that has withstood regulatory scrutiny in the securities industry for many years. Where practical problems exist in the Reproposal, they are in areas where the Commission continues in its effort to regulate those in the financial services industry who are beyond its jurisdiction and its area of expertise.

Without diminishing its support for the Reproposal as a whole, the CME would like to comment on three sections.

1. Reproposed Regulation 1.35(a-1)(5)(iii) — *Eligible Customers* and 1.35(a-1)(5)(iv) — *Account Certification*. In order for a money manager to use the end of day allocation process, it must first obtain the written consent of its participating eligible customers and certify, in writing, to the appropriate futures commission merchant that it is aware of the regulation's conditions for

30 South Wacker Drive Chicago, Illinois 60606 312/930-1000

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bunching orders and that it will remain in compliance with them. These requirements are applicable regardless of whether the money manager is otherwise subject to Commission regulation. The CME believes that the regulation of relationships between money managers and their customers is a matter best left to a money manager's primary regulator. It should not insist on these requirements for money managers it does not regulate.

The Commission over time has adopted a comprehensive set of disclosure and customer consent requirements for the purpose of protecting the customers of its registrants. Other regulators have done the same for those within their jurisdictions. A regulator must consider each new disclosure or consent proposal in the context of the "mix" of other required disclosures and consents. Less important information's ability to obscure or trivialize more important information is a well-known phenomenon. In the securities industry, where disclosure is the cornerstone of the regulatory scheme, bifurcated and summary prospectuses and simplified shareholder reports have been used to address this problem.

The Commission's Reproposal, however, will inject an additional disclosure and consent requirement into the "mix" of disclosures and consents that other regulators require without an evaluation of its place in those disclosure schemes. If the Commission's consent requirement is adopted, it will lead to anomalous results.

For example, under the Securities and Exchange Commission's current disclosure and consent requirements, an investment adviser that discloses that it will not pay for research with customers' brokerage may change its practice and do so without the written consent of its customers. Its customers will, however, have to give written consent to allow its futures orders – but not its securities orders – to be allocated at the end of the day. The adviser's customers understandably will be confused by a regulatory consent requirement for something of less consequence when similar requirements do not exist for matters of greater consequence. The difference between important and less important disclosures and consents can become obscured as a result. This is bad regulatory practice.

There also are other regulators and regulatory schemes that rely less on disclosure and informed consent and more on well-established concepts of fiduciary duty to regulate relationships between money managers and their customers. These regulatory schemes are often born from a recognition that the customers cannot adequately manage their own financial affairs. Regulation of trusts and common trust funds is an example of such a scheme. The Commission would, nevertheless, impose a disclosure and written consent obligation in these circumstances as well. Trustees will be left with the task of identifying the appropriate "customers" and deciding whether they are capable of giving informed consent.

These are but two examples of the results that can occur when a regulator attempts to regulate in an area regulated by others without a sufficient understanding of the business environment and regulatory scheme there in place. The decision whether to require disclosure and consent of post trade allocation practices should be left to each money manager's primary regulator and should not be a condition in the Commission's regulation.

Having stated why we believe imposing a disclosure and consent on those regulated by others is not a good idea, the CME believes that if the Commission nevertheless feels compelled to act in this area, that it require only notification to customers. If the appropriate regulator for a money manager thereafter determines that written consent is also desirable, it can require it and enforce its requirement, if necessary. Then, the decision will not only be made by the correct regulator, but that regulator also will have the ability to take regulatory action should the money manager fail to obtain the consent.

Notification rather than written consent would also be consistent with the Commission's recent proposals to otherwise regulate the relationships between Commission registrants and sophisticated investors. For example, the proposed amendments to CFTC Regulation 1.55, eliminate the requirement for written acknowledgement of risk disclosure by sophisticated customers. A similar rationale applies to those eligible customers defined in the Reproposal. Upon notification, an eligible customer (by definition a sophisticated entity) may direct heightened attention to its investment performance or request that its accounts not be subject to post-trade allocation.

2. Reproposed Regulation 1.35(a-1)(5)(v)(E). The Reproposal requires that each account manager must make available for review, upon request of an eligible customer, data sufficient for that customer to compare its results with other "relevant" customers. Again, the CME believes that a money manager's primary regulator should impose such a requirement if it determines that such a requirement is necessary. The primary regulator is in a better position to determine whether it is more appropriate for it, the customer or both to have the ability to request the information. The CME is not aware of any other regulator of the money management industry that requires a money manager under any circumstances to provide comparative data to customers upon request. This requirement also raises the same enforcement issues raised by the disclosure and consent requirements. The Commission has no authority to enforce this requirement and it is questionable whether other regulators will seek to enforce a requirement that they have not imposed themselves.

The elimination of this comparative data production provision will not necessarily affect the regulatory protections offered to eligible customers. By limiting end of day allocation participation to eligible customers who are sophisticated, the Commission has assured that only those entities with significant economic weight can participate in post-trade allocation. These

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entities typically are in a position to exert sufficient influence on their money managers to gain the disclosure necessary to assure themselves that they are being treated fairly.

3. Reproposed Regulation 1.35(a-1)(5)(iii)(A) – *Types of Customers*. The CME is not aware of any information that supports the statement that high net worth individuals are more susceptible to the risks of misallocation than are institutions. Therefore, we would support the inclusion of natural persons who meet the requisite asset test in the list of eligible customers. Moreover, the CME believes that the Commission should strive for a consistent definition of “sophisticated customer” throughout its regulations. Thus, those entities or individuals deemed to be “Eligible Participants” pursuant to the CFTC’s Part 35 and 36 regulations should also qualify as “Eligible Customers” under the Reproposal. This approach offers simplicity and clarity for futures-industry participants.

Thank you for the opportunity to comment on the Reproposal and for your consideration of the CME’s views prior to its implementation.

Sincerely,



Paul B. O'Kelly  
Senior Vice President and General Counsel