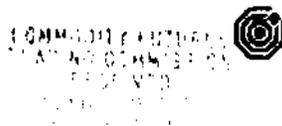


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# Chicago Board of Trade

**Yvonne J. Downs**  
Senior Vice President  
Office of Investigations and Audits

MAR 9 6 02 PM '98

March 9, 1998

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

**COMMENT**  
Mar 10 6 24 PM '98

COMMODITY FUTURES  
TRADING COMMISSION  
RECEIVED FOR  
PUBLIC RECORD

Re: 63 Fed. Reg. 695 (January 7, 1998) Eligible Orders

Dear Ms. Webb:

The Chicago Board of Trade ("CBOT®" or "Exchange") appreciates the opportunity to respond to the Commodity Futures Trading Commission's ("CFTC" or "Commission") proposal to amend Regulation 1.35(a-1) relating to account identification for eligible bunched orders. The Commission originally proposed amendments to Regulation 1.35 in 1993. Since that time changes have been made with regard to bunched orders and allocation of trades using predetermined allocations routines. In light of industry comments on the earlier proposal and subsequent clarification of certain acceptable bunching and allocation practices, the current proposal focuses on end of day allocation for managed accounts.

The CBOT commends the Commission's effort to amend the regulations to afford a defined group of sophisticated customers with advantages currently available to securities industry participants with regard to arbitrage transactions. The repropoed amendments exempt certain accounts from the requirements that the account identification be indicated on an order at the time of placement, and at the time of report of execution. The repropoed amendments attempt to serve two very worthy goals: first, to facilitate efficient and equitable access to the futures and futures option markets for sophisticated customers, and second, to provide suitable protection against fraudulent misallocation of trades. The CBOT endorses the Commission's goals for these repropoed amendments. However, in order to fully realize the benefits that the amended Regulations could provide, the CBOT makes several suggestions and proposed changes to the Commission's repropoed amendments. The suggestions proposed by the Exchange are intended to result in an equitable balance between the costs and benefits of regulatory requirements, while ensuring that the benefits of the repropoed amendments are afforded to the greatest number of market users.

### Eligible Customers

While endorsing the goals of the repropoed regulations, the CBOT is of the opinion that the potential universe of eligible customers should be expanded to include other appropriately qualified persons. The CBOT questions why the regulations entirely exclude natural persons from the listing of customers eligible to receive the end of day allocation. If the allocation of

Ms. Jean A. Webb  
March 9, 1998  
page 2

the orders is truly fair and equitable and made in a non-preferential and verifiable manner, then there is no reason why sophisticated individuals should not benefit from the end of day allocation when trades are part of a larger cross-market and diversified trading strategy.

The Commission seems to believe that preferential allocations would be more likely to occur if individually owned accounts were included in the eligible orders category. Why is a natural person different from a large pool or institution? After all, large institutional accounts are managed by natural persons. If the purpose of the end of day allocation is to ensure an equitable distribution of the fills when considered in relation to the other positions in a portfolio, the CBOT questions why a natural person should not be able to have a portfolio manager execute the same type of strategy for his/her benefit. The proposal to exclude all natural persons from the list of eligible customers seems to contradict the spirit of and reason for the amendments, particularly if the true test of an eligible customer is an entity or person's sophistication level to monitor the results of post trade allocation. Therefore, the CBOT encourages the Commission to include in its listing of eligible customers certain natural persons, as defined in CFTC Regulations 35.1(b)(2)(xi) and 36.1(c)(2)(xi); sole proprietorships or natural persons who are broker-dealers or FCMs and who meet the relevant financial criteria, and floor brokers and floor trades.<sup>1</sup>

#### Eligible Account Managers

The CBOT compliments the Commission on its decision to expand the listing of eligible account managers to include registered CTAs. However, the Exchange does question the Commission's reason for excluding non-U.S. investment advisers registered with the Commission. If the Commission believes such registered non-U.S. investment advisers are qualified to solicit customers in the U.S. and participate in our markets, the exclusion of this class of account managers seems contradictory to the Commission's recognition of their fitness. Moreover, such advisers are subject to CFTC recordkeeping requirements. This is more alarming to the Exchange given the significant role that foreign advisers have in the current financial markets. Therefore, the Exchange believes that the proposed Regulation 1.35(a-1)(5)(ii) should be expanded to include foreign advisers registered with the Commission, as well as to afford the exchanges the flexibility to expand the relief, on a case-by-case basis, to other account managers who are adequately regulated and subject to fiduciary liability.

#### Eligible Orders

The reproposal set forth by the Commission states that for an order to be eligible for end of day

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<sup>1</sup>NFA has stated that it is submitting a request to the Commission to provide for a uniform definition of "sophisticated customer" in Commission Regulation 1.3, in an effort to provide clearer guidance to the industry. The CBOT also supports and is participating in developing a uniform definition of "sophisticated customer".

Ms. Jean A. Webb  
March 9, 1998  
page 3

allocation it must be placed as part of the management of a portfolio also containing instruments which are either exempt from regulation pursuant to the Commission's regulations or excluded from Commission regulation under the Act. However, as the Commission itself has acknowledged, there may be instances where a CTA placing exchange traded futures only orders on more than one futures exchange may need post-trade allocation in order to achieve equivalent treatment of customers' accounts. For example, account managers may be arbitraging between contract markets or across futures and futures option products and thus the end of day allocation would benefit those customers and ensure a fair and equitable allocation of trades. Thus, the CBOT encourages the Commission to delete the proposed mixed portfolio requirement.

The CBOT understands that the original requests for these regulatory amendments were based on concerns of account managers and FCMs dealing with mixed portfolios. However, the benefits to the customers associated with an end of day allocation, including a more even and non-preferential treatment of accounts, should be available to all sophisticated users of the futures markets, not just those that trade in other financial markets. The trading advisors that arbitrage between markets, or trade volatility spreads, are under the same pressures of timing and fairness as those that trade across various financial markets. For these reasons, the Commission should accommodate all types of trading strategies by deleting the mixed portfolio requirement.

#### Proprietary Interest

The CBOT is pleased to see that the Commission has determined to use Regulation 1.3(y) to define proprietary interest as it relates to these regulations on end of day allocation. However, there should be some limited flexibility in the Regulation as it applies to commodity pool operators or CTAs that may be setting up new pools or liquidating old pools, and thus are required to redeem shares. In such circumstances, these entities may from time to time hold more than a 10% interest in the accounts being traded. If the benefit of end of day allocation is to ensure the fair and equitable treatment of all accounts within the account manager's control, then the fair and equitable treatment should not be limited at all times by an arbitrary percentage which may ultimately harm the customer these regulations are designed to protect. Therefore, the CBOT recommends that the regulation be revised to clarify that an account will not be disqualified if from time to time the 10% proprietary interest test is exceeded on a temporary or marginal basis.

#### Customer Protection

The proposed regulation has been changed to require each account manager to certify in writing, to each FCM executing and /or allocating any part of an eligible order, that the account manager is aware of the provisions of this paragraph and is, and will remain, in compliance with the requirements therein. The CBOT agrees that this representation/certification by the account manager to the FCMs handling the accounts is a good safeguard for the customers associated with these accounts, as well as a protection for all the FCMs carrying the accounts. However, the CBOT suggests that the account manager should only be required to supply the FCM with one

Ms. Jean A. Webb  
March 9, 1998  
page 4

certification/representation which would relate to all eligible accounts and which would remain in force until the certification is revoked or the FCM is otherwise notified of a change. The CBOT believes this would be easier to administer, and therefore reduce the regulatory costs, while accomplishing the same regulatory and customer protection function, whether an account manager is managing one or several groups of accounts.

The requirement that the FCM assure that allocations are made only to eligible accounts is similar to the requirements set forth in the previously approved regulation regarding bunching of orders. This requirement coupled with the requirement that prior to placing the initial eligible order the account manager must provide each FCM allocating the order with a list of eligible futures accounts does a great deal to strengthen the customer protection for these types of accounts. However, some FCMs are concerned with the extent of their liability as a result of these regulations. Since the Commission has limited the account managers that are eligible to transact this type of business and suggested a rigorous outline of customer protection and trading oversight, it is unnecessary to require the FCMs to have responsibilities above and beyond those already placed on them to ensure the fair and equitable treatment of their customers by Regulation 166.3, which requires that FCMs diligently supervise the handling of customer accounts.

The CBOT agrees that eligible customers must be notified that their accounts may be subject to end of day allocation. However, the Exchange believes that since the only accounts envisioned to be afforded the benefits of end of day allocation are those of sophisticated customers, it seems unnecessary to obtain written consent from the customers involved in these types of transactions. Indeed the Commission amended Regulation 155.5, effective April 21, 1998, to delete the requirement that various risk disclosure statements be provided to and signed by defined sophisticated customers. Similarly, in this context, account managers should be relieved of the necessity to obtain written consent from sophisticated customers who have been notified that their accounts may be subject to end of day allocation. This is particularly appropriate when a customer has given power of attorney and control of his/her account to the account manager, and the account manager has a fiduciary responsibility to properly handle the account in a fair and equitable manner.

#### Allocation Requirements and Recordkeeping

The repropoed regulations continue to require that each eligible order and the account manager placing the order be identified on the office order ticket, if applicable, and the floor order ticket at the time of order placement. Similarly, the requirement that eligible orders be identified on the trade registers and other contract market surveillance records has been retained, although it has been changed to a recordkeeping requirement.

Although the CBOT questions the necessity to designate the account manager on the original order tickets, the Exchange does understand the Commission's desire to identify the end of day allocation orders in some special manner. Therefore, the CBOT suggests that the Commission

Ms. Jean A. Webb  
March 9, 1998  
page 5

change the regulation to allow some type of group id or other identification on the eligible orders. In this way, the FCM may determine the best way to identify the trade, which is preferential to the Commission setting FCM business practices. Also the use of a group identifier or some other method deemed appropriate by the FCM will enable the identification of these types of trades on the trade register through the account number field.

The CBOT understands the Commission's desire to ensure the protection of the customer and ensure its and the Justice Department's ability to review these types of transactions. However, the proposed requirement that the eligible order designation be reflected throughout the processing of the order, i.e., on the trade register and other surveillance systems and on the customer account statements, will result in extensive cost to the industry, including firms, the exchanges and clearing corporations. It will require a change in the uniform TREX record, vendor systems', and clearing organizations' trade record layout. Additionally, the benefit of this type of information is questionable. The need to review these types of trades can be accomplished in manners similar to those currently used to review the account of any customer that has given discretionary authority to another person. The identification of the eligible orders which have received end of day allocations through out the entire process also seems to have little benefit to the sophisticated customer afforded this treatment. Such a customer has already been notified that his/her or its account may include such transactions, so identifying the trades which have been subject to post trade allocation does not seem to provide any additional benefit to that sophisticated customer. Additionally, the customers can receive or obtain detailed information regarding allocations from the account manager, if they so desire. In sum, the identification of the trades allocated at the end of the day on the trade register, other surveillance records, and account statements does not appear to benefit the customer or aid in the customer's overall protection in a manner which would justify the considerable costs to the industry.

#### Contract Market Rule Enforcement Programs

The responsibility for the surveillance of the allocation and related performance of the account managers seems to be appropriately placed with the NFA rather than the contract market on which the trades are transacted, since the NFA is the agency that regulates and monitors CTAs and CPOs. The contract market, e.g., the CBOT, will look at these transactions only if they are a part of a regular trade practice investigation or chosen as part of its normal testing of accounts during its routine review of member firms. Because the NFA has the explicit responsibility, it would be duplicative and unduly burdensome to require contract markets to conduct specific regulatory reviews of these types of accounts as part of these regulations.

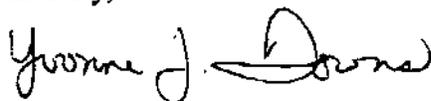
#### Conclusion

The CBOT once again compliments the Commission on its efforts to alleviate the regulatory restrictions on the placement of futures and futures options orders for the accounts of sophisticated customers. The Exchange also urges the Commission to carefully consider the points enumerated in this letter so as to ensure that the costs associated with these proposed rule

Ms. Jean A. Webb  
March 9, 1998  
page 6

changes do not outweigh the benefits to an increasingly significant portion of the customers of the futures industry.

Sincerely,

A handwritten signature in cursive script that reads "Yvonne J. Downs". The signature is written in black ink and is positioned above the typed name.

Yvonne J. Downs