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CBOE 25 Years of Investment Innovation

COMMODITY FUTURES TRADING COMMISSION RECEIVED

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William J. Brodsky
Chairman and
Chief Executive Officer

Phone: 312 786-7001
Fax: 312 786-7407
brodsky@cboe.com

COMMENT

April 27, 1998

COMMODITY FUTURES TRADING COMMISSION RECEIVED FOR PUBLIC RECORD

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

Re: Application of Cantor Fitzgerald Futures Exchange as a Contract Market in US Treasury Bond, Ten-Year Note, Five-Year Note and Two-Year Note Futures Contracts

Dear Ms. Webb:

The Chicago Board Options Exchange ("CBOE") respectfully submits the following comments on the application of Cantor Fitzgerald Futures Exchange ("CFFE") for designation as a contract market for computer-based trading of futures contracts in specified US Treasury securities. CBOE is interested in this application because it represents one of the first proposals in this country seeking to apply to the trading of financial instruments a combination of an electronic computer-based trading system together with the regulatory structure of a traditional floor-based exchange market.

CBOE maintains the world's largest floor-based, open-outcry exchange market for securities options and other securities derivatives. Although CBOE's marketplace operates under the regulatory oversight of the Securities and Exchange Commission and subject to the Securities Exchange Act of 1934, the regulatory scheme with which we are familiar is not dissimilar to that administered by the Commodity Futures Trading Commission under the Commodity Exchange Act in that both have as their focus providing fair, honest, transparent and competitive markets in which customer orders can receive efficient execution at the best available prices. CBOE is concerned that, as market sponsors seek to make greater use of modern computer technology in the operation of financial markets, governmental regulators and self-regulators do not permit any relaxation of those safeguards that are necessary to assure that markets remain fair and competitive, and that the protection of investors remains paramount.

The unique ownership, management and operational structure proposed for the CFFE raises a number of disturbing questions that we believe must be carefully considered by the Commission in connection with its review of the subject application. To some extent, these questions would be raised by any proposal to utilize a totally electronic, computer-based system to trade products that are identical or similar to products that are already traded in open-outcry markets. That is, simply because electronic markets are capable of providing virtually instantaneous executions of customer orders once they are entered into the system does not mean that, in the interest of speed of execution alone, such markets should be held to any lesser standards than traditional, open-outcry markets when it comes to such matters as transparency, competitive fairness and adequacy of regulation.

These questions are exacerbated in the case of the CFFE proposal on account of its peculiar structure, whereby a private business organization engaged in brokerage activities, the group of Cantor-affiliated companies, would not only operate the computers that constitute the marketplace and provide for the dissemination of market information, but also would exercise effective control over the board of directors of CFFE itself. At the same time, the regulatory responsibilities of the CFFE are proposed to be met in some not fully described manner by virtue of CFFE's affiliation with the New York Cotton Exchange, an existing self-regulatory organization. This unusual structure raises significant questions of conflicts of interest, adequacy of Commission oversight and whether trading in the CFFE would be competitive and fair that we believe must be resolved before the application can be approved.

This is not to say that the Commission should place undue barriers to increased utilization of technology by the markets it oversees. It does suggest that the Commission should move carefully in this area, however, to assure that as markets become ever more automated, important public interests continue to be taken into account. One way to do this is exemplified by the approach of the Securities and Exchange Commission to the recent proliferation of proposals to introduce electronic trading to securities markets. Last year, the SEC issued a thoughtful and comprehensive "Concept Release" that requested comments on the issues raised by the adaptation of existing regulatory structures to the various alternative trading systems that are being proposed as a direct consequence of technological developments.[1] More recently, after digesting the many comments that were furnished in response to the Concept Release, the SEC has proposed a series of rules that, among other things, would permit self-regulatory organizations to experiment with limited volume, two-year pilots involving the application of new types of technology to securities trading.[2] We agree with the careful and deliberate approach being taken by the SEC in considering the application of computer and communications technology to securities markets, and we believe the CFTC would be remiss if it simply were to act *ad hoc* on individual applications such as the one submitted by the CFFE without first requesting comment on and considering the broader ramifications of computer-based trading of financial futures and options on futures.

We appreciate the opportunity to present our views to the Commission, and hope you find them useful.

Sincerely,

William J Brodsky

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[1]Securities Exchange Act Release No. 38672, 62 FR 30485 (May 23, 1997).

[2]Securities Exchange Act Release No. 39884 (April 17, 1998).