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Chicago Board of Trade

Thomas R. Donovan
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February 24, 2000

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VIA FACSIMILE

COMMENT

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

**Re: Proposed Revision of the Commission's Procedure for the Review of
Contract Market Rules [64 Fed. Reg. 66428 (Nov. 26, 1999)]**

Dear Ms. Webb:

The Chicago Board of Trade ("CBOT") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or "Commission") proposed Rule 1.41(z). The proposed rule would allow U.S. futures exchanges to implement new rules and rule changes without prior agency review or approval, pursuant to self-certification procedures that are comparable to the ones that the Commission recently adopted in CFTC Rule 5.3 for new contract listings.

We are pleased that the Commission is using its exemptive authority under CEA Section 4(c) to fashion regulatory relief for exchanges. As you know, the CBOT has been urging the Commission to exercise its exemptive authority to promote fair competition between domestic exchanges and OTC derivatives markets since the Commission received that authority in 1992. The CFTC staff task force recommendations issued earlier this week for a new regulatory oversight framework for derivatives predicated upon general core principles is a significant development that could lead to true, meaningful relief for the U.S. futures exchanges. In the meantime, prompt adoption of Rule 1.41(z), with certain modifications, would provide welcome interim relief in furtherance of the Commission's broader regulatory reform initiatives.

The CBOT has several specific comments on the Commission's rule proposal.

Certification

An exchange operating under CFTC Rule 1.41(z) would be required to file its rule submission with the Commission at least one business day before making its rule or rule change effective. The submission must include, among other required information, a certification by the exchange that its rule or rule change "neither violates nor is inconsistent with" any provision of the CEA or the Commission's regulations.

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We recommend that the Commission delete the “not inconsistent with” concept from the required certification. A designated contract market has a legal obligation to comply with CEA and CFTC requirements, and it is appropriate for the Commission to require an exchange to certify that its rule proposals do not violate those requirements. It is a different matter, however, to require an exchange to represent that its rule submissions are “not inconsistent with” CEA or CFTC requirements. A highly subjective standard such as this could well result in reasonable differences of opinion between the Commission and an exchange as to whether the exchange’s rule is or is not consistent with CEA and CFTC requirements -- requirements which themselves are in many cases open to disagreement as to interpretation. (The CEA’s audit trail requirements are one example.) The risk of being second-guessed for its reasonable judgment that a rule meets the “not inconsistent with” test could likely discourage an exchange from using the 1.41(z) certification procedures.

Under the Commission’s new Rule 5.3, which it adopted last November in a companion release to the current rulemaking proposal, the Commission also requires an exchange to make this two-part certification when it submits rules for contract terms and conditions under the new Rule 5.3 procedures. We ask that the Commission please amend Rule 5.3 to delete the “not inconsistent with” language from that required certification as well, for the same reasons described above with respect to the proposed Rule 1.41(z) certification language. As a more general matter, given that the Rule 5.3 and Rule 1.41(z) self-certification procedures would both be available for exchange rules pertaining to contract terms and conditions, the CBOT encourages the Commission to make conforming changes to Rule 5.3 to ensure consistency between the two procedures.

Exclusivity of Regulation 1.41(z)

As stated in its release, the Commission is proposing the Rule 1.41(z) procedure as an alternative, and not a replacement, to the existing filing and review procedures in Rule 1.41 for exchange rules that do not pertain to contract terms and conditions. The CBOT agrees with this approach, and recommends against imposing a requirement on exchanges that they must use the 1.41(z) process exclusively for all qualifying rules.

Instances may occur when an exchange believes that formal Commission review and/or approval of a rule prior to its implementation is in the exchange’s and indeed in the marketplace’s best interests. For example, the CEA and Commission rules contain many nuanced provisions (e.g., audit trail requirements), which we know from past experience, are open to disagreement over their intended meaning. For rule proposals that fall into an interpretive gray area, an exchange may be reluctant to certify that its rule does not violate CEA or CFTC requirements, rather than risk a contrary finding by the Commission with its potential negative market impact. In those instances, an exchange should have the flexibility to decide whether to submit the rule under the under the 1.41(z) procedure or other procedures in Rule 1.41.

Suspension of Effectiveness of an Exchange Rule

The Commission is proposing to reserve the authority to suspend or stay the operation of an exchange rule or rule change adopted pursuant to the self-certification procedures if the Commission initiates proceedings to disapprove or alter such rule or rule change, during the pendency of such proceeding. We ask the Commission to delete this feature of its proposal.

We believe this change is appropriate because suspension of an exchange rule by agency action during the pendency of a disapproval proceeding could be disruptive to the marketplace. In addition, an exchange will view Commission initiation of proceedings to disapprove or alter one of the exchange's rules as a very serious matter. As a result, an exchange can be expected to decide with due deliberation whether or not to suspend operation of the rule voluntarily, taking into account the Commission's grounds for initiating the proceeding and the potential implications to its markets based on its extensive market knowledge and the input of market users.

Contracts with Open Interest

We do not believe it is necessary, as proposed, to preclude exchanges from implementing rules or rule changes pursuant to Rule 1.41(z) with respect to contract months with open interest. In those cases in which a rule change could affect pricing of contracts with open interest, the exchange should be trusted to decide whether to delay implementation of the rule based on its assessment of what is best for the market place. We are closest to our markets and, hence, in the best position to weigh the varying considerations involved in making such a decision, just as we are in deciding whether to suspend a rule facing potential Commission disapproval. For this reason, we also recommend deleting this restriction from Rule 5.3 as part of the conforming changes.

Emergency Rules

The Commission has raised whether it should differentiate treatment of exchange emergency rules under CFTC Rule 1.41(f) versus other exchange rules that could be adopted pursuant to Rule 1.41(z). We believe this concern is unwarranted. We believe that an exchange should have the flexibility to submit an emergency action rule either under Rule 1.41(f) – which offers the benefit of immediate effectiveness – or under 1.41(z). By its nature, the implementation of an emergency rule carries the risk of subsequent litigation from market users who believe they may be adversely affected, whether justified or not, by the action, and that risk is one factor to be weighed by an exchange when deciding how to submit an emergency action rule.

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New Electronic Trading Systems

The Commission has requested comment on whether exchanges could adopt rules implementing a new electronic trading system under the self-certification procedures of Rule 1.41(z). We believe the answer should be yes. The CBOT sees no reason to differentiate between rules relating to electronic trading systems from those relating to the more traditional open outcry system. Exchanges are well aware of the requirements of the CEA and Commission rules, regardless as to which method of trading is affected and regardless as to whether it is a "new" or "replacement" electronic system.

We believe that the issue of Commission review of an exchange's electronic trading system should not be confused with the issue of whether Commission review of the exchange's rules for its electronically-traded markets is necessary or appropriate. In any event, we believe the Commission should apply the same standards of review to all exchanges' electronic trading systems.

We appreciate the Commission's consideration of our comments, and would be happy to discuss them further with Commission staff.

Sincerely,

A handwritten signature in cursive script that reads "Thomas R. Donovan". The signature is written in black ink and is positioned centrally below the word "Sincerely,".

Thomas R. Donovan