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Chicago Board Brokerage

STATEMENT BY CHICAGO BOARD BROKERAGE
OPPOSING APPROVAL OF CANTOR FINANCIAL FUTURES EXCHANGE

U.S. COMMODITY FUTURES TRADING COMMISSION

AUGUST 11, 1998

Chicago Board Brokerage, L.L.C. (CBB) is a government securities broker registered with the Securities and Exchange Commission pursuant to Section 15C of the Securities Exchange Act. CBB has received approval to operate a fully interactive electronic trading system in the government securities market.*

CBB wants to emphasize two significant issues for consideration by the Commission as it reviews the proposed Cantor Financial Futures Exchange (CFFE). CBB believes these issues weigh against approval of the CFFE application.

1. The CFFE will not provide an interactive electronic market for trading of Treasury futures contracts. CFFE will instead require users to complete their trades through telephone calls to terminal operators located at a central CFFE facility.
2. Permitting Cantor Fitzgerald L.P to play a central role in the operation of the proposed CFFE will have adverse effects on competition.

Failure of CFFE to Provide an Interactive Electronic Marketplace

The market for U.S. Treasury securities is the largest securities market in the world. The Treasury reported \$3.35 trillion of marketable debt outstanding as of July 31, 1998. Average daily turnover in the Treasury market is well in excess of \$ 175 billion each day. In many respects, the Treasury market is also the most important financial market in the world. Treasury securities are regarded as the equivalent of money by investors, governments and regulatory authorities the world over. The smooth functioning of the market is crucial to the ongoing financial operations of the United States government and is also the single most important factor in the implementation of US monetary policy.

*CBB is jointly owned by Ceres Trading Limited Partnership, an entity owned by the members of the Chicago Board of Trade, and Prebon Alliance, Inc. a subsidiary of Prebon Yamane (USA) a large institutional broker in the over the counter markets.

Over the last 21 years, the futures market has assumed a critical role in the Treasury market. The availability of the Treasury futures market has enabled market participants to better manage their risk in the cash market and has deepened liquidity in the Treasury market overall. The Federal Reserve Bank of New York reported that the primary dealers executed more than 13,400 Treasury futures transactions in the week ending July 29.

The introduction of a new exchange in the Treasury market is an event that must be viewed in relationship to the market as a whole. A new exchange must foster investor confidence and should serve several important goals. Price discovery should be a fair and transparent process, in which market participants are assured that they can accurately determine the current market price. Market participants should also be sure that they are receiving trade execution at that market price. A marketplace that displays a price, but does not make it equally available to all eligible participants, lacks a key element of market transparency. For the reasons laid out below, the CFFE, as currently proposed, will not meet the high standards for market transparency that the Treasury market requires.

The CFFE proposes to introduce to the futures market an exchange based on the methods currently available for trading Treasury securities in the interdealer market for Treasury securities. Although the traditional system for trading may have served the needs of the Treasury marketplace in the past, the simple fact is that technology has moved ahead so rapidly in recent years that the CFFE system has already become outdated.

Moreover, the application of current technology will create a fully interactive, user-controlled, screen-based market to which traders can have ready, equal access at much reduced cost – in short, a level playing field for everyone. This is precisely what CBB has done in creating an interactive electronic trading system for the cash market. Significantly, the proposed CFFE is not this kind of state-of-the art facility. Indeed, it would be little more than an extension to the futures markets of Cantor Fitzgerald's current phone-based service to its customers in the cash markets.

Cantor Fitzgerald itself admits as much and claims to have a more advanced, truly interactive system ready for introduction in September 1998. We believe it is incumbent on the Commission to consider why it should approve an inadequate system that cannot meet the highest standards, and why Cantor Fitzgerald would seek approval of such a system, if it is on the threshold of introducing a significantly superior one.

First, we would like for the Commission's benefit to highlight several particularly important differences between the CFFE system and a truly interactive system for trading financial instruments.

Interactivity

CFFE -- Although they view prices displayed on a CFFE computer screen, users have no direct ability to execute trades at those prices. Instead, they must make a

telephone call to a central CFFE facility and speak to a terminal operator. This interposes an unnecessary step between the user and trade execution. The terminal operator step takes time and increases the potential for human error.

Fully Interactive System -- A fully interactive electronic system allows users to control the entry of prices and execution of trades. The user, therefore, manages the price discovery process and is assured of trade execution at the market price he/she sees. A fully interactive electronic system clearly serves the goal of market transparency – in sharp contrast to the CFFE in which a telephone call to a middleman carries the risk of human discretion, leaving market participants with the sense that the real market is shaped out of public view.

Trading Practices

CFFE – The proposed CFFE system incorporates several practices that unnecessarily compromise market transparency. The two most egregious of these – exclusive time and clearing time – give certain users an option to execute trades before orders are made available on the screen for other users. The duration of the exclusive time and clearing time options are not set; they will vary widely with market conditions and liquidity.

Exclusive time allows users to disguise the amount of contracts that they want to trade at a displayed price while maintaining the right to continue to trade at that price for the duration of their exclusive time. This rule applies even if multiple users are concurrently seeking trades at the same price for the same contract. In other words, the first user stays at the front of the line, executing trades at his preferred price, without disclosing to anyone other than the terminal operator the amount he really seeks to trade. The exclusive time practice obscures market depth at the displayed price level and severely disadvantages other users seeking to trade at that price.

Clearing time allows a user who is first in line at one price to become first in line at a different price received by CFFE for that same contract. The first user is permitted to trade for an amount, and at a price, which are not made available on the screen to other users.[†]

CFFE will display only bids and offers that are currently at the best price for each contract. Less-favorably priced orders are discarded by CFFE, even if the amount to be traded at the less-favorable price far exceeds the amount available at the best price. This feature withholds valuable information from users as they seek to discover the price at which the market is most likely to trade.

[†] We understand that Cantor Fitzgerald has removed clearing time from the current CFFE application, but plans to reintroduce the clearing time practice at a later date. CBB maintains that clearing time will never be an appropriate practice for an organized exchange.

Fully Interactive System – A fully interactive system is user-controlled and has no place for such compromises in trading practices. Every user views all information on-screen in real time fully and equally. A user executes a trade directly through his/her workstation and receives a confirmation in one or two seconds. All other users become aware of the executed trade instantly and simultaneously.

Anonymity

CFFE – No matter how careful the safeguards, a system that places a middleman such as the CFFE terminal operator between the user and trade execution will always bear the risk of human indiscretion.

Fully Interactive System – A fully interactive electronic system assures anonymity in a way that cannot be matched by the CFFE terminal operator system. Computers have no incentive to disclose information about the users and their transactions.

Audit Trail

CFFE – The CFFE will rely on taped lines to maintain an audit trail of orders received and communications between terminal operators and users. Although taped lines can be an effective safeguard for individual trading firms, they do not provide the quality of recordkeeping that market participants have a right to expect from an exchange.

Fully Interactive System – A fully interactive electronic system has the ability to provide an audit trail of each keystroke command sent to the system. The CFFE should be held to this high, readily attainable standard.

It can be seen readily that the CFFE application fails markedly to meet the high standards of market transparency and accountability to which the Commission and other regulators properly attach great importance.

Potential Adverse Effects On Competition

Cantor Fitzgerald has suggested to this Commission that its purpose in attempting to enter the futures market is pro-competitive and beneficial for customers. But the Commission should be skeptical of this message in light of what Cantor Fitzgerald has done to attempt to stifle competition in the cash markets.

Cantor Fitzgerald is the undisputed -- and self-confessed -- "dominant" and "world's largest" interdealer broker of U.S. Treasuries. As such, Cantor Fitzgerald wields significant market power in the cash markets, controlling 40% of the overall market for the wholesale brokerage of U.S. Treasuries and as much as 70% of the market for the wholesale brokerage of long-term Treasuries. Cantor Fitzgerald also charges customers the highest commissions in the market for its brokerage services.

CBB has attempted to enter the cash Treasuries market by introducing a new interactive, electronic system for the brokerage of Treasuries. CBB's new system promises to make trading Treasuries easier, faster and less expensive for more and more customers. Indeed, Cantor Fitzgerald has itself estimated that CBB's commissions could be as much as 80% lower than Cantor's commissions.

Rather than rolling up its sleeves to compete on the merits with CBB, however, Cantor Fitzgerald has instead committed itself to an all-out campaign to destroy CBB's ability to compete in the cash Treasuries markets and, ultimately we believe, to exclude CBB from those markets altogether. Cantor Fitzgerald has sued CBB over rights to CBB's interactive technology. It sought a preliminary injunction that would have put CBB out of business. And when it failed to obtain that injunction, Cantor Fitzgerald threatened to sue CBB's customers, prospective business partners and even issued a press release in which it threatened to sue *anyone else who deals with CBB*.

We respectfully submit that the Commission should weigh Cantor Fitzgerald's actual conduct in the cash Treasuries markets against its professed interest in increased competition.