



December 15, 2003

Ms. Jean A. Webb  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

RE: Modification of Rule 37703.A governing the calculation of Final Settlement Price for  
E-mini NASDAQ Composite Index.  
Submitted per Sec. 5c(c)(1) of the CEA and Regulation Sec. 40.6(a).  
CME Submission # 03-110.

Dear Ms. Webb:

Pursuant to Section 5c(c) of the Commodity Exchange Act ("CEA") and Regulation §40.6 thereunder, Chicago Mercantile Exchange Inc. ("CME" or "Exchange") hereby certifies the following amendments to the Exchange Rules governing the calculation of the Final Settlement Price for E-mini NASDAQ Composite Index futures. The Exchange certifies that this action neither violates nor is inconsistent with any provision of the CEA or of the rules thereunder.

E-mini NASDAQ Composite Index futures contracts are cash settled on the Final Settlement Date at a value known as the "Special Opening Quotation" (SOQ). Current Exchange Rules stipulate that the SOQ utilize the following plugs as the values of the constituent stocks as follows.

- The Volume Weighted Price (VWP) of the stock during the first five (5) minutes of trading; OR
- The closing price of the stock on the previous day provided that the constituent stock has NOT opened for trade on the expiration day between 8:30 a.m. (9:30 a.m. Eastern Time) and 3:00 p.m. (4:00 p.m. Eastern Time).

The revised methodology utilizes the following plugs as the values of the constituent stocks as follows.

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- The Volume Weighted Price (VWP) of the stock during the first five (5) minutes of trading; OR
- The closing price of the stock on the previous day provided that the constituent stock has NOT opened for trade on the expiration day between 8:30 a.m. (9:30 a.m. Eastern Time) and 9:30 a.m. (10:30 a.m. Eastern Time).

The two methodologies differ to the extent that some constituent stocks may open for trading between 9:30 a.m. (Chicago time) and the close of the daily session. Rather than reference the VWP during the first five minutes of trade, whenever that may occur during the day, the revised methodology would reference the previous day's closing price for the stocks that open for trading later than 9:30 a.m.

In adopting this amendment, the impact on the final settlement price should prove to be very minimal, as evidence below would show. It will, however, facilitate an earlier resolution of the final settlement price. Under this arrangement, the determination of the final settlement price would commence immediately after the 9:30 a.m. "cutoff time"; whereas, under the previous methodology, the calculation would almost certainly be impossible before the stock market closes at 3:00 p.m. (Chicago time.) This early resolution of the final settlement price would be beneficial to the market participants.

The NASDAQ Composite Index is comprised of approximately 3,500 stocks, most of which exhibit miniscule trading activity. It is virtually certain that some of the stocks will only open for trading after 9:30 a.m. (Chicago time) The magnitude of any possible variation, however, is likely to be low to the extent that the illiquid index components comprise an extremely small proportion of the Index's weighting. The following table documents the performance of the NASDAQ Composite on recent (hypothetical) expirations. Please note that the contract was recently introduced and has not yet gone through a final settlement cycle.

Opening Time (Chicago Time)	Hypothetical September 19, 2003 Expiration			Hypothetical June 20, 2003 Expiration		
	# Securities	Market Value (\$ bil.)	Weight	# Securities	Market Value (\$ bil.)	Weight
8:30 am – 9:30 am	2,721	2,786.1	99.04%	2,774	2,389.6	98.87%
9:30 am – 3:00 pm	441	20.0	0.71%	438	19.8	0.82%
Later than 3:00 pm or never opened	199	7.1	0.25%	237	7.4	0.31%
<i>Total</i>	3,361	2,813.2	100.00%	3,449	2,416.8	100.00%

**Opening Time of NASDAQ Stock Market Securities**

Source: NASDAQ

The above table shows that some 400 stocks<sup>1</sup> may open "late" and thus could contribute to the variation in NASDAQ's SOQ calculation. These 400+ stocks, however, account for less than 1% of the weight in the NASDAQ Composite. Further, some of the stocks may have appreciated vis-à-vis previous day's closing prices while others have declined. Some of the gains would have offset the losses, leading to a small aggregate variation. Further, the fact that these stocks did not open earlier may have signaled that there would not have been large departure in valuation from the previous day.

As a thought experiment, let us assume that the late-opening stocks are collectively "mis-priced" by 5%, a rather large variance given the logic laid out in the preceding paragraph. With an aggregate weight of less than 1%, this translates into a diminutive variation in the SOQ of less than 0.05%. At the prevailing Index level of around 2,000 points, this is equivalent to a difference of less than 1 index point or \$20 per open contract at the expiration.

As of this writing, the open interest in the E-mini NASDAQ Composite Index futures for the December 2003 expiration stands at 155 contracts. It is expected that only a fraction of these positions will remain open at the expiration on December 19, 2003. To the extent that arbitrageurs, if any, would not likely employ many of the illiquid stocks in the Composite Index, exact price convergence is not as important as it may be for other stock index futures.

The Exchange intends to implement the amendment on Tuesday, December 16, 2003 upon notification to shareholders and members, with the December 2003 contract, expiring on December 19, 2003, being the first affected expiration. The rule amendments are noted below with deletions bracketed and overstruck and additions underlined.

## **CHAPTER 377: E-MINI NASDAQ COMPOSITE INDEX FUTURES**

### **37703. SETTLEMENT PROCEDURES**

Delivery under the E-Mini NASDAQ Composite Index futures contract shall be by cash settlement.

#### **37703.A. Final Settlement Price**

The Final Settlement Price shall be determined on the third Friday of the contract month or, if the NASDAQ Composite Index is not scheduled to be published for that day, on the first earlier day for which the Index is scheduled to be published.

The final settlement price shall be a Special Opening Quotation of the NASDAQ Composite Index to be determined by the NASDAQ Stock Market Inc. ("NASDAQ"). If the NASDAQ does not open on the day scheduled for the determination of the Final Settlement Price, then the Final Settlement Price shall be the Special Opening Quotation of the first subsequent day on which NASDAQ does open.

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<sup>1</sup> Although the table shows that 400+ stocks opened late on the two hypothetical expiration days, the identities of the 400+ stocks may differ from one day to the other.

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The Special Opening Quotation of the NASDAQ Composite Index shall be based on Volume Weighted Prices (VWP) of NASDAQ Composite Index stocks. The VWP of a stock shall be computed from transaction prices in the five-minute period beginning with its first transaction price at or after 8:30 a.m. Chicago time, as reported by NASDAQ.

The VWP of a stock in the index shall be a weighted average of its transaction prices during this five-minute period. The weight associated with a particular transaction price shall be the fraction of the total volume of trade during this five-minute period which was executed at this transaction price.

If the first transaction of a stock occurs after ~~[2:55 PM]~~ 9:25 a.m., Chicago time, then its VWP shall be computed from transaction prices reported before ~~[3:00 p.m.]~~ 9:30 a.m., Chicago time. If a stock does not trade after 8:30 a.m. and before ~~[3:00 p.m.]~~ 9:30 a.m., Chicago time, then its VWP shall be its closing price from the previous day. However, if the President of the Exchange or his delegate determines that there is a reasonable likelihood that trading in the stock shall occur shortly, the President or his delegate may instruct that the price of stock shall be based, for the purposes of calculating the Final Settlement Price, on the opening price of the stock on the next day that it is traded on its primary market. Factors to be considered in determining whether trading in the stock is likely to occur shortly shall include the nature of the event and recent liquidity levels in the affected stock.

With the exception of trade reports with .O modifiers, trade reports that do not have modifiers attached to them shall be used for the computation of VWPs.

*[The remainder of this Chapter remains unchanged.]*

Please do not hesitate to contact Mr. Richard Co at 312-930-3227 or rco@cme.com if any questions arise during the processing of this submission. Please reference our CME Submission #03-110 on all future correspondence for this submission.

Sincerely,



John W. Labuszewski, Director  
Research & Product Development

CC: Mr. David Van Wagner  
CFTC Division of Trading and Markets