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July 6, 2009

Mr. David A. Stawick  
Secretary to the Commission  
Commodity Futures Trading Commission  
Three Lafayette Center  
1155 21<sup>st</sup> Street, NW  
Washington, DC 20581

**Re: Request for Approval of Amendment to ELX Futures, L.P. Rule IV-5(a)(iv)and(v) to add an Exchange of Futures for Futures, or “EFF,” Rule to the Rule Governing Exchange of Futures for Related Positions**

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- I. Text of Rule Amendment is Attached Hereto
  - II. Effective Date – August 24, 2009, which is more than 45 days after Commission Receipt
  - III. Approved by the Management Board of the Exchange on June 30, 2009 with no substantive opposing views expressed.
  - IV. No Confidential Treatment Requested
  - V. Operation, Purpose and Effect of the Proposed Rule, and Discussion of Relevant Provisions of the Commodity Exchange Act that Are Implicated in the Approval

Pursuant to Commission Reg. 40.5, 17 CFR 40.5, ELX Futures, L.P. (“ELX Futures”) a Designated Contract Market (“DCM”), hereby requests the Commission’s approval for an amendment to ELX Rule IV-15 “Exchange of Futures for Related Positions.” The amendment to Rule IV-15, the text of which is appended hereto, provides for the execution of Exchange of Futures for Futures (“EFF”) transactions. The purpose of the Rule is to enable market participants to establish positions in futures contracts on ELX and liquidate such positions on another DCM that lists an identical contract, or to establish a position on such other DCM and liquidate it on ELX. ELX is seeking

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Commission approval of the amendment in order to ensure that the objectives of the EFF Rule, and the ability of market participants to utilize the EFF facility, cannot be curtailed by the unilateral action of another DCM on which the identical contracts that would be the subject of the EFFs are listed.

The Commission has previously approved an EFF facility, and the ELX amendment does not present a novel issue. The first EFF rule was proposed by the New York Mercantile Exchange (“NYMEX”) in 2002 in connection with its cash settled Brent futures contract, which competed with the similar contract traded on the International Petroleum Exchange (the “IPE”), now ICE Futures Europe, a subsidiary of Intercontinental Exchange, Inc. The Commission approved the EFF Rule following publication in the Federal Register (March 13, 2002, Vol. 67, No. 49, pp. 11286-11288), and NYMEX implemented it as Rule 6.21D.

The NYMEX EFF was designed to allow the liquidation of a trade on the IPE and a posting of a similar quantity of contracts on the same side of the market as the liquidated position on the NYMEX via the EFF. Since the NYMEX EFF was introduced, there has been a broad expansion in the use of the EFP and similar mechanisms (e.g. EFS, EFR, EOO) to include many derivative types. It makes no logical sense to distinguish futures exposure from off-exchange exposure, and the Commission accepted this argument in 2002 when it approved NYMEX’s Rule 6.21D.

The NYMEX EFF was circumscribed in its application. NYMEX Rule 6.21D only permitted a liquidation on another exchange and the establishment of a position on ELX Futures, but not the reverse. ELX Futures would have the EFF mechanism freely used in a non-discriminatory manner so that users of the EFF vehicle could move positions from the clearinghouses for the Chicago Board of Trade (“CBOT”) to the clearinghouse for ELX Futures via an EFF transaction, but we also intend to allow the trade to go the other way as well, i.e. moving ELX Futures positions to the CBOT via EFF transactions.

In the instant case, ELX Futures intends to treat the EFF as it would any other Exchange of Futures for Related Position transaction (defined in ELX Rule IV-15), allowing a market participant to establish and offset a position; and have it accepted by the ELX’s clearinghouse, in this case the Options Clearing Corporation (“OCC”), and by the clearing division of CME Group Inc. (“CME Group”), which clears on behalf of the CBOT.<sup>1</sup>.

The specific purpose of ELX Future’s request for prior approval of the Rule is to confirm that the EFF Rule can be used to create a trade that must be accepted under CBOT Rule 538 of the Rules of CBOT, a DCM that is wholly owned by the CME Group, and will not subject the CBOT participant to disciplinary action or the threat thereof. Under Section 15(b) of the Commodity Exchange Act, the Commission is given explicit authority “in

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<sup>1</sup> An EFF consists of two related but discrete transactions which are executed non-competitively between the same exempt commercial participants: (i) the Buyer of the ELX contract is the seller of the CBOT contract; or (ii) the seller of the ELX contract is the Buyer of the CBOT contract.

requiring...any bylaw, rule or regulation of a contract market." We ask specifically that the Commission use the powers granted to it to order an amendment to CBOT Rule 538 in order to give effect to ELX Futures instant rule proposal.

In a related context, the Chicago Mercantile Exchange ("Chicago Merc), also wholly owned by CME Group, previously used the self-certification process to interpret its rules to prohibit a transaction (referred to as a "basis trading facility," or "BTF") that was similar in purpose to the EFF, as described below:

The BTF was established by Euronext.liffe and was similarly designed to allow a trader simultaneously to liquidate a Eurodollar position on Euronext.liffe or the Chicago Merc and reestablish that Eurodollar position on the other exchange at the same price. The BTF was structured primarily to facilitate the movement of positions from the Chicago Merc to Euronext.liffe. Euronext.liffe claimed that this facility could also be used to move positions from Euronext.liffe to the Chicago Merc. This apparently could have been accomplished by treating the Euronext.liffe transaction as the off-exchange portion of a "Exchange Basis Facility," or "EBF" transaction under Chicago Merc Rules. An EBF is the term that is used by the Chicago Merc for an EFP transaction executed in its interest rate products and, like other EFPs, or Exchanges for Swaps, an EBF trade typically involves a negotiated combination of transactions in a Chicago Merc futures contract and an over-the-counter swap or forward on the same or a related underlyer. Under the Euronext.liffe BTF, a market participant could similarly negotiate the terms of coordinated transactions in the Euronext.liffe and CME Eurodollar futures contracts. Euronext.liffe apparently took the position that traders could also establish positions on the CME via a BTF transaction, by executing the CME leg of the transaction under the EBF facility. A number of traders took advantage of the BTF after its introduction to transfer positions.

The Chicago Merc subsequently issued an interpretation stating that it would be a violation of its fictitious trading rules to engage in a "prearranged transaction or series of transactions by means of which one or more parties engages in a transaction at Chicago Merc and reverses that transaction at Chicago Merc or any other board of trade." Relying on the authority granted to DCMs under the CFMA, the Chicago Merc self-certified that its interpretation did not violate, and was not inconsistent with, the CEA. The premise of the Chicago Merc's objection appears to have been its contention that a futures transaction on another exchange was not a permissible part of an EBF transaction, because the EBF facility only contemplated over-the-counter derivative or physical transactions as the off-exchange portion of the EBF.

Euronext.liffe filed a series of letters with the Commission challenging the Chicago Merc's certification, based on its contention that the Euronext.liffe side of a BTF trade was no less permissible or legitimate than an over-the-counter swap. It also argued that the Chicago Merc's action was taken only for anti-competitive reasons and that such action violated Core Principle #18 applicable to DCMs because its interpretation was not "necessary or appropriate to achieve the objectives of the CEA" and would result in an "unreasonable restraint of trade." The Commission, however, took no action on

Euronext.liffe's objections, thereby allowing the Chicago Merc's interpretation to remain in effect. As a result, market participants using the BTF would subject themselves to the risk of Chicago Merc's disciplinary action, which effectively precluded its use.

CME Group now owns at least four contract markets: Chicago Merc, CBOT, NYMEX and the Commodity Exchange, Inc. ("Comex"). CME Group controls 100% of the market share in U.S. Treasury futures contracts, and more than 95% of the market share in futures trading generally.<sup>2</sup> CME Group uses the rules related to EFPs and the like in different fashions across its various markets to further its business goals, and backs those goals up with its rulemaking and disciplinary powers. The arbitrariness of the rules and interpretations, and the threat of disciplinary action, flies in the face of market competition and must be regulated by the Commission.

The rules and interpretations of the Chicago Merc and CBOT explicitly prohibit contingent trades as the basis for an EFP or similar trade and in certain cases they allow transitory transactions without drawing a distinction between a transitory and contingent trade. The EFP/EFS/EOO Rules for NYMEX, on the other hand, are silent on the topic of which, if any, EFP or related trades are prohibited. In fact the Clearport Service developed by NYMEX prior to its merger into CME Group does not limit or prohibit contingent or transitory transactions but instead encourages them as the cornerstone to its business model and business success..

Comex's precious metals market rules are currently silent on the topic of transitory and contingent transactions. Prior to the rule change that adopted such silence, the Comex rules expressly allowed transitory EFPs, to facilitate overnight gold and silver trading. That is not to say that the business practice of overnight transitory gold trades have stopped, but rather identifying them as transitory EFPs in the rules has stopped. CME and ABOT Advisory RA0815-3 Q&A 17 permits transitory EFPs for Chicago Merc's foreign exchange futures contracts, which has been a longstanding practice.

The conclusion is that the rules of the various DCMs, which are wholly owned by the CME, differ depending on the competitive position and commercial needs of the respective marketplace. The use of the threat of disciplinary action by an SRO to prevent another exchange from competing is a chilling threat, and coming from a market that is a monopoly and tailors its rules to its for-profit goals, a cynical threat as well.

Since the threat was once made, our users will not likely use an EFF or similar market mechanism, especially in the current regulatory environment, and risk investigation or prosecution without the Commission's confirmation that the transactions are permissible and cannot be prohibited by another DCM. Section 15 (b) of the Commodity Exchange Act and DCM Core Principle 18 provide a clear basis for the Commission granting the action that we are requesting, by declaring that the EFF complies with the Act and is in

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<sup>2</sup> In May 2009, 96.25% of all domestic U.S. futures and options contracts were executed on the CME Group according to the volume report issued by the Futures Industry Association.

the public interest, and cannot be prohibited under any interpretation to the contrary by another DCM.<sup>3</sup>

While the anti-competitive concerns raised here by ELX are the primary concern, ELX also believes that EFF transactions across DCMs/DCOs provide the market with enhanced flexibility that would be beneficial in times of systemic financial stress. Clearing and mutual offset services have been widely supported as beneficial as a means to remove massive amounts of liquidity risk from the financial system. Introducing the ability to move and offset positions through and across multiple clearinghouses via the proposed EFF mechanism could well serve a salutary purpose during a period of market unrest.

We look forward to responding to any questions.

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<sup>3</sup> Section 15(b) of the CEA states: “ The Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objectives of this Act, as well as the policies and purposes of this Act, in issuing any order or adopting any Commission rule or regulation...., or in requiring or approving any bylaw, rule, or regulation of a contract market .....

= additions and [ ] = deletions

#### **IV-5 Exchange of Futures for Related Positions**

(a) The following transactions may be executed outside of the ELX System in all Futures in accordance with the requirements of this Rule.

(i) Exchanges of Futures for, or in connection with, cash commodities ("Exchange for Physical Transactions" or "EFPs").

(ii) Exchanges of Futures for, or in connection with, swap transactions ("Exchange for Swap Transactions" or "EFSs").

(iii) Exchanges of Futures for, or in connection with, over-the-counter derivatives ("OTC") transactions ("Exchange for Risk Transactions" or "EFRs"). The OTC component of an EFR must comply with any applicable regulatory requirements prescribed by the CFTC.

(iv) Exchanges of Futures for, or in connection with, futures transactions ("Exchange for Futures Transactions" or "EFFs").

(v) For purposes of this Rule, all EFPs, EFSs, EFF's and EFRs shall be referred to as Exchanges of Futures for Related Positions.

(b) The Related Position (cash, swap, futures or OTC derivative) must involve the commodity underlying the Future, or must be a derivative, by-product or related product of such commodity that has a reasonable degree of price correlation or other significant price relationship to the commodity underlying the Future.

(c) An Exchange of Futures for a Related Position consists of two discrete, but related simultaneous transactions. One party must be the buyer of (or have the long market exposure associated with) the Related Position and the seller of the corresponding Future, and the other party must be the seller of (or have the short market exposure associated with) the Related Position and the buyer of the corresponding Future. However, a Participant may facilitate, as principal, an Exchange of Futures for a Related Position on behalf of a Customer, provided that the Participant can demonstrate that the Futures Position or Related Position, as the case may be, was passed through to the Customer.

(d) The accounts involved on each side of an Exchange of Futures for a Related Position: (i) must have different Beneficial Ownership; (ii) must be under separate control; or (iii) must involve separate legal entities.

(e) The quantity covered by the Related Position must be approximately equivalent to the quantity covered by the Futures.

(f) Exchanges of Futures for Related Positions may be entered into in accordance with the applicable trading increments for the Future involved, at such prices as are mutually agreed upon by the two parties to the transaction.

(g) Clearing Privilege Holders on opposite sides of an Exchange of Futures for a Related Position shall subsequently approve the terms of the transaction, including price, quantity, commodity, Contract month and date prior to submitting the transaction to the Clearinghouse. All Exchanges of Futures for Related Positions must be submitted to the Clearinghouse by a Clearing Privilege Holder acting on its own behalf or for the beneficial account of a Customer who is a party to the transaction.

(h) Each Exchange of Futures for a Related Position shall be designated as such, and cleared through the Clearinghouse as if it were a transaction executed on the ELX System. The transaction shall be submitted to the Clearinghouse within the time period and in the manner specified by the Clearinghouse.

(i) The time of execution of an Exchange of Futures for a Related Position must be recorded on the Future order ticket, and on the record submitted to the Clearinghouse.

(j) Parties to any Exchange of Futures for a Related Position must maintain all documents relevant to the Future and the cash, swap, or OTC transactions, including all documents customarily generated in accordance with cash or other relevant market practices and any documents reflecting payment and transfer of title, and must provide such documents to the Exchange upon its request.