

**CFTC Letter No. 00-30****February 23, 2000****No-Action****Division of Trading & Markets**

Re: Rule 1.46 - Request for No-Action Position for FCMs  
Carrying Accounts of Participants in Certain Chicago  
Mercantile Exchange Market Maker Programs

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Dear :

This is in response to your letters dated December 13, 1999 and December 20, 1999 to the Division of Trading and Markets ("Division") of the Commodity Futures Trading Commission ("Commission"), as supplemented by your letters dated January 21 and February 10, 2000, and telephone conversations with Division staff. You requested, on behalf of three registered futures commission merchants ("FCMs"), no-action relief, for a period of one year, from the requirements of Commission Rule 1.46<sup>1</sup> as they would otherwise apply to the accounts of certain members of the Chicago Mercantile Exchange ("CME" or "Exchange") participating in two "Market Maker Programs" ("the Programs")<sup>2</sup> adopted by the Exchange.

Based upon the representations made in your correspondence, we understand the facts to be as follows. In order to increase volume and liquidity in its stocker cattle futures and milk options contracts, the CME has selected four of its members to participate in a Market Maker Program for Stocker Cattle futures and three members to participate in a Market Maker Program for Milk Options (one member will participate in both programs). The Programs are to be operated in accordance with contracts between the Exchange and the selected members. Participants in the Programs will be required to make two-sided markets in stocker cattle futures and milk options contracts. Participants will be further required to make a good-faith effort to provide bid and ask quotes under the terms of the contract rules and in accordance with certain price and quantity conditions set by the Exchange. In return for their participation, the Exchange will provide a \$50,000 indemnity against losses incurred as a direct result of the Program to each participant in the Stocker Cattle Program, and a \$250,000 indemnity against losses incurred as a direct result of the Program to be divided equally among the participants in the Milk Options Program. To be eligible for the indemnity, the market-making positions must be held in a special market-making account separate from the participant's regular trading account. The participants are prohibited from transferring positions between their regular and special accounts.

Participants in the Milk Options Program may use not only outright positions in milk options, but

spreads involving milk options and futures. Those in the Stocker Cattle Program may use outright futures positions, or may employ spreads involving stocker cattle futures and futures and options on stocker, feeder and live cattle.

You state that, due to the operation of the Programs, participants may have positions in their regular and market-making accounts that would otherwise be required to be offset by operation of Rule 1.46. Rule 1.46(a) generally requires, absent one of several exceptions set forth in the rule, that an FCM close out a customer's previously held short or long commodity futures or option position if an offsetting purchase or sale is made for such customer's or option customer's account, and that an FCM furnish promptly to such customer or option customer a purchase-and-sale statement showing the financial result of the transactions involved. It has long been held that an FCM must take into consideration positions that it is carrying in separate accounts of the same customer in applying Rule 1.46.<sup>3</sup>

Rule 1.46 was originally adopted by the Commission's predecessor agency, the Commodity Exchange Authority, in 1948<sup>4</sup> "in aid of the prohibition against wash sales and fictitious sales."<sup>5</sup> The rule serves to protect market integrity, helping to ensure the accuracy of market information, including actual open interest. Accurate reporting of open interest provides a guide to the relative liquidity of the market, benefiting all who trade in the futures and options markets, or who rely upon prices in those markets for pricing transactions in cash market channels. In addition, the rule safeguards customers from certain abusive practices relating to the holding open of offsetting positions, such as wrongful allocation of trades, concealment of losses, or unnecessary commission-fee generation. The rule also serves to protect against the inadvertent holding of a position into the delivery period.<sup>6</sup>

Based upon our evaluation of the information provided in your letter, as supplemented, we believe that granting your request would not be contrary to the objectives of Rule 1.46. Participants in the Programs are members of the Exchange, directing their own trading. Such persons have the capability and incentive to closely monitor their accounts and do not need the customer protections afforded by the rule to the extent other customers may.

The Division also recognizes that because each position in the market maker's accounts will be traded and offset separately, the amount of open interest reported for any futures or option contract traded in the market maker's special and personal accounts will be greater than if open positions in both accounts were offset against each other. The Division believes, however, that any increase in reported open interest will not have a substantial adverse impact on the market. The Exchange is undertaking the Programs for the purpose of increasing volume and liquidity. The Programs are being implemented at the initiative of the Exchange following the normal Exchange procedures for adopting rules and in accordance with contractual provisions developed by the Exchange. Moreover, participants are prohibited from transferring positions between their regular and special accounts, and all open positions in each of the market participant's accounts must be offset, on or subject to the rules of a contract market, in an open and competitive manner.

Accordingly, based upon the above representations, for a period of one year following inception of the

Programs, the Division will not recommend that the Commission take any enforcement action under Rule 1.46 against the three FCMs carrying accounts on behalf of those Exchange members selected by the CME to participate in the Programs based solely upon the FCMs' failure to comply with Rule 1.46 by closing out offsetting positions in regular and market-making accounts. The position taken in this letter does not affect any other duties or responsibilities of any of the parties.

This letter, and the no-action position set forth herein, are based upon the representations that have been made to us. Any different, changed, or omitted material facts or circumstances might require us to reach a different conclusion. You must notify us immediately in the event the operations or activities of the parties change in any material way from those represented to us. Further, this letter represents the position of the Division only. It does not necessarily reflect the views of the Commission or any other division or office of the Commission.

If you have any questions concerning this correspondence, please contact Andrew Shipe, an attorney on my staff, at (202) 418-5450 or legal assistant Jane Croessmann at (816) 931-7602.

Very truly yours,

John C. Lawton

Acting Director

1 Commission rules referred to herein are found at 17 C.F.R. Ch. I (1999).

2 The Stocker Cattle and Milk Options Market Maker Programs were submitted to the Division pursuant to Section 5a(a)(12)(A) of the Commodity Exchange Act ("CEA"), 7 U.S.C. § 7a(a)(12)(A)(1994) and Commission Rule 1.41(c). The Stocker Cattle Market Maker Program was submitted on August 10, 1999 and became effective August 19, 1999. The Milk Options Market Maker Program was submitted on December 20, 1999 and is effective pursuant to a separate letter issued by the Division simultaneously with this letter. This letter applies only to the application of Rule 1.46 to accounts held by participants in the Programs, and expresses no opinion regarding any other aspects of the Programs.

3 U.S. Department of Agriculture, Commodity Exchange Authority Administrative Determination No. 134 (May 25, 1948); 57 Fed. Reg. 55082, 55083 & n. 2 (November 24, 1992).

4 13 Fed. Reg. 7820, 7840 (December 18, 1948).

5 57 Fed. Reg. 34533 at 34535 (August 5, 1992).

6 Id.