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MEMORANDUM

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TO: The Commission

FROM: Division of Trading and Markets

RE: Cantor Financial Futures Exchange, Inc.
Proposed New Rules 4-A, 25 and 305-A and
Proposed Amendments to Rules 32, 300, 302,
and 306 - - Block Trading Proposal

RECOMMENDATION: That the Commission approve the above-referenced
proposed rule and rule amendments.

CONSULTED: Division of Economic Analysis
Division of Enforcement
Office of General Counsel
Office of the Executive Director

CONTACT PERSON: Riva Spear Adriance (x5494)

I. Introduction

By letters dated September 15, 1999, through January 13, 2000, the New York Board of Trade ("NYBT") submitted to the Commission on behalf of Cantor Financial Futures Exchange, Inc. ("CX" or "Exchange"), proposed new CX Rules 4-A, 25 and 305-A and proposed amendments to CX Rules 32, 300, 302, and 306 (collectively the "Block Trading Proposal"), pursuant to Section 5a(a)(12)(A) of the Commodity Exchange Act ("Act") and Commission Regulations 1.38 and 1.41(c).¹ The Block Trading Proposal would permit the execution of large orders by negotiation between certain qualified parties to the trade rather than through the CX automated trading system (CX's "centralized market").

CX's proposal is the first block trading proposal that the Commission has received since issuing its *Advisory on Alternative Execution, or Block Trading, Procedures for the Futures Industry* ("Block Trading Advisory") on June 10, 1999.² Because of the novelty of the proposal and the uncertainty of its effect on the markets, the Division of Trading and Markets ("Division") is recommending, and the Exchange has agreed to, implementation of the Block Trading Proposal on a one-year pilot program basis.

¹ The Exchange's proposal was described in submissions received on September 15, 1999, January 11, 2000, and January 13, 2000. These submissions are found in Appendix A.

² 64 Fed. Reg. 31,195, (June 10, 1999) ("Block Trading Advisory"). The Block Trading Advisory announced the Commission's intention to consider contract market proposals to adopt alternative execution, or block trading, procedures for large size or other types of orders on a case-by-case basis under a flexible approach to the requirements of the Act and the Commission's regulations. This approach places the choice to permit alternative execution procedures with each contract market, allowing each contract market to consider the distinctive nature and requirements of its markets and market participants. The Block Trading Advisory followed a request for comments on alternative execution procedures included in the Commission's concept release: *Regulation of Noncompetitive Transactions Executed on or Subject to the Rules of a Contract Market*, 63 Fed. Reg. 3708 (January 26, 1998) ("Noncompetitive Concept Release").

On October 7, 1999, the Commission published the Exchange's Block Trading Proposal in the *Federal Register* for public comment.³ The comment period on the proposal ended on October 22, 1999. The Commission received eight comment letters, from seven parties in response to the release. These comments are summarized and discussed below in Section III of this memorandum.

II. Description of CX's Block Trading Proposal

A. *Structure of a Block Trade at CX*

CX proposes to allow the execution of large orders by negotiation between the parties to the trade rather than through CX's centralized market. The counterparties would report the relevant details of the transaction to the Exchange once agreement has been reached on the terms of the block transaction.

B. *Eligibility Requirements*

Proposed Rule 305-A(a) would permit block trading in any contract that has been so designated by CX.⁴ The exchange intends to permit block trading in its U.S. Treasury Bond, U.S. Treasury Ten-year Note, Flexible Coupon U.S. Treasury Bond, and Flexible Coupon U.S. Treasury Ten-year Note futures contracts. Under proposed Rule 305-A(a)(6), block trading participants would be limited to parties that qualified as "eligible participants" within the meaning of Commission Regulation 36.1(c)(2).⁵ According to CX, the entities that would qualify as "eligible

³ 64 Fed. Reg. 54,620 (October 7, 1999).

⁴ See CX's September 15, 1999, submission at 1 and January 11, 2000, submission at 1-2. At the present, CX is designated in eight contracts: U.S. Treasury Bond Futures Contract, U.S. Treasury Ten-year Note Futures Contract, U.S. Treasury Five-year Note Futures Contract, U.S. Treasury Two-year Note Futures Contract, Flexible Coupon U.S. Treasury Bond Futures Contract, Flexible Coupon U.S. Treasury Ten-year Note Futures Contract, Flexible Coupon U.S. Treasury Five-year Note Futures Contract, and Flexible Coupon U.S. Treasury Two-year Note Futures Contract.

⁵ The Commission Regulation 36.1(c)(2) presents a list of sophisticated individuals and entities that would be "eligible participants" in Part 36 transactions. Part 36 permits the development of professional markets pursuant to Section 4(c) of the Act. Under Regulation 36.1(c)(2), the list of

participants” would be essentially the same entities that already engage on a large scale in over-the-counter trading of financial instruments that, in many cases, has similar characteristics and risks as block trading.⁶ Proposed Rule 305-A(a)(6) also would allow a commodity trading advisor (“CTA”), including any investment advisor registered as such with the Securities and Exchange Commission that is exempt from registration under the Act or the Commission’s regulations (“Investment Advisor”), to transact block trades for customers who are not eligible participants, if the CTA has total assets under management that exceed \$50 million.

Under CX’s proposal, a “Clearing Member,” “Screen Based Trader,” or “Foreign Screen Based Trader” (collectively “CX Traders”), as those terms are defined in the Exchange’s rules, who was an eligible participant would be able to enter into block transactions either on a proprietary basis, or, if otherwise permitted, on behalf of customers or other third parties. Such customers or other third parties also would be required to be eligible participants unless their trades were carried out by a CTA or Investment Advisor with total assets under management that exceeded \$50 million.

C. Primary Market Makers

In connection with its Block Trading Proposal, CX proposes to establish a new class of market makers called “Primary Market Makers.” Under proposed Rule 305-A(a)(1), Primary Market Makers would be the only entities that would be allowed to make a market in block trades. However, the Primary Market Maker

eligible participants was modeled on the list of “appropriate persons” set forth in Section 4(c)(3)(A) through (J) of the Act and on the definition of “eligible swap participants” under Part 35 of the Commission’s Regulation. See 60 Fed. Reg. 51323, 51328-9 (Oct. 2, 1995) (Final Rules).

⁶ CX September 15, 1999, submission at 11.

could make a market in block trades only if it was satisfying its obligation to make markets in the relevant underlying centralized contract market.⁷

Under proposed Rule 305-A(a)(2), block transactions would be prohibited directly between two Primary Market Makers or between an agent representing a Primary Market Maker and another Primary Market Maker. A CX Trader would not be responsible for determining whether a customer or third party with whom it was trading or for whom it was acting was in violation of Primary Market Maker requirements under the proposed rules.⁸

D. Size and Price Requirements

Proposed Rule 305-A(a)(4) requires that each buy and sell order underlying a block trade must indicate that it is to be, or may be, executed through CX's block trading procedures. The minimum size of a block order for CX's U.S. Treasury Bond and U.S. Treasury Ten-year Note futures contracts would be at least 100 contracts.⁹ The rule also states that a trader may not aggregate orders for different accounts in order to satisfy the minimum size requirement, unless it is a CTA or Investment Advisor that has more than \$50 million in total assets under management.

⁷ See proposed Rule 305-A(a)(1). Primary Market Makers would be required to make markets in the underlying contract market throughout the trading session except for up to six five-minute intervals, unless a Primary Market Maker traded 5000 contracts or more in any trading day. A Primary Market Maker who traded 5000 contracts in the underlying contract market in any trading day would be obliged to make a market only during at least 60% of the session. These requirements differ from the requirements of CX's current "regular" Market Makers, who are merely required to make a market during at least 60% of the trading session.

⁸ Under the rule, the block trade would not be rescinded upon the discovery that such customer or third party was in violation of one of the Primary Market Maker requirements. Instead, the Exchange could take action against the customer or third party by requiring such customer or third party to register as a Primary Market Maker, by withdrawing Primary Market Maker privileges or by banning such customer or third party from use of the block trading procedures, as appropriate. See also Section II.B.

⁹ See Section III.E.

In order to ensure that block trading prices are linked to that of the centralized markets, proposed Rule 305-A(a)(5) would require that block trades be executed at a price that was "fair and reasonable" in light of (i) the size of the block; (ii) the price and size of other trades in the same contract at the relevant time; (iii) the price and size of trades in other relevant markets, including without limitation the underlying cash and futures markets, at the relevant time; and (iv) the circumstances of parties to the block trade.

E. Transparency

Proposed Rule 305-A(d) requires each party to a block trade to record on its order ticket the contract, contract months, quantity, price, time of execution, identity of the counterparty, and, if applicable, identity of the customer.

Information identifying the relevant contract, contract month, price, quantity, time of execution and the counterparty clearing member for each block trade must be reported to the Exchange within ten minutes of its execution under proposed Rule 305-A(c).¹⁰ In the case of a block trade that was executed during the last ten minutes of, or after, a trading session on any given day, the details of the block trade must be reported to CX prior to the opening of business in London on the next business day.¹¹ CX would publicize information identifying the trade as a block

¹⁰ CX has stated that possible market participants have raised concerns regarding (1) the current lack of reporting software or procedures; and (2) possible difficulties in adhering to a reporting requirement of less than ten minutes before such software or procedures are developed. The Division believes that, while a ten-minute reporting requirement is reasonable during the period interested parties are developing reporting software and procedures, a reporting requirement of no more than five-minutes is appropriate as a long term requirement. As discussed below, the Exchange has agreed to reduce this ten-minute reporting requirement to five minutes within 90 days from approval of the block trading proposal by the Commission, allowing market participants a start-up period for developing reporting software or procedures. See CX's January 11, 2000, submission at I-4. See also Section III.C.

¹¹ CX trading session hours begin at 2:30 a.m. Eastern Standard Time ("EST") (7:30 a.m. Greenwich Mean Time ("GMT")) when CX's London trading facility opens. The New York and Chicago trading facilities open at 7:30 a.m. EST (12:30 p.m. GMT). While the London trading facility closes at 12:30

trade and identifying the relevant contract, contract month, price and quantity for each block trade immediately after such information has been reported to CX.

F. Compliance and Surveillance

The Compliance Department of the New York Cotton Exchange ("NYCE") would handle compliance and surveillance of block trades carried out under CX's block trading procedures. The NYCE Compliance Department would review all available documentation and relevant price relationships with respect to block trades executed during the one-year pilot program, in order to verify whether such trades were conducted in compliance with CX rules.¹²

G. Documentation

NYBT, the NYCE's parent, has represented that the NYCE Compliance Department would take the following measures in reviewing CX block trades: (i) Primary Market Makers would be required to produce satisfactory documentation of block trades including account statements; (ii) Primary Market Makers would be monitored for compliance with minimum volume and other requirements specified in their market-making agreements with CX; (iii) the price of each block trade would be reviewed to confirm that it was "fair and reasonable" with respect to the size of the block trade, the prices in all relevant markets and the circumstances of the parties to the transaction; and (iv) parties to each transaction would be monitored to determine whether market making was conducted by a party that was not a Primary Market Maker.

p.m. EST (5:30 p.m. GMT), the trading session continues until 5:30 p.m. EST (10:30 p.m. GMT) when the New York and Chicago trading facilities close.

¹² CX's September 15, 1999, submission at 4, and January 11, 2000, submission at I-9.

Documentation on, and maintenance of, the order ticket by block trade parties would be required under proposed Rule 305-A(d). Each CX Trader that is a party to a block trade would record the contract, the number of contracts traded, the price, the time of execution, the identity of the counterparty and, if applicable, the customer for which the trade was executed, on its order ticket.

Furthermore, CX has stated that its trade register would contain all the information required by Commission Regulation 1.35(e), as well as an indicator showing that a trade was executed as a block trade. The Exchange also stated that each party to a block trade would need to identify the block trade as such in its records and in data transmitted to the Exchange, as required under Commission Regulation 1.38(b). The Division recommends that the Commission remind CX that block trading participants remain subject to reporting and recordkeeping requirements under the Act and the Commission's Regulations.¹³

III. Summary of Comments Received

As previously noted, the Commission published CX's Block Trading Proposal in the *Federal Register* for public comment on October 7, 1999. Of the eight comment letters that the Commission received in response to the publication of the Block Trading Proposal, representing seven entities, four were from contract markets,¹⁴ three were from trade associations,¹⁵ and one was from another

¹³ In approving NYMEX's EFS proposal, the Commission required NYMEX to agree to require and retain documentation similar to that required in connection to EFPs. See the Division's December 14, 1998, memorandum to the Commission recommending the approval of NYMEX's EFS proposal at 28-33. Review of the Block Trading Proposal during its pilot period would allow the Commission to evaluate whether greater documentation, similar to EFP documentation, would be preferable for block trading transactions and, if so, to require such documentation.

¹⁴ Comment letters were submitted by the Chicago Board of Trade ("CBT"), Chicago Mercantile Exchange ("CME") and New York Mercantile Exchange ("NYMEX"). The CBT submitted two comment letters.

governmental entity.¹⁶ Two commenters supported the proposal,¹⁷ three commenters opposed the proposal,¹⁸ one commenter neither supported nor opposed the proposal¹⁹ and one commenter was opposed to block trading generally.²⁰

A. Fulfilling the Needs of Certain Market Participants

FIA noted that the Block Trading Proposal would be useful to market participants who increasingly wish to be able to trade large numbers of futures contracts as part of larger, structured capital markets transactions.²¹ In order for

¹⁵ Comment letters were submitted by the Futures Industry Association ("FIA"), Managed Funds Association ("MFA") and National Grain Trade Council.

¹⁶ A comment letter was submitted by the Federal Reserve Bank of Chicago.

¹⁷ Supporting comment letters were submitted by FIA and MFA.

¹⁸ All three commenting futures exchanges, CBT, CME and NYMEX, were opposed to the proposal, primarily due to concerns regarding market fragmentation, the development of a two-tier market, lack of price transparency and, on the part of CBT, surveillance concerns.

¹⁹ The Federal Reserve Bank of Chicago pointed to the need to evaluate a block proposal based on the effect that it would have on price discovery and the retail customer. Letter from Michael H. Moskow, Federal Reserve Bank of Chicago, to the Commission (October 22, 1999) at 1.

²⁰ The National Grain Trade Council stated that they were strongly opposed to the notion of block trading in futures markets, and were specifically concerned that the allowance of the CX proposal, if successful, would not be limited at Treasury securities but might extend to agricultural futures. Letter from the National Grain Trade Council to the Commission (October 22, 1999) at 2.

²¹ Letter from Ronald H. Filler, President, FIA Division of Law and Compliance, to the Commission (October 21, 1999) at 2. In addition, based on other sources, the Division understands that, for example, institutional traders may simultaneously buy or sell portfolios of several hundred stocks on the New York Stock Exchange ("NYSE") by program trading on the Super Designated Order Turnaround ("Super DOT") system, an electronic order routing system. Program trading is defined by NYSE as trading strategies involving the purchase or sale of 15 or more stocks having a total market value of \$1 million or more. NYSE Website, www.nyse.com, December 22, 1999. The traders may then choose to offset the risk from the large equities position with an equal but opposite large position in the futures market through one of the stock index products. Arbitrageurs may use a similar strategy in index arbitrage, where the purchase or sale of a basket of stocks is made in connection with the sale or purchase of a derivative product, as in index futures, in order to profit from the price difference between the basket and the derivative product. Institutional traders who do not want to commit cash to equities or interest rate products immediately may use large positions in either the stock index or interest rate futures as a temporary measure. As the rate of return on investments is used to evaluate these managers, they do not want cash to remain idle. Consequently, they hedge their cash in the futures markets against stock index futures or interest rate products, such as Treasury securities, to achieve an increased rate of return on their investment until they are ready to invest the cash in the underlying commodity. Institutional traders may also use large positions in the futures markets to create synthetic cash or equity positions to save the transaction costs and avoid the tax implications of liquidating established portfolio holdings. By

such transactions to be implemented smoothly, efficiently and cost effectively, according to FIA, such transactions require size and price certainty.²² FIA pointed out that sizes and prices obtained for such transactions in a centralized market reflect liquidity available at that time and, therefore, may fail to achieve desired economic objectives or to reflect actual supply and demand of the market at large. FIA stated that trading large orders in the centralized market results in volume and price distortions, producing unintended results in such circumstances and possibly resulting in aberrant pricing.²³ FIA asserted a "compelling need" for alternative procedures in all contract markets, facilitating the execution of large orders, to enhance the ability of these markets to meet the needs of institutional participants concerning transaction size and price.²⁴

The Block Trading Proposal would achieve the goals desired by FIA.²⁵ CX, in its submission, states that the need to integrate large blocks of orders into the

various combinations of buying (selling) in the spot market, buying (selling) in the futures market, and buying (selling) in the Treasury bill market, synthetic positions in Treasury bills, spot or futures market can be achieved as desired. See DANIEL R. SIEGAL & DIANE F. SIEGAL, FUTURES MARKETS 72-4, 134-35, 157-79 (1990).

²² For example, when hedging risk or arbitraging across capital markets it is in the institutional trader's interest that trader's offsetting futures position(s) is (are) executed at a single price and at a certain size. An institutional trader will desire that the size of its futures trades match its hedging or arbitrage trades in other markets, and the trader can assess the outcome of its total trading strategy across all markets more readily with a single price on the futures leg of such cross-market transactions.

²³ The Division of Economic Analysis ("EA") has noted that the traditional trading venue, the centralized market, may be incapable of providing the required liquidity for large transactions without large costs. When this occurs, large buy (sell) orders tend to raise (lower) the market price, thus increasing the per unit price of a block trade as compared to a more average size order. See Beth Seely, *The Economics of Block Trading*, Working Paper No. 99-02, EA (November 1, 1999) at 5. This memorandum is found in Appendix B. See also *infra* Section III.E.

²⁴ In a staff report on the October 1987 Market Break, the Securities and Exchange Commission noted that "efforts by the futures markets to provide better systems for integrating block trading" could help to ameliorate the price effects of block-size transactions on the futures markets. SECURITIES AND EXCHANGE COMMISSION, *THE OCTOBER 1987 MARKET BREAK*, 3-19, n. 49 (1988).

²⁵ In its comment letter, MFA urged the Commission to give serious consideration to FIA's comment letter.

ongoing trading activity without impacting the prices in the relevant market is particularly relevant to markets that trade contracts in government securities.²⁶ A block trading facility transfers this price execution risk from customers to market professionals paid to assume such risks.

B. Two-Tiered Market

The Chicago Mercantile Exchange ("CME") raised concerns that CX's Block Trading Proposal would lead to a two-tiered market for block trades and centralized trades, in which smaller entities, who trade in sizes smaller than block trades, would be limited to trading in the centralized market.²⁷ The CME believes that anytime a block trade is executed outside the bid/ask spread in the centralized market, a participant in the centralized market will have lost an opportunity to obtain an execution at the price at which the block trade was executed. Possible bifurcation of the marketplace into separate larger vs. smaller participants markets was also raised by NYMEX, pointing to CME comments on the issue.²⁸

CX contends that it has structured its Block Trading Proposal to "complement, not supplant" the trading activity on the centralized contract market.²⁹ To prevent a material adverse effect on liquidity in the centralized market, the Exchange includes several provisions intended to contribute significant volume to CX's centralized market.

Under the Block Trading Proposal, Primary Market Makers would be prohibited from entering into block trades with other Primary Market Makers in

²⁶ CX's September 15, 1999, submission at 7-8.

²⁷ Letter from Scott Gordon, Chairman, CME, to the Commission (October 22, 1999) at 2.

²⁸ Letter from R. Patrick Thompson, President, NYMEX, to the Commission (October 27, 1999) at 2.

²⁹ CX's September 15, 1999, submission at 10.

order to ensure that professional participants could not move all their trading activity to a separate, "professional" market. Instead, Primary Market Makers desiring to reduce their exposure and to liquidate open positions from block trading activity would be expected to trade in CX's centralized market. Those desiring to make a market in block trades would be required to make a market in the underlying contract, which also may contribute significant volume to CX's centralized market. CX also expects that the availability of block trading at the Exchange may attract parties who now execute similar transactions in the over-the-counter market. Again, CX believes that the addition of these new block trading participants could also add liquidity to the Exchange's centralized market, increase open interest at the CX and thus make the Exchange attractive to even more potential market users.³⁰

The Commission previously considered the issue of separate professional markets when it promulgated Part 36 of the Commission's Regulations which essentially permits the development of professional markets, by allowing transactions carried out by appropriate persons (eligible participants) and in appropriate contracts (i.e. cash settled or by means other than transfer or receipt of a commodity) to be exempt from specified requirements of the Act and the Commission's Regulations.³¹

³⁰ See CX's September 15, 1999, submission at 8. See also Federal Reserve Bank of Chicago, *supra* note 19, at 2.

³¹ See 60 Fed. Reg. 51323, 51323-4 and 51335 (Oct. 2, 1995). The President's Working Group on Financial Markets recently noted that sophisticated counterparties of the kind that use over-the-counter derivatives do not require the same protections under the CEA as those required by retail investors, but recommended that such exclusion from, or lesser, regulation should be limited to financial markets, which are not readily susceptible to manipulation and which currently do not serve a significant price discovery function, as do non-financial commodities with finite supplies. *Over-the-Counter Derivatives Markets and the Commodity Exchange Act*, Report of the President's Working Group on Financial Markets (November 1999) at 2, 16, 17, 19, 21-22.

The Division further notes that certain aspects of CX are particularly structured to help avoid the creation of a two-tiered market. For instance, prices of the block trade market would be linked to the prices in the centralized market by the requirement that prices be "fair and reasonable." In addition, although customers who do not qualify as "eligible participants" could not directly trade in CX's block trading market, such customers could take part in block transactions through a CTA or Investment Advisor's management of their assets.³²

C. *Transparency*

NYMEX and CME both commented that there was a lack of transparency in CX's Block Trading Proposal.³³ NYMEX believes that the time lag in reporting block trades would have a detrimental effect on the markets, allowing the parties to a trade to have knowledge that is not available to others. Therefore, NYMEX was concerned that other market participants would lack adequate information, allowing the integrity of the price transparency function to suffer. According to CME, the lag in the reporting of block trades would allow parties to a block trade to use information concerning the trade to trade in other related markets, to the detriment of those who lacked the block trading information.³⁴ CME asserts that once information concerning a large block trade at a price below the market becomes known, the price in the centralized market will go down, offering parties to

³² It does not appear that customers with an average-size order would have the same interest in block trading. This is because auction markets do not exact the same price premium for small orders that they do for large orders. See *infra* Section III.E. Therefore, for such customers, trading in the centralized market would most probably be preferable to trading in a block transaction.

³³ NYMEX, *supra* note 28, at 2. As pointed out in Section II.E, the Block Trading Proposal requires the information concerning the block trade be reported to the Exchange within ten minutes of the execution of the transaction, or, if executed within the last ten minutes of the trading session or after the session has closed, by the opening of the next trading session.

³⁴ CME, *supra* note 27, at 3.

the trade the advantage of selling in the centralized market before the trade is reported and the prices go down. According to the CME, the consequence of this trading with non-public information would be that market participants would become demoralized and less willing to make bids or offers that might be "picked-off." As a consequence, the bid/ask spread would widen and liquidity in the centralized market would be reduced.

The assertion made by both NYMEX and CME is that information concerning a block trade will affect the centralized market. The Division believes, however, that the time delay before information concerning the block trade is publicized by the Exchange should actually act to diminish any impact on the market due to such information.³⁵ Under the Block Trading Proposal, the markets would have factored in price information from a variety of other sources unrelated to the block trade before the block trading information was publicized and, when publicized, the block trade information would be old information. The time delay increases the probability that the market would have had an opportunity to move away from the price at which the block trade was executed. Accordingly, block trade information should neither create market movement nor significantly impact price discovery. The Division notes that time value of information has been recognized by the exchange community, as shown by the fees charged by exchanges for the provision of real-time price quotes while allowing the publication of delayed price information for free.³⁶

³⁵ The Division notes that exchange of futures for physicals transactions are executed off of the centralized market, in a non-competitive manner, at times with a significant time lag in the required reporting period. See, e.g., NYMEX Rule 230.17(C) and CME Rule 538(4).

³⁶ The CME and CBT report "snapshot" price quotes on the Internet, updating them every 10 minutes. NYMEX and the Coffee Sugar Cocoa Exchange, ("CSCE") provide 30-minute delay price quotes on their web sites.

In addition, since the parties to the block trade would not be disclosed, market participants would not have information that would be necessary to react to the report of the block in any predictable manner. Furthermore, information concerning a block transaction is information concerning an executed trade, not a prospective order. Such information would have less impact on market prices than declared interest to buy or sell at a stated price and size.³⁷

Notably, the London International Financial Futures and Options Exchange ("LIFFE") has a block trading program which is substantially similar to CX's Block Trading Proposal and requires that block trade information be published by the Exchange within ten minutes after the execution of the trade.³⁸ The Division understands that very little effect on the market has been seen upon publication of the block trading information.

If CX's Block Trading Proposal were to bring trades to a regulated exchange that would otherwise be executed over-the-counter without any public disclosure, as pointed out by CX and the Federal Reserve Bank of Chicago, transparency would actually increase despite any reporting time lag.

However, balancing the public nature of the futures markets generally with the special circumstances concerning a completed trade and the practical nature of the reporting process, the Division believes that, while it may not be reasonable or necessary to require parties to a block trade to report block trade information immediately after execution of a block trade, it is preferable for the Exchange to

³⁷ See *infra* Section III.G.

³⁸ LIFFE block trading participants are required to report block trading information to LIFFE within five minutes of execution of the transaction. LIFFE has five minutes in which to review and, if accepted, to publicize the trade. The Division understands that LIFFE publicizes its block trades almost immediately after the receipt of block trading information.

receive such information as soon as possible and to publicize such information immediately after its receipt.³⁹ In this way, all interested parties will have the same information available to them as soon as practicable, regardless of the potential value of such information.

Accordingly, it should be noted that since the comment period, CX has amended its proposal by: (1) agreeing to the reduction of the reporting time from ten minutes to five minutes within ninety days of approval of the Block Trading Proposal; and (2) clarifying that the Exchange would publicize information concerning a block trade immediately after the information was received. Consequently, the affect of the time lag in reporting of block trading information should not have the negative implications raised by NYMEX and CME, and would actually seem to prevent the very informational discrepancy problem which they raised.

D. Market Fragmentation

Both CBT and CME comment that the Commission should allow only the exchange with the principal market in a particular futures contract to adopt alternative execution procedures.⁴⁰ An exchange other than the principal market for a particular futures contract would be "free riding" on the principal exchange's successful contract design. CME contends that when a market desires to offer noncompetitive trading practices, the Commission must evaluate whether the

³⁹ See *supra* note 10. The Federal Reserve Board of Chicago pointed out that reducing the required reporting time and specifying a limit within which CX would publicize the trades would minimize any negative impact on transparency. Federal Reserve Board of Chicago, *supra* note 19, at 3.

⁴⁰ See letter from Thomas R. Donovan, President, CBT, to the Commission (November 22, 1999) at 5-6; CME *supra* note 26, at 3. See also letter from Scott Gordon, Chairman, CME to the Commission (April 28, 1998) (commenting in response to the Noncompetitive Concept Release) at 4.

principal market is adversely affected.”⁴¹ CBT claims that the Block Trading Proposal would trigger market fragmentation, and thus drain the liquidity from CBT’s U.S. Treasury securities futures contracts, cause price discovery to become more opaque, make hedging more expensive and increase the U.S. government costs of financing its debt.

The extent of market fragmentation that occurs in the market for an underlying commodity varies considerably.⁴² Markets with little fragmentation of the underlying commodity provide market users with few alternative sources for the benefits of price basing, risk shifting and price discovery offered by exchange traded futures. However, unlike the market for many commodities, the market for U.S. Treasuries is already fragmented with the cash market, the repo market and the option market, all of which offer substitute products to the exchange-traded U.S. Treasuries futures contracts. All of these products reflect the same underlying instrument. Accordingly, the Division believes that it is difficult to make the case that CX’s Block Trading Proposal would “trigger” market fragmentation in the U.S. Treasuries market that would have a significant adverse impact on market performance and quality.

Duplication or modification of contracts has been used for years by futures exchanges to compete with exchanges that have successfully developed and promoted a new contract.⁴³ Furthermore, the Act does not require the Commission

⁴¹ CME, (April 28, 1998), *supra* note 40, at 4.

⁴² Evaluation of block trading in the futures markets should include the extent of fragmentation in the underlying market compared to its occurrence upon the introduction of block trading. Agricultural commodity markets may not be fragmented to the same extent as in the financial markets. See Beth Seely, *supra* note 23, at 12-13.

⁴³ Compare, e.g., New York Cotton Exchange’s U.S. Treasury Notes, Five-year futures contract (approved April 12, 1987) with CBT’s U.S. Treasury Notes, Medium Term futures contract (approved June 19, 1979; dormant November 1, 1982; reactivated May 20, 1988); CME’s 90-day U.S. Treasury

to protect the primary market for any futures contract or to prevent competition. In fact, Section 15 of the Act requires the Commission to take into consideration the public interest to be protected by the antitrust laws and to seek to take the least anticompetitive means of achieving the objectives, policies and purposes of the Act when it considers, among other things, contract market rule proposals.

Accordingly, acting to protect a primary market for any futures contract from challenges by other contract markets could be contrary to the Commission's responsibility under Section 15. Indeed, when considering the listing of contracts by more than one exchange, the Commission has previously stated that, as indicated by experience, "proliferation does not necessarily lead to an undesirable dispersion of liquidity" and that the listing of duplicative and related contracts "provides the competition which helps keep the terms and conditions of existing contracts aligned with commercial practices and effectively serviced by their designated futures exchange." The Commission further stated that "competition would be expected to increase the efficiency of financial futures markets."⁴⁴

E. Minimum Size of Block Trades

The Federal Reserve Board of Chicago commented that the Commission must estimate the effects of block trading not only upon a petitioner's share of a contract, but upon the whole market for a contract.⁴⁵ According to the Federal Reserve Board

Bills futures contract (approved November 26, 1975) with CBT's 91-day U.S. Treasury Bills futures contract (approved March 29, 1983); Kansas City Board of Trade's Natural Gas, Western futures contract (approved May 3, 1995) with NYMEX's Natural Gas, Permian Basin futures contract (approved February 14, 1996); and CSCE's Milk, BFP futures contract (approved cash-settled February 27, 1997) with CME's Milk, BFP futures contract (approved physical delivery October 10, 1995; amended to make cash-settled May 16, 1997).

⁴⁴ See REPORT TO CONGRESS IN RESPONSE TO SECTION 21 OF THE COMMODITY EXCHANGE ACT, Pub. L. No. 96-276, 96th Congress, 2nd Sess. Section 7, 94 Stat. 542 (June 1, 1980), pp. 77-87.

⁴⁵ Federal Reserve Bank of Chicago, *supra* note 19, at 3.

of Chicago, a minimum size of 50 contracts, which would automatically be adjusted upward as the average monthly trading volume in the underlying contract rose, as originally proposed by CX, does not take into consideration the larger market for Treasury Bond futures.

The Division, in consultation with EA, relied on the importance of the definition of a "large" transaction in evaluating the Block Trading Proposal.⁴⁶ A "large" transaction is viewed as one that potentially may affect the quality of the price due to the significant impact of large orders on the market. The traditional trading venue, the centralized market, whether trading floor or its electronic alternative, does not readily provide the required liquidity for large transactions without large costs. Large buy orders tend to move the price up, large sell orders tend to move the price down, causing the per unit price of a "large" order to be greater than that of more average-sized orders, in effect causing parties to pay a "premium" to fill large orders. This market impact tends to increase with trade size. Consequently, it is anticipated that a "large" order transacted as a block will have savings associated with the use of the alternative execution procedures that are greater than any premium paid for the block trade.⁴⁷

Therefore, the Division and EA reviewed data showing the number of trades carried out at various transaction sizes in both the cash Treasury market and CBT Treasury futures market.⁴⁸ In both the cash and futures markets for U.S. Treasury Bonds, more than approximately ninety-five percent of transactions executed per

⁴⁶ See Beth Seely, *supra* note 23, at 13.

⁴⁷ *Id.* at 5-7, 13. See also Yakov Amihud and Haim Mendelson, Evaluation of Alternative Execution Procedures in Futures Markets 62-4 (Sept. 1, 1999) (attachment to CBT's September 1, 1999, letter commenting on the Commission's Noncompetitive Concept Release).

⁴⁸ See Appendix C. EA gathered data on trade sizes in CBT's Treasury Bond and Ten-year futures contracts. The cash market data was provided for three interdealer brokers.

day were less than the equivalent of 100 CX futures contracts. In both the cash and futures Treasury markets for U.S. Treasury 10-year Notes, approximately ninety-two percent of transactions executed per day were less than the equivalent of 100 CX futures contracts.⁴⁹ Consequently, the Division and EA recommended that the Exchange amend the Block Trading Proposal to increase the minimum block trade for U.S. Treasury Bond and U.S. Treasury Ten-year Notes futures contracts to a more appropriate size of 100 CX futures contracts. The Exchange agreed to do so. Data for the cash market showed that the average size transaction for the U. S. Treasury Five-year and Two-year Notes is either close to or substantially above 100 CX futures contracts, raising the size of a "large" transaction accordingly. The markets in both CBT and CX Five-year Note and Two-year note futures contracts are substantially less liquid than the Bond and Ten-year Notes futures contracts, both raising CX's concern with the success of any block trading facility in those futures contracts as well as lessening its interest in pursuing those contracts. Accordingly CX amended its Block Trading Proposal to exclude these contracts at this time.

F. Price Discovery and Hedging Benefits

CBT commented that noncompetitive practices might divert order flow from the competitive futures markets, jeopardizing the price discovery and hedging benefits found by Congress to be in the public interest.⁵⁰ NYMEX states that the role exchanges play in achieving true price discovery and in the provision of transparency in a centralized marketplace is among their most important

⁴⁹ See Appendix C. The Division, following consultation with EA, finds it difficult to envision any circumstance in which a "large" transaction would not be one which was a size larger than 92% of the transactions traded per day.

⁵⁰ CBT, *supra* note 40, at 2-3.

functions.⁵¹ The Federal Reserve Board of Chicago pointed out that any reliance on a contract market for price discovery would be greater if the market was populated by "retail" customers, and deterioration of the price discovery element would have a larger negative effect.⁵²

In support of its proposal, CX contends that block trades, while not transacted in a centralized market, would be carried out by large government securities dealers who would be competing with each other for customers, as is the current practice in the cash and over-the-counter markets in Treasury securities. These customers would be sophisticated parties, with the ability to take into account prices in the centralized futures markets, the cash markets, and the over-the-counter markets. In addition, CX block trade prices would generally be publicly disseminated within ten minutes of the executed transaction. Furthermore, due to the effect on pricing caused by large orders in a centralized market, the removal of large orders would actually allow the price discovery role of the centralized market to proceed with less disruption.

Finally, as pointed out previously, the market for U.S. Treasuries is a fragmented market, with the cash market, the repo market, the option market, and the futures markets all offering products based on the same underlying instrument, and each contributing to price discovery.⁵³ Therefore, the CX futures contracts are based on government securities that are widely traded and for which cash price information is easily accessible. While the price information of U.S. Treasury bond futures contracts trades may be relied on by parties, the futures market is not the

⁵¹ NYMEX, *supra* note 28, at 2.

⁵² Federal Reserve Bank of Chicago, *supra* note 19, at 3.

⁵³ See *supra* note 42 and accompanying text. See also CX's September 15, 1999, submission at 10.

only pricing source and the cash market does not “discover” the long bond price through the futures price.⁵⁴ For the same reason, the hedging benefits of the U.S. Treasury futures contracts may be gained through the use of alternate instruments.⁵⁵

Moreover, the competitive nature of the financial markets and the requirement that the block price be “fair and reasonable” is expected to link the block trade prices to the prices in the related markets.⁵⁶

G. Impact of Block Trading on Surveillance

According to CBT, the Block Trading Proposal will create a new type of inter-market frontrunning between CX's block trading facility for U.S. Treasury contracts and CBT's U.S. Treasury contracts.⁵⁷ This assertion of possible trading abuses is based on the concern expressed by NYMEX and CME,⁵⁸ namely the lag in time between the execution of block trades and the reporting of trade information to CX. CBT maintains that during this ten-minute period, a party to the transaction could enter into CBT's market or the cash market and execute transactions with the benefit of unreported information. CBT also has expressed concern that CX's audit trail and surveillance system would not detect whether trades are reported promptly, as block transactions will take place in private negotiations.⁵⁹ Therefore,

⁵⁴ CX's September 15, 1999, submission at 10. *See also* Report of the President's Working Group on Financial Markets, *supra* note 31 at 16.

⁵⁵ *See supra* Section III.E.

⁵⁶ The Block Trade prices on LIFFE seem to be linked to the prices in its centralized market as the block trade prices have been either within the bid/ask spread or, if outside the spread, less than the premium that would be paid if the large order was brought to the centralized market.

⁵⁷ *See* letter from Thomas R. Donovan, President, CBT, to the Commission (October 22, 1999) at 1.

⁵⁸ *See supra* Section III.C.

⁵⁹ The same concern could currently be raised for other off-floor noncompetitive transactions such as EFPs. Moreover, both sides would have to conspire not to report promptly.

CBT claims that CX's Block Trading Proposal could require CBT to divert its resources, and make significant expenditures to expand compliance activities to preserve its markets against frontrunning abuses.⁶⁰

The Division notes that the frontrunning potential that CBT ascribes to CX's proposal would appear to be present with respect to trading between CBT's market and the cash Treasury securities market. To the Division's knowledge, CBT has not attempted a surveillance program, similar to the program it suggests would be needed as a result of CX's Block Trading Proposal, to detect frontrunning abuses between these markets. Instead, dealers and commercials routinely trade based upon their knowledge of their cash market transactions, hedging their risk. As CX pointed out in its submission, the Commission has stated that "[b]ecause the futures markets are derivative, risk-shifting markets, it would defeat the market's basic economic function - the hedging of risk - to question whether trading based on knowledge of one's own position were permissible."⁶¹

CBT assumes that information concerning the block order, when publicized, will affect the price of a contract, allowing a party to the transaction to buy (sell) ahead of a rise (fall) in price brought about by the block trade information.⁶²

⁶⁰ CME and CBT each currently have a surveillance program in effect which carries out surveillance for possible frontrunning between the NYSE and S&P stock index futures contract, by the CME, and NYSE and Dow stock index futures contract, for CBT. The Division understands that these programs were set up at the urging of the Securities and Exchange Commission, due to concerns that a broker-dealer might attempt to trade in the futures market on non-public information concerning a trade on the NYSE carried out for its customer and the customer's related upcoming futures trade. To the Division's knowledge, for the approximately ten years that CME has been carrying out a frontrunning surveillance program, and the shorter time the CBT has carried out its program, no actions based on frontrunning abuses have ever been brought.

⁶¹ *A Study of the Nature, Extent and Effects of Futures Trading by Persons Possessing Material Non-Public Information*, submitted by the Commission to the Committee on Agriculture of the House of Representatives and the Committee on Agriculture, Nutrition and Forestry of the Senate (September 1984), at 8; CX's January 11, 2000, submission at 2.

⁶² See *supra* Section III.C.

Frontrunning abuses arise from positions taken based on non-public knowledge regarding a customer's imminent order,⁶³ as when, for example, a party takes a position ahead of a customer's large pending order knowing that the bid or ask will respond to the order, moving away from the order, allowing the party to profit from the market move. With CX's proposal, block trade parties would only have non-public information regarding an executed trade. As the non-public information regarding a CX block transaction would concern a completed transaction, no bid/ask responses to an order would be necessary and, therefore, no market moves away from an order would take place. Consequently, there would be no anticipated market movement to frontrun and there could be no frontrunning abuse.

Furthermore, as mentioned above, the time delay before information concerning the block trade would be publicized by the Exchange also would diminish any impact on the market due to such information. The market would have factored in price information from a variety of other sources unrelated to the block trade before the block trading information was publicized. Information concerning an executed block trade, as experience at LIFFE shows, would not impact market prices, as the market would have had an opportunity to move away from the price at which the block trade was executed.⁶⁴

⁶³ The Commission's definition of "frontrunning" is "taking a future or option position based upon non-public information regarding an impending transaction by another person in the same or related future or option." CFTC, GLOSSARY: A LAYMAN'S GUIDE TO THE LANGUAGE OF THE FUTURES INDUSTRY, (1997).

⁶⁴ Fraud and manipulation in the financial markets generally has been less of a concern than in the market for physical commodities. Report of the President's Working Group on Financial Markets, *supra* note 31 at 16, 22. Furthermore, futures contracts traded through CX's block trading facility would actually be under stronger surveillance and regulation than is currently the case in the over-the-counter market for similar products. The Division understands that LIFFE has carried out a thorough review of the block trades carried out in its markets and, apparently, the only inappropriate behavior discovered concerned efforts by one party to aggregate smaller orders to reach the minimum block trade size.

H. Various Improvements Suggested

FIA also included several comments to explain how FIA believes block trading procedures could be best designed to maximize their utility and benefits, and requested clarification of CX's proposed implementing rules. FIA emphasized that it did not wish its comments to be construed as objections to, or to delay, the Commission's approval of the Block Trading Proposal.⁶⁵ A desire for clarification of Primary Market Maker's requirements and possible liability was expressed in several FIA comments.

CX has redrafted Rule 305-A, with input from the Division, to clarify those points.⁶⁶ The prohibition on block trade transactions being executed between two Primary Market Makers and the requirement to report a block transaction within ten minutes were both viewed by FIA as burdensome and unnecessary. The Division believes, however, that these measures would reduce concerns regarding problems with liquidity, price discovery and market transparency.⁶⁷ FIA also raised concerns that a proposed automatic adjustment to the minimum number of contracts eligible for a block trade would be confusing and would discourage the use of block transactions. In response, CX has agreed to delete the automatic minimum size adjustment and to retain a more straightforward minimum of 100 contracts with no size adjustment.⁶⁸

⁶⁵ FIA, *supra* note 21, at 1-2.

⁶⁶ See generally CX's January 11, 2000, submission.

⁶⁷ See *supra* Sections II.B and II.D.

⁶⁸ See *supra* Section III.E. Any determination by CX to modify the minimum contract size for block trades would require submission of the proposed modification to the Commission pursuant to Section 5a(a)(12)(A) of the Act and Commission Regulations 1.38 and 1.41(c). While the Commission has proposed a new Regulation 1.41(z) that would allow exchanges to implement rule proposals without prior Commission review, Regulation 1.41(z) would not be available for rule proposals that, in the absence of some type of Commission exemption, would be inconsistent with the Act or the

FIA stated that the requirement in proposed Rule 305-A(a)(4) that the price of the block trade be “fair and reasonable” was unnecessary and inappropriate for alternative execution procedures, as the prices of other trades in the same contract may not be representative of the market for larger orders. The Division notes that in other contexts, prices for certain transactions are allowed to differ from the centralized price as, for example, in CME’s “All-Or-None Transactions” Rule.⁶⁹ However, while the price for large transactions may appropriately differ from that of the underlying market, the price negotiated for the block trade should relate to the prices of the centralized markets.⁷⁰

CX has agreed to amend its rule proposal to allow a “fair and reasonable” analysis to take into account: (i) the size of the block; (ii) the price and size of other trades in the same contract at the relevant time; (iii) the price and size of trades in other relevant markets, including without limitation the underlying cash market and CX, at the relevant time; and (iv) the circumstances of the parties to such block trade. When a “fair and reasonable” analysis is carried out concerning the price of a block trade, CX has agreed with the Division that consideration of the relevant markets would include CX centralized markets, the cash market and CBT’s markets in U.S. Treasuries. The Division recommends that the Commission, in its approval letter to the Exchange, reiterate the importance of including all futures and cash Treasury markets in CX’s analysis of whether block trades satisfy the “fair and reasonable” price requirement.

Commission’s regulations, such as non-competitive block trading proposals. See 64 Fed. Reg. 66428, 66430 (November 26, 1999).

⁶⁹ CME Rule 521 allows bids or offers for large amounts to be offered to the floor and requires that the large order be filled on an all-or-nothing basis. The rule allows the price of the all-or-none transaction to differ from the pit price.

⁷⁰ See *supra* Section II.B and II.F; and Beth Seely, note 23, at 12-15.

IV. Discussion

A. Authority to approve Block Trading Proposals

Under Section 4(a) of the Act and Commission Regulation 1.38(a), the Commission has broad authority to approve contract market rules that allow futures and option transactions to be executed in a noncompetitive manner. Section 4(a) makes it unlawful for any person to enter into a contract for the purchase or sale of a commodity for future delivery "unless such transaction is conducted on or subject to the rules of a board of trade which has been designated by the Commission as a contract market for such commodity."⁷¹ Precursor statutes to the 1936 Act, as well as the current version of the Act, contain the phrase "subject to the rules of a board of trade" in several places.⁷²

The origin of this phrase can be traced to the rules of the CBT (as codified in 1917), which were in effect when the 1936 Act was passed.⁷³ Those CBT rules recognized "private" futures transactions, executed by members but not executed in the centralized futures pit. However, those private contracts were subject to CBT's rules and regulations.⁷⁴ Furthermore, Commission Regulation 1.38(a) provides that its open and competitive execution requirement "shall not apply to transactions which are executed noncompetitively in accordance with written rules of the contract market which have been submitted to and approved by the Commission,

⁷¹ 7 U.S.C. § 6(a).

⁷² See, e.g., Pub. L. No.67-331, 42 Stat. 998 (Grain Futures Act of 1922).

⁷³ See REPORT OF THE FEDERAL TRADE COMMISSION ON THE GRAIN TRADE: VOLUME V FUTURE TRADING OPERATIONS IN GRAIN (September 15, 1920) at 46 n.1.

⁷⁴ See Rule 16 ("Exchange Contracts and Members' Contracts) and Rule 28 ("On the Exchange, or on Change") of the Rules and Regulations of the Board of Trade of the City of Chicago reprinted in THE EIGHTY-SIXTH ANNUAL REPORT OF THE TRADE AND COMMERCE OF CHICAGO (1944).

specifically providing for the noncompetitive execution of such transactions.”⁷⁵

These provisions do not limit the types of transactions that may be approved by the Commission. Consequently, as previously noted by the Commission,⁷⁶ the language of Section 4(a) and Regulation 1.38 allows the Commission to approve exchange rules that permit futures transactions to be executed by means other than open outcry. However, transactions carried out on an exchange under alternative execution procedures approved by the Commission, as in the case of EFP transactions and NYMEX EFS transactions, remain subject to, among others, the anti-fraud and anti-manipulation provisions of the Act.

B. Block Trading Factors to be Considered by the Commission

In its Block Trading Advisory, the Commission stated that exchanges which submit alternative execution procedures proposals to the Commission for approval should address in their submission the various issues and questions raised in the Commission’s Noncompetitive Concept Release. Issues suggested for consideration include: (1) the impact of the proposal on the usefulness of the contract market as a vehicle for price discovery and risk transfer; (2) whether the proposal represents the least anticompetitive means of achieving the contract market’s objective; (3) whether the proposed transactions fulfill some need of market participants that traditional open outcry cannot fulfill as well, and (4) whether the transactions are structured in such a way as to complement the competitive market.⁷⁷

⁷⁵ Commission Regulation 1.38 was adopted pursuant to Sections 4b and 8a(5) of the Act. 7 U.S.C. §§ 6b and 12a(5). See 17 Fed. Reg. 7905 (August 29, 1953).

⁷⁶ See the Block Trading Advisory at 31197. See also the Division’s December 14, 1998, memorandum to the Commission recommending the approval of NYMEX’s EFS proposal at 22-23.

⁷⁷ Block Trading Advisory at 31198.

As previously pointed out, CX's Block Trading Proposal should not adversely impact the usefulness of the futures market as a vehicles for price discovery and risk transfer in the U.S. Treasury markets.⁷⁸ The Block Trading Proposal was structured to support the competitive market while allowing for alternative procedures, allowing negotiation away from the centralized market.⁷⁹ With its Block Trading Proposal, CX is attempting to fulfill the needs of certain participants not currently met by its centralized market.⁸⁰ The structure chosen by CX for its Block Trading Proposal has been crafted to encourage increased liquidity in its centralized markets.⁸¹

C. Pilot Program

CX's Block Trading Proposal is the first such proposal before the Commission since the Commission published its Block Trading Advisory. Accordingly, there is some degree of uncertainty as to what effect the proposal will have on the centralized markets. Therefore, the Division recommends, and the Exchange has agreed to, implementation of the Block Trading Proposal on a one-year pilot program basis. Through the use of a pilot program, the Commission will be able to collect empirical information on the effect of block trading on the markets and to adjust its oversight if necessary.

V. Conclusion

The Division has reviewed CX's Block Trading Proposal, and believes that it is not inconsistent with the Act or the Commission's regulations. The Division

⁷⁸ See *supra* Section II.F.

⁷⁹ See *supra* Section II.B and D.

⁸⁰ See *supra* Section II.A and note 9.

⁸¹ See *supra* Section II.B.

recommends that the Commission remind CX to consider trading prices in all relevant futures and cash markets when evaluating the price of a block trade. The Division recommends that the Commission remind CX that they and all block trading participants remain subject to reporting and recordkeeping requirements under the Act and the Commission's regulations. Finally, as the first block trading program to be implemented in the futures industry, the Division believes that the Block Trading Proposal should be implemented as a one-year pilot program. Accordingly, the Division recommends that the Commission approve proposed new Rules 4-A, 25 and 305-A and proposed amendments to Rules 32, 300, 302, and 306 pursuant to Section 5a(a)(12)(A) of the Act and Commission Regulations 1.38 and 1.41(c) on a one-year pilot program basis.