



**The American
Stock Exchange**
An NASD Company

Michael J. Ryan, Jr.
Executive Vice President
and General Counsel

COMMENT

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August 27, 2001

Via Overnight Delivery

Ms. Jean Webb, Secretary
Office of the Secretariat
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Proposed Regulation to Restrict Dual Trading in Security Futures Products, 17
CFR Part 41, 66 FR 36218 (July 11, 2001)

Dear Ms. Webb:

The American Stock Exchange LLC ("Amex" or "Exchange")¹ is pleased to submit this comment letter in connection with the Commission's (the "Commission" or "CFTC") proposal to restrict dual trading in security futures products.² Although we generally support the Commission's dual trading prohibition proposal, we have two (2) concerns described below. First, we note that providing a blanket exception from the dual trading ban for electronic exchanges or marketplaces is inconsistent with the purpose and intent of the Commodity Futures Modernization Act of 2000 (the "CFMA"). Second, we believe that the definition of "customer," and therefore, "dual trading" in proposed Regulation 41.27(a)(4) is not consistent with the CFMA.

The CFMA defines "dual trading" as the execution of customer orders by a floor broker during the same trading session in which the floor broker executes any trade in the same contract market or registered derivatives transaction execution facility ("DTEF") for (1) the account of such floor broker, (2) an account for which such floor broker has trading discretion, or (3) an account controlled by a person with whom such floor broker has a relationship through membership in a broker association.³ The Commodity Exchange Act ("CEA") in Section 1a (16) defines the term "floor broker" as "any person who, in or surrounding any pit, ring, post, or other place provided by a contract market or derivatives transaction execution facility for the meeting of persons similarly engaged, shall purchase or sell for any other person any commodity for future delivery on or subject to the rules of any contract market or derivatives transaction execution facility." (emphasis added) Accordingly, the CEA does not limit a "floor broker" to a traditional exchange or trading floor, and therefore, dual trading may similarly occur in a non-floor trading environment.

¹ The Amex is a national securities exchange registered with the SEC pursuant to Section 6 of the Securities Exchange Act of 1934, as amended (the "1934 Act").
² See Proposed Regulation to Restrict Dual Trading in Security Futures Products, 17 CFR Part 41, 66 FR 36218 (July 11, 2001)(the "Proposing Release").
³ "Broker Association" is defined in Section 4j(c) of the CEA to include two or more contract market members or registered derivatives transaction execution facility members with floor trading privileges of whom at least one is acting as a floor broker, who (1) engage in floor brokerage activity on behalf of the same employer, (2) have an employer and employee relationship which relates to floor brokerage activity, (3) share profits and losses associated with their brokerage or trading activity, or (4) regularly share a deck of orders. See Section 251 of the CFMA.

The Commission in Proposed Regulation 41.27(a)(6) defines dual trading in a narrower manner than the CFMA. In particular, the Proposed Regulation defines "dual trading" as the "execution of customer orders by a floor broker through *open outcry* during the same trading session in which the floor broker executes, directly or indirectly, either through open outcry or through a trading system that electronically matches bids and offers, a transaction for the same security futures product on the same designated contract market or registered derivatives transaction execution facility for an account" (emphasis added) of a non-customer. The CFMA by its plain terms does not so limit its dual trading definition, and therefore, its prohibition to a "floor-based" designated contract market or a "floor-based" DTEF. In proposing a narrower prohibition than the CFMA, we assert that the Commission would establish quite different regulatory systems based on the trading platform, and therefore, provide unintended incentives and/or disincentives depending on the particular system. In addition, the Commission in its Proposing Release failed to address the fact that other trading platforms, such as electronic exchanges, may have persons performing the traditional function of a "floor broker." In fact, we understand that favorable tax treatment is now being sought for upstairs electronic traders claiming to be performing the economic functions of floor brokers. Similarly, the concept of what is considered "open-outcry" for purposes of the Proposed Regulation was left exceedingly vague, given the fact that an open-outcry system may arguably exist in a number of different trading environments.

The definition of "floor broker" as defined in Section 1a(16) of the CEA set forth above clearly covers non-floor trading platform situations because it assumes that a physical floor may or may not exist. We believe that providing an exception for "electronic-based" exchanges or markets from the dual trading prohibitions misapprehends the evolving nature and manner of trading. For instance, would a traditional exchange that employs an electronic trading system to execute orders and effectively assume the "open outcry" function become exempt from the dual trading prohibition? Moreover, this exception to the dual trading prohibition would hinge on whether or not a marketplace is deemed "open outcry," presumably based on the existence of a physical trading floor. This distinction ignores the realities of modern trading and technological advances that provide floor characteristics to the electronic world. In fact, traditional securities exchanges have implemented electronic systems such that the differences between an electronic and floor-based exchange are blurring.⁴ With respect to exchange proposals to trade security futures products, we note that every publicly announced proposal to date has indicated an intention to operate electronically. Therefore, the failure of the Proposing Release to extend to electronic marketplaces has the real possibility of rendering the dual trading prohibition meaningless for trading securities futures products.

We also concur with the views of the New York Board of Trade ("NYBOT") in its letter dated August 10, 2001 to the Commission. Specifically, the NYBOT's discussion regarding "control" of when an order is executed in the marketplace is very persuasive. The superficial distinctions of "control" based on whether the market is floor-based or electronic suggests that the Proposed Regulation could be manipulated by market participants. We further believe that a proposed dual trading ban should be consistent across marketplaces whether floor-based or electronic.

On a different issue, we note that the proposal limits the definition of "dual trading" as defined in the CFMA. In particular, the proposed regulation provides that a floor broker having an ownership interest or a share of trading profits of 10% or more renders such account a "Non-Customer" account. This concept, although existing in Part 16 of the Commission's existing regulations, was not applied to the CFMA's definition of dual trading. We believe that this was not an oversight and that

⁴ See also Approval of International Securities Exchange LLC ("ISE"), Securities Exchange Act Release No. 42455 (February 24, 2000), 65 FR 11388 (March 2, 2000). The ISE is the only fully electronic options exchange in the U.S. Although the ISE operates without a physical trading floor, electronic systems developed and implemented by the other options exchanges provide a comparable trading environment.

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account. This concept, although existing in Part 16 of the Commission's existing regulations, was not applied to the CFMA's definition of dual trading. We believe that this was not an oversight and that Congress deliberately excluded this provision from the definition of dual trading. Moreover, we believe that a de minimis standard should be substituted for an ownership interest or share of trading profits of 10% or greater, because otherwise, the dual trading prohibition may be subsumed by the asserted definition of "Non-Customer."

Thank you for this opportunity to comment on the Proposing Release. If there are any questions or comments regarding this letter and related matters, please contact the undersigned at (212) 306-1200 or Jeffrey P. Burns at (212) 306-1822.

Sincerely,



Michael J. Ryan, Jr.
Executive Vice President
and General Counsel

cc: De'Anna Dow, Acting Director, Division of Trading and Markets
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