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October 22, 1999

COMMENT

Ms. Jean A. Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Dear Ms. Webb:

The National Grain Trade Council submits these comments on "Cantor Financial Futures Exchange's Proposal to Adopt Block Trading Procedures" as published in the ***Federal Register*** on October 7, 1999.

In the ***Federal Register*** notice, the Commission describes the proposal from Cantor Exchange (CX) as follows:

> . . . qualified market participants would be allowed to negotiate and arrange futures transactions of a minimum size bilaterally away from the centralized, competitive market. Once the specific terms of the block transaction had been agreed to, the counterparties would report the relevant details of the transaction to the Exchange for clearing and settlement.

The Council is strongly opposed to the notion of block trading in futures markets. We believe that block trading is anti-competitive and is at odds with the role of the Commission which is "to ensure that all trades are executed at competitive prices and . . . focused into the centralized marketplace to participate in the competitive determination of the price of futures contracts."[1]

Block transactions discover and create futures prices outside the centralized marketplace. Block trading is also anti-competitive because it violates the purpose of an open and focused centralized marketplace to provide "ready access to the market for all orders (which) results in a continuous flow of price information."[2] We recognize that block trading is a practice common in securities markets. However, notwithstanding the recent development of hybrid securities-commodities products, at the basic level, securities and futures instruments and markets remain

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[1] 63 Fed. Reg. 3709 (1998) (quoting REPORT OF THE SENATE COMMITTEE ON AGRICLTURE AND FORESTRY, S. Rep. No. 1131, 93rd Cong., 2d Sess. 16 (1974)).

[2] 63 Fed. Reg. 3709.

differentiated.[3] The instruments serve different functions -- securities facilitate investment and represent equity ownership in a corporation, whereas commodity futures transfer price risk and enable price discovery. By establishing a separate regulatory structure for securities and futures markets, Congress has recognized that what is appropriate for one market may be inappropriate for the other.

The Council believes block trading is an unacceptable practice, which would concentrate trading into a few large institutional corporations. The outcome would drain liquidity, prevent equal access, curtail information, foster "bucketing,"[4] and, in short, destroy 150 years of public confidence in our markets.

We believe the Cantor proposal has broad ramifications. It is clearly an attempt by a new market to capture a competitive advantage against an established market by changing the parameters on what is an acceptable trading environment. We don't think allowing block trading should be an acceptable means to gain market share. The proposal is also troubling because, if successful, it will not necessarily stop with Treasury securities. Once extended into agricultural futures, where supplies are more finite, it will raise more questions.

We can think of no better example of harm wrought by allowing prearranged block trading than the damage to a farmer using the futures market to hedge five thousand bushels of grain production. To a large integrated company, a single contract to sell in the futures market, opposite the company's large buying order, may represent only one of thousands or tens of thousands of contracts purchased in a single transaction or during a trading day. However, to the farmer, that single contract represents an important percent of production, and the price received for it becomes an important element in his profit marketing for the year. The farmer is clearly harmed when the prospective counter party to his futures hedge can legally locate another large institution and contract with that party at a lower price.

Whether it is a farmer trading a handful of contracts or a large commercial trader managing 15,000 contracts, we are concerned about the potential impact of block trading on price discovery, market liquidity, and market efficiency. We wonder, for example, about the potential impact on a firm managing a large portfolio of options that seeks a delta neutral position. How would such a firm deal with their adjustments of options portfolios in a situation where there are essentially two markets -- the floor market and a backoffice market for block trading?

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[3] Sanford J. Grossman, *An Analysis of the Role of "Insider Trading" on Futures Markets*, 59 J. BUS. S144-45 (1986).

[4] Bucketing is defined as "(d)irectly or indirectly taking the opposite side of a customer's order into the broker's own account or into an account in which the broker has an interest, without open and competitive execution of the order on an exchange." THE COMMODITY FUTURES TRADING COMMISSION, THE CFTC GLOSSARY: A LAYMAN'S GUIDE TO THE LANGUAGE OF THE FUTURES INDUSTRY (1990).

For all of these reasons, we urge the Commission not to approve the proposal from the Cantor Financial Futures Exchange to permit block trading.

Respectfully,

Robert Petersen

Robert R. Petersen
President