October 16, 2003

BY FIRST CLASS MAIL AND E-MAIL

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

Re: U.S. Futures Exchange, L.L.C. Application for Contract Market Designation

Dear Ms. Webb:

The Board of Trade of the City of Chicago, Inc. ("CBOT®") appreciates the opportunity to comment on the application submitted to the Commodity Futures Trading Commission ("Commission") by U.S. Futures Exchange, L.L.C. ("Eurex US") for designation as a contract market pursuant to Sections 5(b) and 6 of the Commodity Exchange Act, as amended ("Act" or "CEA"), and Part 38 of the Commission's Rules.

I. Introduction

A. General

Congress has found that futures and options transactions are "affected with a national public interest by providing a means for managing and assuming price risks, discovering prices or disseminating pricing information through trading in liquid, fair and financially secure trading facilities." Section 3(a) of the CEA. Congress also has specified that the CEA serves that national public interest "through a system of effective self-regulation of trading facilities, clearing systems and market participants under the oversight of the Commission." Section 3(b) of the CEA.

Contract market designation is the linchpin of that Congressionally-mandated "system of effective self-regulation." In order to be designated as a contract market, a board of trade must meet the comprehensive standards set out by Congress under Sections 5(a)-(d) of the CEA and by the Commission in Part 38 of its Regulations.

On September 16, 2003, Eurex US filed its contract market designation application[1] with the Commission. Although much of that application remains a secret as certain of its core documents are not part of the public record, the Commission requested public comment on

[1] For purposes of this comment letter, Eurex US's "application" will be considered to include all of the exhibits that were filed with its September 16th letter, or that were substituted for any such exhibits on September 26, 2003.

the application initially by October 1, 2003, and then pursuant to an extension, by October 16, 2003.

On October 14, 2003, the Commission announced its determination to consider the Eurex US application outside of the 60-day framework of the "fast track" procedures described in Commission Regulation 38.3. In a public statement, the Commission stated that it had taken this action "in order to ensure that it has an adequate opportunity to consider fully the issues presented by [Eurex US's] application." Therefore, the application will be considered under Section 6 of the CEA.

As discussed in detail below, the CBOT opposes the Commission's designation of Eurex US as a contract market based on the application materials submitted to date since Eurex US has failed to show how it would meet many of the standards mandated by Congress for contract markets. Designating Eurex US as a contract market on this record would contravene the CEA, undermine the Commission's mission and harm the national public interest.

B. The CBOT is unable to provide meaningful comment regarding Eurex US's application because crucial documents have been withheld from the public

The Commission has requested public comment on the Eurex US application for contract market designation in accordance with its policy. The public comment process can only serve its purpose for the public and for the Commission, if it is a meaningful opportunity for comment. While Eurex US submitted its contract market designation application on September 16, no one other than Eurex and the Commission really knows what that application contains. Initially, Eurex US requested confidential treatment of all but four of the 20 exhibits it submitted with its application. On September 17, 2003, the CBOT requested all of the application exhibits, among other things, under the Freedom of Information Act and Commission Regulation 145.7. On October 2003, the Commission made an initial determination to deny the CBOT's request, except for certain substitute exhibits submitted by Eurex US on September 26, 2003, and published on the Commission's website on September 30, 2003. The CBOT has filed an application for administrative review of the initial determination.

Among other things, the Commission withheld all of the outsourcing agreements between Eurex US and other parties, including Eurex Frankfurt, AG ("Eurex Frankfurt") (Exhibits 8-9), the National Futures Association ("NFA") (Exhibit 6)[2] and The Clearing Corporation

[2] We understand that the Board of Directors of NFA has not yet agreed to undertake any self-regulatory programs for Eurex US. In that regard, Eurex US's application is premature. The Commission, and the public commenting on the application, are entitled to rely upon only final agreements, not drafts. The Commission should not continue to consider Eurex US's application until a final executed version of the agreement is submitted and then released for public scrutiny and comment. The CBOT understands that certain Directors of NFA have expressed their objections to the proposed agreement on the basis that NFA's Articles of Incorporation prohibit NFA from exercising such authority with regard to designated contract markets, and also on the basis that the proposed agreement would call NFA's tax exempt status into question.

("CC")[3] (Exhibit 10). Since Eurex US proposes to outsource nearly all of its operational, self-regulatory, market supervision and clearing functions, there is no way for the public to provide useful comments regarding its compliance with the Designation Criteria, or its ability to comply with the Core Principles, unless the key provisions of those agreements are made public. If all of these functions were to be performed in-house, one would expect that they would be described in Eurex US's application. An applicant's decision to outsource the performance of certain functions that are necessary to its performance of its statutory obligations should not diminish the applicant's regulatory burden or shield the vendors or the agreements from public scrutiny.

Providing public comments on an application that is largely non-public renders those comments necessarily incomplete. Assuming that the Commission intends to try to resolve the FOIA issues as quickly as possible, its effort will prove inadequate under law if interested parties have an insufficient opportunity to respond to the sealed application materials, because the process will "deprive[ed] the public of a meaningful opportunity to comment and to offer criticism and comments." *Home Builders Assoc. of N. Cal. v. US Fish and Wildlife Svc*., 268 F.Supp.2d 1197, 1231 (E.D. Cal. 2003). The Commission should defer action on the application until the FOIA issues have been resolved, and the public is able to address in a fully informed manner the statutory questions raised by the Eurex US application, based on subsequently released exhibits.

The public comment process is particularly important with regard to the Commission's consideration of the Eurex US application since it presents so many new and profound legal questions and regulatory dilemmas. In particular, public comment is beneficial where, as in this case, Congress has required the Commission to consider "the costs and benefits of" its action, before issuing an order designating Eurex US as a contract market or denying its application. CEA §15(a). Those costs and benefits must be considered in light of a range of statutory factors, including protection of market participants and the public; efficiency, competitiveness and financial integrity of futures markets; price discovery; sound risk management practices and other public interest considerations. CEA §15(a)(2). Public comment will be able to most effectively assist the Commission as it considers these weighty issues, if it is based on all of the relevant information relating to Eurex US's arrangements for clearing, the performance of self-regulatory tasks, and key operational and market supervision functions.

For the above reasons, the public comment process should be reopened once the Commission has resolved Eurex US's confidentiality claims concerning the supporting materials it submitted with its application. While first deciding what is in the public record and then seeking comment is a sensible way to proceed generally, in this case it is most appropriate in light of the different ways that Eurex US and Eurex Frankfurt spokesmen have described their business plans. For example, on the same day that Eurex US filed its contract market designation application, at a news conference to announce that filing, Eurex US and Eurex Frankfurt touted the global clearing partnership they would use, and they have made

[3] The Board of Trade Clearing Corporation has announced its intention to change its name to The Clearing Corporation. Although the legal change has not yet taken place, it will be referred to as The Clearing Corporation, or CC, in this letter.

numerous public references both before and since that time to a planned link between their respective clearinghouses. Eurex US and Eurex Frankfurt also have announced what products they intend to trade and a common trading platform that would allow trading in the U.S. and trading in Frankfurt to occur as if the trades were executed on the same market. Yet Eurex US's application appears to be completely silent with regard to any such clearing partnership, product offerings or linked exchanges.

Therefore, Eurex US appears to be asking the Commission to approve a way of doing business it never intends to use – which calls into question the legitimacy (let alone material completeness) of the application in the first place. Nothing in the CEA or Commission regulations contemplates that an applicant would be disingenuous enough to have two business plans – one "plain vanilla" plan for Commission consideration, and one "real" plan to be implemented once designation is granted. The Commission should ask the real Eurex US to reveal itself and its true business plan before asking for public comment on the real Eurex US application, or considering whether approval of that application is warranted. Otherwise, interested parties will have grounds to protest the Commission's decision after contract market designation, because the designated entity will not be conducting its business as described in its designation application, in effect a regulatory bait-and-switch operation. *American Lands Alliance v. Norton*, 242 F.Supp.2d. 1, 14-15 (D.D.C. 2003)

II. The Commission should not approve Eurex US's application for contract market designation because it is materially incomplete

Section 6 of the CEA states that an application for contract market designation must be accompanied by "a showing that it complies with the conditions set forth in this Act, and with a sufficient assurance that it will continue to comply with the requirements of this Act." Those conditions and requirements are the criteria for designation in Section 5(b) of the CEA, the core principles for operation under Section 5(d) of the CEA, and the provisions of Part 38 of the Commission's regulations.

In many areas in many ways, the Eurex US application fails to make the required showing that it complies, and will continue to comply, with the CEA's requirements. As we will describe in detail, the Eurex US application does not sustain its burden of proving that it would meet the statute's requirements in areas like preventing manipulation, ensuring financial integrity, listing contracts not readily subject to manipulation, and ensuring fair and equitable trading, among others.

A publication on the Eurex website (www.eurexchange.com) entitled "An Introduction to Eurex US" (attached as Appendix A) states that "[i]t should be noted that changes to the contract terms, trading and clearing conditions and all other matters discussed in this flyer may be made during the process of obtaining designation as a U.S. contract market." (page 5, footnote 1). Thus, Eurex US has effectively conceded that it understood it would have to provide contract terms as well as additional materials on trading and clearing conditions in support of it application. Until Eurex US does so, the Commission should consider the application to me materially incomplete under section 6 of the CEA.

III. Special Factors When the Operator of a Foreign Board of Trade Applies to Operate a U.S. Designated Contract Market

A. General Issues

Eurex US's application raises novel issues of the national interest and the public interest, which supersede any narrow, private commercial interest. Eurex Frankfurt operates Eurex Deutschland, a "foreign board of trade" as defined under Commission Regulation 1.3(ss). Eurex US is a wholly owned subsidiary of U.S. Exchange Holdings, Inc., which in turn is a wholly owned subsidiary of Eurex Frankfurt, a German *aktiengesellschaft*. Eurex Frankfurt is a wholly owned subsidiary of Eurex Zurich AG ("Eurex Zurich"), a Swiss *aktiengesellschaft*. Eurex Zurich is owned jointly by Deutsche Börse AG, a German *aktiengesellshaft* listed on the Frankfurt Stock Exchange and headquartered in Frankfurt, Germany, and SWX Swiss Stock Exchange, a Swiss company headquartered in Zurich, Switzerland. Never before has the operator of a foreign board of trade, or an enterprise owned by the operator of a foreign board of trade, applied to operate a U.S. designated contract market (US DCM).[4]

The Eurex US application thus presents a number of important questions of first impression. Neither Congress nor the Commission has ever considered whether having the operator of a foreign board of trade own or operate a U.S. self-regulatory organization, let alone a contract market, presents special issues and regulatory risks.

In other areas of commerce, however, Congress has found it to be in the national interest to impose special rules governing foreign acquisitions or ownership of enterprises in the U.S. These include:

- Air carriers, both passenger and freight, e.g., 14 C.F.R. §§297.12, 297.24, 297.3 (2000); 49 U.S.C.A. §§40102, 41101, 44101, 444102 (2000).

- Telecommunications, e.g., 47 U.S.C.A. §§ 301, 306, 309, 314, 327, 390, 606, 609 (2000).

- Maritime shipping rights, e.g., 46 App. U.S.C.A. §§808, 861, 865, 883, 883-1, 889 (2000).

- Power generation, especially nuclear facilities, e.g., 16 U.S.C.A. §797 (2000); 42 U.S.C.A. §2133 (2000).

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[4] While NQLX, a joint venture of a foreign board of trade (LIFFE) and a U.S. organization (NASDAQ) did apply to become a U.S. designated contract market in 2001, the Commission never addressed issues pertaining to a foreign entity's operation of a U.S. contract market since NQLX was designed to be operated as a joint venture. Months after contract market designation was granted, NASDAQ dropped out of the venture. NQLX now is being operated exclusively by LIFFE. The Commission has never before faced the issues posed by the Eurex US contract market designation application.

- Banks, e.g., 12 U.S.C.A. §619, 3101 (2000); 12 C.F.R. §211.4-6, 211.21, 211.23-27, 211.30, 211.605, 225.4, 225.13, 225.31, 225.41, 225.81, 255.82, 225.86, 225.90-93, 225.101, 225.102, 225.124, 225.143, 225.170, 225.174 (2000); 15 C.F.R. §806.15 (2000); 31 C.F.R. §800.101 (2000).

For example, the banking industry is heavily regulated in general, and the Foreign Bank Supervision Enhancement Act of 1991 expanded the authority of the Federal Reserve Board to regulate foreign banks in the U.S. In particular, such expanded authority includes an application and approval process in which a foreign bank must show that it is subject to "comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country," as well as provisions for frequent examinations, discretionary inspection authority, and reporting obligations. Furthermore, although foreign banks may own or control U.S. national banks, all of the directors and the Chief Executive Officers of such U.S. national banks must be U.S. citizens, and the majority of the directors must reside in the state, or within 100 miles, of the location of the national bank.

Imposing special scrutiny and potentially special conditions on foreign-owned enterprises is not unique. Nor is it intended to be hostile to the legitimate commercial interests of any foreign entity or the goal of opening up all markets to the forces of fair competition. Rather, consideration of these kinds of issues would ensure that before the Commission takes this unprecedented step, it has analyzed all of the possible ramifications of its actions.

B. Areas of Special Regulatory Concern

1. A foreign entity that owns or operates a US DCM may serve conflicting national interests

Contract market designation is based on a Commission assessment of the capabilities offered by any applicant to assume the self-policing, self-regulatory duties the statute imposes. As the media and public officials are daily questioning the efficacy of U.S. self-regulation in the securities markets, it is an odd time to chart new self-regulatory waters by allowing the operator of a foreign board of trade to control a US DCM. The Commission therefore should consider the inherent risks presented by allowing any foreign entity to operate a US DCM.

Implicit in the self-regulatory reliance Congress has placed on designated contract markets is the recognition that the interests of the Commission and US DCMs (and other self-regulatory organizations) are perfectly aligned insofar as both recognize the national interest of the United States and its investors as paramount. The same cannot be said for a DCM owned or operated by a foreign entity. That entity may be expected to have its principal allegiance to its home government and economy, rather than to the U.S. If a self-regulatory decision needs to be made that presents a conflict between the interests of the home country and those of the U.S., how can the Commission be certain that a foreign entity's U.S. contract market would have the same allegiance to U.S. interests as a U.S. owned DCM would have? For example, would a foreign owned US DCM be inclined to overlook rule violations by members who are

citizens of its home country? Would a foreign owned US DCM be willing or able to thwart US economic policy? Would a foreign owned US DCM, offering products based on U.S. government debt, be as sensitive as the CBOT would be to any concerns raised, for example, by the Treasury Department or the Bond Market Association?

2. The Commission's extra-territorial jurisdiction is limited with respect to a foreign entity

Compounding the conflict of national interest that a foreign entity would have, the Commission also would face an unarguable impediment to the effective and efficient exercise of its oversight responsibilities where a foreign entity operates a US DCM. If the Commission wishes or needs access to any person operating a US DCM, it has ample jurisdictional powers over such person. The remedies available to the Commission range from an immediate audit of books and records to a plethora of legal enforcement powers the statute affords. These powers create a powerful incentive for U.S. self-regulatory organizations to cooperate fully with the Commission.

No one could maintain that the Commission's extra-territorial reach to a foreign entity and its owners is comparable to its jurisdictional reach over U.S. persons. Indeed the fact that the Commission has entered into Memoranda of Understanding with over 20 countries to date confirms the obvious point that its jurisdiction over U.S. persons is much stronger than its extra-territorial reach. Thus, the Commission's ability to apply its full enforcement powers to the owner/operator of a U.S. designated contract market is simply not as clear or immediate when the owner/operator is a foreign entity.

The misalignment of national interests and the Commission's limited extra-territorial jurisdiction over foreign officials who play a role in running a US DCM will undoubtedly pose real, not merely theoretical, regulatory challenges. As a single member LLC, Eurex US is subject to the unfettered control of its parent, U.S. Exchange Holdings, Inc., which is represented to be a wholly owned subsidiary of Eurex Frankfurt. While the bylaws and articles of incorporation for U.S. Exchange Holdings, Inc. do not appear to have been made a part of the application, we are concerned that this governance structure maximizes the control of Eurex Frankfurt, but minimizes its accountability. Certainly the Commission has had sufficient regulatory experience to appreciate the kinds of potential dilemmas that could be presented by a foreign entity's ownership of a US DCM, dilemmas that could arise in matters of great consequence to our economy and the ability to fulfill the CEA's statutory purpose.

Although Eurex US's cover letter to its application is silent on what products it intends to offer, several of its proposed rules and press statements confirm that Eurex US will attempt to trade U.S. government debt futures and options. Congress has made clear in Section 2(a)(8)(B) of the CEA that it believes futures trading on U.S. government securities could have an impact on the debt financing requirements of the United States, and even requires the Department of the Treasury and the Federal Reserve Board to review and offer their views on the impact any new contract might have on the continued efficiency and integrity of the

underlying market for government securities.[5] Congress thus understands that trading in certain underlying commodities as the subject of certain futures contracts does matter to our national economy no matter what new US DCM offers these instruments. Certainly these concerns should be heightened when the US DCM is owned by a foreign entity.

3. A foreign entity that owns or operates a US DCM may face particular difficulties in connection with market emergencies

Market emergencies also present special difficulties for foreign entities operating US DCMs. As Congress expressly envisioned when it enacted Section 8a(9) of the CEA, contract markets are called upon to remedy any act "of a foreign government affecting a commodity or other major market disturbance which prevents the market from accurately reflecting the forces of supply and demand." The recognition in Section 8a(9) that a foreign government could trigger a major market disturbance in U.S. markets illustrates the potential conflict of interest that a foreign entity that owns a US DCM might face. Can the Commission expect that a foreign entity will be willing to permit its US DCM to take emergency action when the emergency is caused by the foreign government in its home country? While it is true that the Commission itself could take action to address the emergency in that circumstance, the Commission cannot excuse the foreign owned US DCM from its responsibility to do so without creating regulatory disparities with U.S. owned DCMs. Moreover, even if the Commission took emergency action itself, the foreign entity likely would not be able to cooperate in the implementation of the Commission's order.

4. A foreign entity that owns or operates a US DCM may present financial integrity risks

The CEA confirms that financial integrity is of critical importance to any board of trade applying to become a contract market. See CEA §5(b)(5). Yet a foreign entity that owns a foreign board of trade and a US DCM presents certain financial integrity risks. What happens when a clearing firm of both the foreign board of trade and the US DCM is in trouble and threatening to default? Who ensures that the accounts of U.S. customers receive fair and equitable treatment, rather than an arrangement that favors customers trading on the foreign board of trade? Can the Commission be sure that the operator of the foreign board of trade will not manage such an event to make certain that no market participants on the foreign exchange are harmed before trying to take care of the accounts of U.S. market participants? Will the Commission be able to direct any transfers of positions or will it have to share that authority with the home regulator of the foreign board of trade? What happens to

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[5] Section 2(a)(8)(B) of the CEA states in part:

> When a board of trade applies for designation or registration as a contract market or derivatives transaction execution facility involving transactions for future delivery of any security issued or guaranteed by the United States or any agency thereof, the Commission shall promptly deliver a copy of such application to the Department of the Treasury and the Board of Governors of the Federal Reserve System. The Commission may not designate or register a board of trade as a contract market or derivatives transaction execution facility based on such application until forty-five days after the date the Commission delivers the application to such agencies or until the Commission receives comments from each of such agencies on the application, whichever period is shorter.

U.S. customer protection and financial integrity concerns if the foreign board of trade does not have segregation and net capital rules that equate to the protections mandated in the U.S. by Congress and the Commission? Is the Commission certain that U.S. customer monies can never be used to pay off a clearing firm's debts on a foreign board of trade, especially when its foreign operator owns and operates a US DCM?

5. A foreign entity that owns or operates a US DCM may present insider trading issues

Insider trading is another potentially troublesome area. Under the CEA, exchange owners, including the principals of a parent corporation, are not covered by the insider trading prohibitions. See CEA §9(f). Those provisions bar any employee or member of a board or committee of a board of trade, registered entity or registered futures association from willfully and knowingly violating a Commission regulation by trading on the basis of inside information the person learns about through special access related to that person's performance of regulatory duties, or tipping off a third party about such information.

Interestingly, the Commission's Regulation 1.59 prohibits the employees and officials of a U.S. contract market from trading on the basis of inside information on a "linked exchange," a definition that could include a foreign board of trade offering the same products as a U.S. DCM subsidiary or affiliate. But Regulation 1.59 does not impose such a prohibition on the foreign board of trade's employees or officials in any reciprocal or similar way. Thus, a foreign board of trade's employees or officials could receive inside information about trading on the U.S. DCM subsidiary or affiliate from that subsidiary or affiliate, and trade on the basis of that information without violating the Commission's rules or the CEA.[6] When the CBOT signed a Market Supervision Services Agreement with Eurex in 2000 in connection with the a/c/e joint venture, we required that all Eurex employees who worked on our market sign a letter agreeing to abide by Regulation 1.59 and consenting to the Commission's jurisdiction. It would certainly be appropriate for the Commission to require, as a condition of contract market designation, that if a US DCM is owned or operated by a foreign entity or affiliated with a foreign board of trade, it must ensure that the employees and officials of that foreign entity or foreign board of trade agree to be subject to Regulation 1.59 and the Commission's jurisdiction.[7]

6. Additional international regulatory cooperation is needed

The issues discussed above would be raised by any DCM application filed by any board of trade owned or operated by a foreign entity. We know the Commission has always believed

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[6] The existence of this loophole is not surprising. Nor does it suggest that the Commission's regulations were deficient when written. It does confirm, however, that the Commission has never before considered the full scope of regulatory issues posed by foreign board of trade owned US DCMs.

[7] With regard to Eurex US specifically, because of the wholesale outsourcing of its operational and self-regulatory functions, it is appropriate that Regulation 1.59 apply not just to its employees, governing board member(s) and consultants, but also to the employees, officers and directors of its affiliates and delegates who will be performing those functions.

in the importance of international regulatory cooperation to address many concerns raised by the global economy and the limits each nation faces on its ability to regulate activities beyond its shores. The Eurex US application, and the generic issues it raises, offer a telling example of the need for additional regulatory cooperation in these areas.

The Commission may wish to consider what forms of additional international regulatory cooperation agreements may be necessary to deal with the many issues posed for the first time by the Eurex US application, in the absence of, or in conjunction with, special regulatory controls that the CFTC may need to impose with regard to US DCMs owned or operated by foreign entities. As it stands now, however, we believe any board of trade owned or operated by a foreign entity would face a decidedly uphill struggle trying to show that it meets the CEA's standards for contract market designation.

IV. The CEA requires that the Commission conduct a cost-benefit analysis before issuing an order designating Eurex US as a contract market

In the Commodity Futures Modernization Act of 2000, Congress enacted a new Section 15(a) of the CEA to require the CFTC to conduct a cost-benefit analysis before adopting any regulation or issuing any order. Section 15(a) provides: "Before promulgating a regulation or issuing an order … the Commission shall consider the costs and benefits of the action of the Commission." When the Commission approves or disapproves a contract market designation application, the Commission issues an order of designation. Section 15(a)(3) excuses the Commission from conducting a cost-benefit analysis for three types of orders: "an order that initiates, is part of, or is the result of an adjudicatory or investigative process of the Commission, an emergency action or a finding of fact regarding compliance with a requirement of the Commission." Contract market designation orders are not one of these kinds of orders that Congress exempted from the cost-benefit requirement. Hence, the CFTC must apply its congressionally-mandated cost-benefit analysis framework to the Eurex US application in order to comply with Section 15(a) of the CEA.

A cost-benefit analysis is especially appropriate for the Eurex US application because of its novel and precedent-setting features as discussed in this letter. In addition to the unique roles of Eurex Frankfurt (parent) and Eurex Deutschland (affiliate) in Eurex US's operations, the application poses many issues relating directly to the kinds of considerations Congress mandated that a CFTC cost-benefit analysis address: considerations of "protection of market participants and the public;" "efficiency, competitiveness and financial integrity of futures markets;" "price discovery;" "sound risk management practices" and "other public interest considerations." Section 15(a)(2) of the CEA.

Moreover, the focus on competitiveness and the public interest make it all the more important that the Commission conduct due diligence on, and consider issues relating to, reciprocity in Germany and any other affected countries. We understand from German counsel (see the letter from the law firm of Baker &McKenzie, attached as Appendix B) that state regulatory authorities in Germany are unlikely to permit in Germany what Eurex US is trying to become here: an exchange offering the same contracts (we believe) that an established domestic exchange already offers. Those authorities would take the position that no need has been demonstrated for more than one exchange and multiple exchanges could lead to market

fragmentation that would hurt market liquidity and complicate market surveillance. Certainly, the Commission should consider the substance of what we have been advised is the German view to see whether it has validity for our markets. It should also consider whether "fair competition" policies would be furthered by granting an application as a US DCM to an entity owned, operated or affiliated with a foreign board of trade established in a country that would not likely allow a US DCM to open a similar exchange in that country.[8]

The required cost-benefit analysis also provides the Commission with an additional statutory reason to consider Eurex US' advertised practices of payment for order flow, noncompetitive trading, and fee holidays in Europe to entice market users in the US. The Commission should consider in all of these areas whether Eurex US's parent and affiliate are abusing or leveraging their apparent monopoly power in their home markets to effectuate policies in connection with Eurex US that contravene the spirit of our antitrust laws and may also compromise customer protection, market integrity and market transparency.[9]

The Commission's analysis of these issues and any public interest considerations it might identify that are not directly raised by Part 38, the designation criteria or the core principles, should be complete and deliberative. In fact, in order to establish the best possible record, the Commission may want to consider these issues, explain its cost-benefit analysis in a public document, and then seek public comment on that analysis (maybe even including other affected governmental agencies, i.e., the Treasury Department and the Federal Reserve Board) before it takes any final action on the application.

V. Governance and Conflicts of Interest - Core Principle 6 (Emergency Authority); Core Principle 14 (Governance Fitness Standards); and Core Principle 15 (Conflicts of Interest)

The application does not identify the management of Eurex US. Executive officers are permitted, but not required. (Article IX of the Limited Liability Company Agreement and Bylaws). There is a one member Board of Directors (Section 5.2); that director is also identified as Eurex US's only executive officer. He is the only person eligible to serve as the Chairman of the Board (Section 9.1), and is also the only person entitled to call, and to receive notice of, board meetings (Section 6). Eurex US's sole member of the Limited Liability Company, US Exchange Holdings, Inc., is identified only as "a Delaware

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[8] In this connection, the Commission should consider the experience of the Chicago Mercantile Exchange in its attempts years ago to get just one trading terminal located in Germany. As we understand it, due to the efforts of Eurex, it took about a year for the CME to obtain permission to locate that one terminal in Germany, and all this after the US and the CFTC had allowed Eurex to locate in the U.S. the trading terminals for its foreign exchange for many years.

[9] We understand that Eurex US is offering a fee rebate contest. (See Appendix H, pg. 10). The top ten Eurex US traders and the top ten Eurex US brokers for the year 2004 would share 50% of the fees earned by Eurex US for finishing in the top ten. That practice would create an incentive for noncompetitive trading and for placing customer business on Eurex US even if other markets offer better prices, liquidity and services to customers. The Commission should investigate fully this aspect of the Eurex program. Top ten lists may be humorous late night television, but sales and trading contests based on top ten lists are not the kind of practices in which self-regulatory organizations in US financial markets should engage consistent with the public interest.

corporation" (Section 3.3(a)) and "a separately capitalized, wholly owned subsidiary of Eurex Frankfurt A.G." (Cover Letter, page 2). Based on this limited information, it is not possible to tell whether Eurex US can comply with Core Principles 14 (Governance Fitness Standards) and 15 (Conflicts of Interest). The concentration of authority in one director raises a serious question whether Eurex US's disaster recovery plan must provide for alternative management in the event of his incapacity or unavailability.

With a single person board, it is difficult to imagine how potential conflicts of interest would be reviewed and resolved. It also makes it apparent that any meaningful management decision would be made by Eurex Frankfurt, in a manner that would be beyond the jurisdiction of the Commission.

Eurex US Rule 207(c)(ii) requires a person who is a member of the Board or any committee to notify the Chief Executive Officer of any information or occurrence that would disqualify him from eligibility to serve in that capacity. However, it appears that the sole member of Eurex US's Board is its Chief Executive Officer. This structure does not allow an effective procedure for identifying or addressing conflicts of interest.

Furthermore, Eurex US Rules 203 and 204 indicate that the members of the Disciplinary Committee and the Appeals Committee, respectively, will be officers or employees of the Company. Could such individuals be expected to reveal potential conflicts to their employer, and possibly risk losing their jobs in addition to their ability to participate on one of these committees? It is also unclear whether Eurex US intends to rely on self-reporting only, or whether it will affirmatively monitor for possible disqualifications, for example, when and if additional Directors are nominated.

Since the Chief Executive Officer is the only Director, and the Disciplinary and Appeals Committee will be made up of officers and employees, the conflict of interest standards set forth in Eurex US Rule 207(d) will apply to these individuals. However, all such persons might be considered to have a "significant, ongoing business relationship" with any possible Named Party in Interest, simply because of the fact of their employment by Eurex US, and the fact that Eurex US will receive the money when a fine is imposed.

Furthermore, the procedures for resolving conflicts of interest require that members of the Board of Directors disclose any relationships with a Named Party in Interest to the Chief Executive Officer or his designee, who will then determine whether recusal is required. This would either mean that the one Director would be required to disclose any such relationship to himself in his capacity as the Chief Executive Officer, or to an individual whom he has appointed. Moreover, the "significant action" provisions of Eurex Rule 207(d) would be largely irrelevant since officers and employees are prohibited from trading pursuant to Eurex US Rule 207(b).

VI. Emergency Authority – Core Principle 6 (Emergency Authority)

Core Principle 6 requires a designated contract market to adopt rules providing for the exercise of emergency authority, where appropriate, including, among other things, the authority to liquidate or transfer open positions and the authority to suspend trading. Eurex

US Rule 804, which addresses emergency actions, vests the entire decision-making authority in the hands of the Chief Executive Officer or his designee. Although that Rule provides that the Board and the Commission shall be notified, as soon as practicable, the Chief Executive Officer is currently the only member of the Board. Rule 804 also requires the Chief Executive Officer to "document the decision-making process." It is difficult to imagine what the "decision-making process" might be when only one person is making the decision, much less whether there can be any meaningful procedures to avoid conflicts of interest in connection with that process under these circumstances.

There is also the question as to whether and to what extent Eurex Frankfurt, as the ultimate parent of Eurex US, might play a role in the exercise of emergency authority by Eurex US. Core Principle 6 requires that any contract market emergency action must be taken "in consultation or cooperation with the Commission." If Eurex Frankfurt will, in fact, be part of the decision-making process, the Commission may be hamstrung in its ability to consult and coordinate, insofar as Eurex Frankfurt is outside of its jurisdiction. Since it appears from press statements that Eurex US will be offering contracts in the same U.S. government debt instruments as the CBOT, emergency action in one market could profoundly affect the functioning of the other market. Under these circumstances, it is essential that any emergency action taken by either market with respect to these products be coordinated in some fashion. The Commission's ability to play an important role in facilitating such coordination may be thwarted if Eurex Frankfurt were pulling the strings. Therefore, Eurex US cannot meet Core Principle 6 unless it has adopted procedures for the exercise of emergency authority independent of any control by Eurex Frankfurt.

VII. Clearing – Designation Criterion 5 (Financial Integrity of Transactions); Core Principle 11 (Financial Integrity of Contracts)

A. Introduction

The limited portions of the Eurex US application that have been made public describe a proposed U.S. exchange that is a subsidiary of a holding company, which is a subsidiary of Eurex Frankfurt, for which trades will be cleared by CC, and for which regulatory services will be performed by the NFA. It has also been represented that market supervision will be conducted by Eurex pursuant to a general services agreement.

The press releases, presentations to firms, and other public statements by Eurex US and Eurex Frankfurt officials paint a far different picture. What emerges from these representations is a proposed U.S. exchange that ultimately will function as nothing more than a "branch office" of Eurex Frankfurt, and a link between Eurex Clearing AG ("Eurex Clearing") and CC that will result in what is nothing more than one clearing organization operating in two locations. Despite regulatory and functional differences, Clearing Members of Eurex Frankfurt and Eurex US will be essentially interchangeable, there will be a single collateral pool and, for fungible products, there will be one pool of open interest and one daily settlement price.

Therefore, any analysis of whether and how Eurex US meets the CEA's Designation Criteria and Core Principles for contract markets must rest upon a full analysis of whether Eurex

Frankfurt meets those Designation Criteria and Core Principles, and particularly insofar as Eurex US trades may be cleared by Eurex Clearing, whether Eurex Clearing meets the Designation Criteria and Core Principles for a registered Derivatives Clearing Organization, and is required by the CEA to so register.

B. The relationship between Eurex US and CC has not yet been approved by CC shareholders

As a preliminary matter, although the Eurex US application repeatedly references its Clearing Services Agreement with CC, the proposed restructuring of CC whereby Eurex US's holding company would make a $15 million investment ("Stock Purchase Agreement"), and would have an option to purchase 51% of CC's common stock if there has already been a change of control of CC ("Stock Option Agreement"), is subject to a future shareholder vote, scheduled for October 23, 2003. The Proxy Statement distributed to CC shareholders (attached as Appendix C) indicates that even if the shareholders do not approve these transactions, CC will remain obligated to provide clearing services to Eurex US. However, given the uncertainty regarding shareholder approval, the Eurex US application should be treated as being premature.

C. Eurex US's proposal to provide 95% performance bond reductions on Treasury-GSD spreads will create serious risks for CC and its clearing members

Eurex US has publicly stated that it plans to provide 95% performance bond reductions on spreads between U.S. Treasury futures and German sovereign debt (GSD) futures. However, the price dynamics of these instruments are not highly enough correlated to warrant a 95% performance bond reduction on Treasury-GSD spreads.

Treasury-GSD correlations are too low and too variable to justify performance bond reductions. Before any contract market declares that any pair of futures contracts should enjoy performance bond reductions on spreads, the contract market and its clearing services provider must perform extensive statistical analysis. The first of several tests that the contract pair must pass is to demonstrate suitably high correlation. The CBOT, for example, requires as a general rule that the correlation of daily price changes in the two contracts must be at least 0.80 (on a scale of 0.00 to 1.00).

Although this standard varies from exchange to exchange, it is fair to assert that both Chicago Mercantile Exchange and the London Clearing House use broadly similar standards and procedures in making initial determinations of the appropriateness of performance bond reductions.

Applying this "0.8" criterion to spreads between CBOT Treasury futures and Eurex GSD futures, we can find no convincing basis for performance bond reductions. Specifically, we have examined the correlation of daily price changes in CBOT 10-Year Treasury Note (TY), 5-Year Treasury Note (FV), and 2-Year Treasury Note (TU) futures versus Eurex Bund, Bobl, and Schatz futures, respectively, over the interval from July 1, 2001 to June 30, 2003. For each contract pair – CBOT TY versus Eurex Bund, CBOT FV versus Eurex Bobl, and

CBOT TU versus Eurex Schatz – we have computed the Pearson correlation for the entire interval as well as Pearson correlations for all 3-month spans contained within it. The following table summarizes our results.

Correlation of CBOT Treasury Futures vs Eurex GSD Futures
July 1, 2001 to June 30, 2003

	2-Year Correlation	Minimum 3-Month Correlation	Maximum 3-Month Correlation
CBOT TY vs Eurex Bund	0.70	0.52	0.82
CBOT FV vs Eurex Bobl	0.70	0.52	0.85
CBOT TU vs Eurex Schatz	0.58	0.26	0.89

As the table's second column establishes, long-run (2-year) correlations for all contract pairs are quite low – certainly too low to warrant performance bond reductions.

And as the third and fourth columns reveal, the correlations between each of these contract pairs appear to be highly variable over short time intervals, making any consideration of performance bond reductions yet more questionable. An illustrative spreadsheet is attached as Appendix D.

A 95% performance bond reduction would be suspiciously high under any circumstance. At futures exchanges other than Eurex US, performance bond reductions, even where warranted, result in spread credits that rarely exceed 80%. Consider, e.g., the CBOT and Euronext.liffe:

> Of the 26 financial contract pairs for which the CBOT currently grants performance bond reductions, spread credits range from a low of 55% (for 4 contract pairs) to a high of 85% (for 3 contract pairs). The median spread credit is 70% (for 7 contract pairs).
>
> Likewise, of the 87 financial contract pairs for which London Clearing House currently grants performance bond reductions on behalf of Euronext.liffe, spread credits range from a low of 35% (for 1 contract pair) to a high of 90% (for 3 contract pairs). As with the CBOT, the median spread credit is 70% (which applies to 19 contract pairs).

It is fair to assert that the Chicago Mercantile Exchange grants performance bond reductions that are similarly conservative.

Against this backdrop, Eurex US's claim that Treasury-GSD spreads should enjoy performance bond reductions on the order of 95% appears unreasonable, and does not appear to represent sound clearing house risk management.

The practical implication of permitting overly generous performance bond reductions is obvious. It would confront Eurex US's clearing house with the chronic risk of being under-reserved. In the event of sharply adverse contract price movements; it would compel Eurex US's clearing house to make capital calls upon its members, in order to fulfill its guarantee with regard to contract integrity. In the worst of circumstances, it could undermine financial markets around the globe by precipitating a clearing house failure.

Making matters worse is that, by granting performance bond reductions that appear to market participants to be "something for nothing," Eurex US might induce them to enter into Treasury-GSD spread trades to a greater extent than they otherwise would. If so, then this would amplify the extent to which Eurex US's clearing house would be under-reserved against the derivative contract exposure that it purports to guarantee.

D. The proposed Clearing Link raises numerous issues

The portion of the Eurex US application for contract market designation that has been made publicly available simply states that CC will provide settlement and clearing services for Eurex US. This statement in itself appears straightforward. However, it is incomplete. There are many unanswered questions raised by other public representations made by Eurex US in the context of a press conference, press releases, presentations to clearing members, and other public statements. See Press Conference ("Eurex US – New Opportunities for Derivatives Trading and Clearing" – 9/16/03) (Appendix E), Press Releases ("Eurex US to launch on February 1, 2004" – 9/16/03 and "Partnership Deal signed between The Clearing Corporation and Eurex"– 9/4/03) (Appendix F), Member Information Presentation ("Eurex's New US Exchange and Global Clearing Solution – Transatlantic Access to the World's Most Liquid Derivatives" – July 2003 (Appendix G), and Eurex US presentation materials entitled "Eurex US Global Access to the World's Benchmark Derivatives" – September 2003 (Appendix H).

These other representations indicate that Eurex Frankfurt and Eurex US intend to develop a "transatlantic marketplace" through a "global clearing solution" involving both Eurex Clearing and CC. Pursuant to this Clearing Link, Eurex Frankfurt and Eurex US would offer fungible Euro-denominated products. However, with respect to all products offered by Eurex US, the arrangement would apparently at least permit members of Eurex US or Eurex Frankfurt to choose to clear their respective Eurex US or Eurex Frankfurt trades either at CC through a Clearing Member of CC or at Eurex Clearing through a Clearing Member of Eurex Clearing.

Based on the public portions of the application, Eurex US has only told a half-truth by representing that its trades will be cleared by CC. It has stated in its Responses to the CFTC Technical Questionnaire (Exhibit 13) document that Eurex Clearing will be used "to assist the U.S. Derivatives Clearing Organization in its assignment and issuance of instructions for the delivery of European instruments." (page 15). However, this is a far cry from revealing that its business goal is to provide a mechanism whereby contracts traded on Eurex US may be cleared in Germany by Eurex Frankfurt Clearing Members.

CC's Proxy Statement reveals that CC and Eurex Clearing are currently negotiating the terms of the Clearing Link Agreement, and that it will allow all contracts traded on Eurex US, and contracts that are traded on Eurex Frankfurt if they are also listed on Eurex US, to be cleared either through CC or Eurex Clearing. Moreover, CC's Proxy Statement indicates that the parties have agreed to use reasonable best efforts to execute the Link Agreement prior to October 15, 2003; thus, there is no reason why the Eurex US application should not include this information.

CC's Proxy Statement acknowledges that the Clearing Link may require CFTC approval. Therefore, it appears that Eurex US is attempting to first obtain Commission approval for a designated contract market on the assumption that all trades will be cleared by CC, while anticipating seeking a second approval for the Clearing Link, if necessary. However, since all of Eurex US's public pronouncements are based on an assumption that there will be a Clearing Link, approval of Eurex US as a designated contract market should not be based on the untrue assertion that all trades may only be cleared through CC. Since the Clearing Link appears to be an essential element of Eurex US's business plan, the Commission should not be asked to waste its resources reviewing a DCM application that does not include consideration of the Clearing Link, based on a full explanation of the details of that Link. On this basis, Eurex US's application for registration as a designated contract market is premature and disingenuous, and should not be considered until Eurex US submits a finalized Clearing Link Agreement to the Commission.

If the Commission were nevertheless to designate Eurex US as a contract market based on the current application, it should make it absolutely clear that any change in the nature of Eurex US's clearing arrangements, like the establishment of an international Clearing Link, would require approval by the Commission, and may not be implemented by certified rules.

Since Eurex US's and CC's public statements make it clear that Eurex US's application cannot be fully analyzed without consideration of the Clearing Link, this letter addresses some of the issues raised by Eurex US's public representations and CC's Proxy Statement.

Designation Criterion 5 and Core Principle 11 both require that the transactions executed on a designated contract market must be cleared and settled through a registered derivatives clearing organization. Since the Clearing Link anticipates that trades executed on Eurex US may be cleared at Eurex Clearing by a Eurex Frankfurt Clearing Member, in the absence of the registration of Eurex Clearing as a derivatives clearing organization, Eurex US would be unable to satisfy these requirements.

In particular, Eurex US trades cleared by Eurex Clearing may be subject to German law and regulatory procedures with regard to risk management, collateral management, and default procedures, as well as German bankruptcy law. Before Eurex US could possibly be designated as a U.S. contract market, the Commission would need to make an independent determination that given these differences in the legal and regulatory environment, Eurex Clearing would nevertheless be able to meet the same Core Principles that apply to a U.S. registered derivatives clearing organization.

Specifically, the Commission would need to examine whether bankruptcy protections equivalent to those in the U.S. would be available to U.S. customers, clearing through a dual Clearing Member of both clearinghouses, whose funds might be on deposit with Eurex Clearing to margin Eurex U.S. trades. Differing international bankruptcy laws can present thorny issues leading to contentious litigation, as was evidenced in connection with the bankruptcy of Griffin Trading Company, where there were competing claims of U.S. and U.K. customers and a Eurex Clearing Member.

The public representations made by Eurex US about the proposed Clearing Link raise questions which must be answered before the Commission will be able to determine whether various aspects of that Link meet the requirements of the CEA and Commission Regulations. For example:

- Eurex US has represented that CC and Eurex Clearing will "mirror" each other's Clearing Members and Trading Members in order to support risk management, exercise and assignment notification and allocation processing, delivery processing, and cash management. What does this mean and how will it operate? Where are the respective liabilities? Whose legal framework will govern each of these processes?

- Eurex US has described a process whereby a member executing a trade on Eurex US chooses to have that transaction cleared by a Eurex Frankfurt Clearing Member through Eurex Clearing. The process appears to involve a Give-Up/Take-Up procedure as well as the designation of Eurex Clearing as a Special Clearing Member of CC and of CC as a Special Clearing Member of Eurex Clearing. The technical details of the procedure are unclear, as are the legal obligations of CC and/or Eurex Clearing, and their respective Clearing Members, at the various stages of the process.

- Eurex US has represented that trades executed on Eurex US cleared by Eurex Clearing are technically imported into the Eurex Clearing system on the next morning. Furthermore, based on the trading hour differences and batch processing cycles, give up trades executed on Eurex US after 11:00 a.m. on Fridays will not be able to be given up to a Eurex Clearing Member until the following Monday. Assuming this risk overnight, or over the weekend, or longer if Monday is a holiday, may result in an exposure that CC clearing firms are unable to absorb. The consequences could result in a major default that poses systemic risk to the entire marketplace.

- What are the full implications of Eurex US's representations that fungible products traded on both exchanges will utilize a single open interest pool and a single collateral pool, particularly with regard to margin payments, settlements, and custody of funds?

- Eurex U.S. has represented that Eurex Clearing will perform delivery and cash management for CC and its clearing members for euro-denominated products, and CC will perform delivery and cash management for Eurex Clearing and its clearing members for dollar-denominated products. Who will be responsible for the proper

performance of, and the financial liability arising from, these functions at each stage in the process?

- CC's Proxy Statement indicates that euro-denominated contracts traded on Eurex US, that are fungible with such products traded on Eurex Frankfurt, will when cleared by CC, have variation margin payments and collection, final settlements, deliveries and option exercises effected in a manner consistent with Eurex Frankfurt and Eurex Clearing rules. What are these rules, and to what extent if any, do they conflict with U.S. requirements? Does this mean that Eurex Clearing rules apply with respect to deliveries of fungible euro-denominated products, regardless of where either party executed his transaction or cleared his transaction? Could an individual who purchased such a product and cleared it through CC, potentially receive a delivery from an individual who sold the product on Eurex Frankfurt and cleared it through Eurex Clearing? What issues and conflicts might arise in this scenario?

The answers to these questions, as well as other similar questions, will impact the Commission's analysis regarding whether or not Eurex U.S. will comply with multiple Designation Criteria and Core Principles for contract markets, in addition to the requirement that its trades be cleared through a registered derivatives clearing organization. In short, it is absolutely critical that the Commission be fully informed (as well as the public in order to provide meaningful comment) regarding the specific details of the Clearing Link in order to be able to assess Eurex US's application for contract market designation.

E. Regulatory arbitrage should not be permitted

The Commission should not permit any exchange to be designated as a U.S. contract market where that market offers its participants an opportunity to escape Commission jurisdiction or the application of U.S. law by choosing to clear their U.S. trades through a foreign clearing member on a foreign clearing organization. In its Member Information Presentation materials (Appendix G), Eurex US has also described its "global clearing solution" as a "single point of clearing – global trading via a local clearing interface", which provides the financial community with a choice of jurisdiction and a choice of rules and standards. It is absolutely clear from Eurex US's coupling of a choice of jurisdiction and a choice of rules and standards with a choice of clearing provider that it anticipates, and indeed could be seen as encouraging, regulatory arbitrage. Under the Eurex model, Eurex US cannot demonstrate compliance with the relevant Designation Criteria and Core Principles for contract markets, unless it can show that Eurex Clearing will offer Eurex US market participants the same regulatory protections as those afforded by US registered derivatives clearing organizations.

F. The linking of CC and Eurex Clearing may present a number of financial risk factors to Eurex US customers

A number of issues that will ultimately affect customers of Eurex US may arise from the fact that Eurex Clearing and CC operate under different laws and regulatory schemes with regard to risk management requirements and procedures, segregation requirements, and financial oversight. For example, which country's laws would apply, and how would differences be reconciled, in the event of the bankruptcy of a U.S. domiciled Clearing Member of both

Eurex Frankfurt and Eurex US, clearing Eurex US trades on Eurex Clearing on behalf of U.S. customers? What would be the applicable priorities with respect to such customers' funds margining positions at Eurex Clearing? How would Eurex Clearing handle the default of such a joint Clearing Member, where there is a shortfall in funds owed to Eurex Clearing, either with respect to proprietary positions or customer positions? What are the implications of differing segregation requirements? It was less than five years ago that some of these issues arose in the context of the bankruptcy of Griffin Trading Company, a CBOT member firm, with a U.K. branch office, whose U.S. and U.K. customers had funds on deposit with Eurex Clearing**.** Furthermore, there may be additional risks imposed upon CC and its Clearing Members should CC clear trades executed on Eurex Frankfurt by foreign customers. These risks could ultimately hurt Eurex US customers who choose to clear their trades through CC Clearing Members.

Segregation of customer funds is one of major elements of the U.S. approach to commodity futures regulation and the protection of customers. There are substantial questions regarding whether U.S. segregation requirements will be met in connection with the implementation of the Clearing Link at each stage, and location, of the process. For example, Eurex Clearing has proposed to provide cash and delivery management services for euro-denominated products traded on Eurex US and cleared by CC Clearing Members. Will U.S. segregation requirements be met in this context?

The Clearing Link clearly will subject each of the linked clearinghouses, and the exchanges' customers, to the risks posed by each other's clearing members. Moreover, it appears that Eurex Clearing itself will be a counterparty to CC, and vice versa, in connection with such trades. Therefore, CC and its Clearing Members will be subject to the risk of a default by Eurex Clearing for any reason.

CC's Proxy Statement indicates that under CC's restructuring proposal, it will back Eurex US trades through a guaranty fund, rather than through stock owned by clearing members. However, if the composition of the clearing membership remains the same, the size of the proposed guarantee fund would be far smaller than the value of the CC stock currently owned by CC's clearing members. In particular, CC represents that the minimum required guaranty fund deposit for current clearing members will be $75,000 for sole proprietor clearing members and $200,000 for corporations, partnerships, limited liability companies and other legal entities. Based on CC's minimum requirements for the purchase of shares which now back its obligations[10], at the unaudited book value of CC shares at August 31, 2003, of $16,628 per share, the minimum investment by Sole Proprietors is currently $166,280, while that of FCM corporations is currently $498,840. It should also be noted that since Eurex US will not require members to purchase seats, CC will no longer have pledged seats as a back-up resource in the event of a clearing member default. At the same time that CC will have reduced resources to support its clearing guarantee, the risks to its clearing members may be significantly increased as a result of its clearing not only Eurex US trades, but also Eurex Frankfurt trades under the Clearing Link.

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[10] Currently, CC requires that shares be purchased as follows: Sole Proprietors – 10 shares; FCM and Non-FCM partnerships - 20 shares; Non-FCM corporations - 25 shares; and FCM corporations – 30 shares.

It is also significant to note that CC's Question and Answer document accompanying its Proxy Statement indicates that CC will not buy back any more of its stock after its proposed share repurchase plan and corporate realignment are completed. After that time, clearing members wishing to sell additional CC stock must find a willing buyer, and Eurex will not be permitted to purchase any more stock during the first year after it makes its investment (unless its stock option becomes executable).

In addition, there will not be a public market for CC stock, and it cannot be sold unless it becomes registered with the SEC or qualifies for a registration exemption. In fact, the Proxy Statement states that the CC stock that clearing members retain "will have limited or no liquidity." (page 13). Given the above, CCs stock will no longer be able to be considered to be "readily marketable" under the terms of the Commission's Division of Trading and Markets' July 17, 1995 no-action letter addressed to CC. ("No action position concerning the treatment of clearing corporation stock for purposes of computing adjusted net capital under regulation 1.17")(Appendix I). Therefore, if and when the proposed CC realignment is completed, any CC stock that FCM clearing members retain will not be able to be classified as a "current asset" for purposes of determining their compliance with minimum capital requirements.

G. The proposed Clearing Link presents opportunities for money laundering

Insofar as the Clearing Link would provide the opportunity for positions in fungible products to be initiated on Eurex Deutschland and offset on Eurex US, i.e., position-switching between Eurex Clearing and CC, there is an opportunity for money laundering. For example, suppose illicitly-obtained money is generated in Russia; the funds are used to open a futures account that trades euro-denominated products on Eurex Deutschland; the position is then transferred to CC and liquidated on Eurex US; and the money has been laundered and is in the U.S. Therefore, it is important that the Commission obtain appropriate assurances that the German authorities will utilize effective tools for detecting and prosecuting any such activity that originates in Germany, and that they will cooperate with the U.S. authorities in an effort to prevent the possible use of Eurex Deutschland and Eurex US for money laundering purposes.

VIII. Membership - Core Principle 14 (Governance Fitness Standards)

Core Principle 14 requires that a board of trade establish and enforce appropriate fitness standards for members of the contract market, and other persons with direct access to the facility. Eurex US's membership applications are based upon the applicants' declarations of compliance with Eurex US's stated qualifications for membership. Although Rule 303(c) indicates that applicants may be investigated, there is no consent or other acknowledgement regarding such possible investigation on the membership applications. Furthermore, although Rule 303 and the membership applications generically refer to required "documents", there is no identification of such documents, nor any explicit reference to any requirement that an entity seeking admission must file any type of financial statement. However, Eurex US's Member Information Presentation materials (Appendix G) indicated that an entity applying for membership would be required to file an unaudited financial statement " . . . unless the applicant is supervised by an appropriate regulatory body." It is

unclear what Eurex US would consider to be an appropriate regulatory body. Does it mean any Commission registrant, or does it mean any bank or any insurance company?

The fact that an entity has a financial regulator does not necessarily mean that the entity is in compliance with that regulator's requirements. Moreover, it is highly unlikely that a regulatory body would provide a written confirmation (as referenced in the Member Information Presentation materials) that an applicant meets its financial requirements. The Commission's Part 38, Appendix B guidance regarding compliance with Core Principle 14 states that a contract market should have standards for the collection and verification of information supporting compliance with its membership fitness standards. Therefore, if an applicant entity is required to have "adequate financial resources" as stated in Rule 302(a)(iv), it appears to be incumbent upon Eurex US to obtain some specific information to verify the existence of such resources. Eurex US's Membership Agreement form authorizes it to obtain reports concerning the member's financial condition, in its sole discretion, but there does not appear to be any requirement that it do so.

Although Eurex US has publicly represented that it will not impose any membership fees (Appendix F), its rules are inconsistent with this representation. Eurex US Rule 303(a) requires that a membership applicant must pay application fees. In addition, Rule 306 permits Eurex US, in its discretion, to impose fees, charges and assessments upon Members, without specifying any limitations. (Cf. CBOT Rule 240.00, which only permits assessments if necessary to meet operating deficits and capital expenditures). Therefore, although Eurex US has made much of the fact that it will not require that members purchase seats, it has reserved to itself in Rule 306 the power to impose any fees it wishes.

IX. Products – Core Principle 3 (Contracts Not Readily Subject to Manipulation); Core Principle 7 (Availability of General Information)

The Eurex US application is incomplete and unable to demonstrate compliance with Core Principles 3 (Contracts Not Readily Subject to Manipulation) and 7 (Availability of General Information) because the specifications of the contracts it intends to offer for trading have been omitted from its application.

Core Principle 7 requires a board of trade to make information available to the public, concerning among other things, the terms and conditions of its contracts. The application does not include the specifications of the contracts that Eurex US intends to offer for trading. Eurex US represents that those specifications "will be posted on [its] website," but this assurance cannot substitute for Eurex US's obligation to demonstrate to the Commission that the public has access to those specifications. Furthermore, in the absence of those specifications, it is also not possible for Eurex US to demonstrate its compliance with Core Principle 3 ("The board of trade shall list on the contract market only contracts that are not readily susceptible to manipulation.").

The application states that Eurex US will certify that the contracts to be traded on its trading system comply with the CEA and Commission regulations. Commission Regulation 40.2 permits a "registered entity" to self-certify a new product. Therefore, it is clear that the self-certification process is not available until the designation order is issued. However, an

applicant for contract market designation cannot be permitted to evade the "demonstration" requirement by concealing the contract specifications until a designation order is issued, especially where, as here, Eurex US has already identified by name sixteen specific products that it intends to offer, in its proposed Rules 408(b)(ii) and 415(f).

Since a version of each of these products is currently offered for trading at either the CBOT or at Eurex Deutschland, the Commission has a legitimate interest under Core Principle 3 in the manner in which the contract specifications differ from the existing products, whether those differences create opportunities for market participants to engage in manipulative behavior, and what plans Eurex US has for thwarting such potential manipulative behavior, and for coordinating surveillance activities.

X. Market Surveillance - Designation Criterion 2 (Prevention of Market Manipulation); Core Principle 4 (Monitoring of Trading); Core Principle 5 (Position Limitations or Accountability)

A. Statutory requirements

Designation Criterion 2 requires a contract market to have the capacity to prevent market manipulation through market surveillance, compliance, and enforcement practices and procedures. Core Principle 4 more specifically requires that a contract market monitor trading to prevent price distortion, and disruptions of the delivery or cash-settlement process, in addition to manipulation.

The Commission's Core Principle guidance, contained in Appendix B to Part 38 of the Commission's regulations, identifies certain acceptable practices for monitoring trading. These include the collection and ongoing evaluation of market data, including information on traders' market activity, in order to make an appropriate regulatory response to potential market disruptions or abusive practices, as well as the collection of fundamental data about the underlying commodities, their supply and demand, and their movement through marketing channels, in order to assess whether market prices are responding to the forces of supply and demand. With regard to the latter, the Commission noted that it is important to analyze data regarding the availability and pricing of the underlying commodities, as well as monitoring the continued suitability of the methodology for deriving indices to which the markets are settled.

B. Who will perform market surveillance

Eurex US has represented that NFA will perform surveillance for market manipulation, price distortions or market congestion.[11] In order to perform this function, the NFA will need to

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[11] Actually, we understand that NFA has not yet agreed to undertake any self-regulatory programs for Eurex US. In that regard, Eurex US's application is premature. It is odd that the Commission would have accepted the Eurex US application as complete when it is premised in large part on a self-regulatory agreement that is merely proposed at this time. The Commission, and the public commenting on the application, are entitled to rely upon only final agreements, not a draft. The Commission should not continue to consider Eurex US's

ensure that its staff includes economists who understand the cash markets and are familiar with cash market participants for all of the products that Eurex US intends to offer for trading, and who will also have the ability to monitor futures trading in those products.

It is also clear that it will be necessary to coordinate surveillance of the trading on Eurex Deutschland with that of the trading on Eurex US, in order to assess any potential manipulative activity involving fungible euro-denominated products, whether or not the Clearing Link is approved and implemented. Coordinated surveillance of the trading on Eurex US and the trading on Eurex Deutschland will become even more vital if the Clearing Link is established, with its single open interest pool and one settlement price per day that is determined by Eurex Clearing.

Perhaps the more basic question that needs to be asked is whose products are such fungible euro-denominated contracts? If they are traded on Eurex Deutschland do they belong to Eurex Deutschland, and if they are traded on Eurex US do they belong to Eurex US, or will Eurex Frankfurt treat them as being Eurex Deutschland's products regardless of the market on which they are traded? If the latter, to what extent will Eurex Frankfurt or Eurex Deutschland conduct their own market surveillance with respect to trading of such products on both Eurex Frankfurt and Eurex US? And to the extent that Eurex Deutschland and Eurex US form "one market" should Eurex Deutschland also be required to be designated as a contract market? All of these issues must be addressed before the Commission will be able to determine whether Eurex US meets the relevant Core Principles.

C. Large trader reporting

Effective market surveillance depends, among other things, upon timely and accurate large trader reporting and the ability to effectively aggregate accounts under common ownership or control. Trades on Eurex US will presumably be subject to CFTC reporting standards with respect to large trader reporting, though its rules fail to specifically address this topic other than to mention generic reporting requirements. Therefore, it is unclear to what extent Eurex US will require that large trader reports be filed with the exchange, or what provisions have been made for the submission and monitoring of large trader information. The determination regarding which market will be responsible for market surveillance when the same products are traded on Eurex Deutschland and Eurex US, and how surveillance will be coordinated, is crucial as it relates to the analysis of large trader positions. Whose reporting rules will apply and how will simultaneous positions on Eurex Deutschland and Eurex US be addressed?

If the Clearing Link is implemented, will the relevant compliance staff have systems and procedures in place to aggregate accounts under common ownership or control, especially in situations where a market participant may be trading on Eurex US alone or on both Eurex US and Eurex Deutschland, and clearing certain trades in Germany and other trades in the U.S. through different clearing members? Traditionally, exchanges look to the clearing members to acquire position and large trader information. However, in this structure, it is not clear as to what jurisdiction Eurex US will have with respect to Eurex Deutschland clearing members

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application until a final executed version of the agreement is submitted and then released for public scrutiny and comment.

or how easy it will be to acquire information. In this regard, will the proposed NFA agreement with Eurex US permit NFA to compel Eurex US members to provide information to it, or to disclose information to the CFTC, regardless of instructions from Eurex US?

D. Market supervision

Eurex US has represented in its application that it will conduct its own market supervision, which will include market supervision through a general services agreement with Eurex. The application also states that Eurex US will conduct real time surveillance using market supervision tools and procedures developed for the Eurex trade system and in connection with the a/c/e trading platform. These representations do not make it clear whether these market supervision functions will be conducted in the U.S. or in Frankfurt where Eurex already has a Market Supervision Control Center, which operates a number of markets.

As the Commission will remember, at the beginning of the a/c/e joint venture, market supervision for the CBOT a/c/e market was conducted in Germany by Eurex, and in May 2001, the CBOT moved its own market supervision (market operations) to Chicago. As it operated when Eurex performed market supervision for the CBOT, and as we understand it operates today, Eurex's market supervision is essentially a functional help desk, with hands on control over the trading system.

However, Eurex US's contract market designation application implies that the market supervision services agreement is an element of Eurex US's compliance with Designation Criteria and Core Principles relating to prevention of market manipulation, financial integrity of transactions, and monitoring of trading. Section 5c(b) of the CEA specifically provides that a contract market may only comply with Core Principles through a delegation agreement if the delegation has been made to a registered futures association or another *registered* entity. Therefore, Eurex US may not rely on Eurex Frankfurt (or its foreign owners or affiliates), for its compliance with any of the Designation Criteria or Core Principles, much less those relating to monitoring of trading and prevention of market manipulation, unless Eurex Frankfurt (or such other foreign entity) becomes a U.S. registered entity.

E. Eurex Deutschland has experienced a number of squeezes, corners and price manipulations

Eurex Frankfurt has experienced a number of squeezes, corners and price manipulations on its markets in recent years.[12] Therefore, even if the Commission were to permit Eurex US to

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12 Henry E. Teitelbaum, *Bobl Squeeze May Help Eurex Rivals,* WALL ST. J. EUR., April 9, 2001. *available at* 2001 WL-WSJE 2847115, Steve Zwick, *Eurex Bobl Gets Squeezed,* FUTURES MAGAZINE, May 1, 2001, at 14. *available at* 2001 WL 14984344, *Battle for a Benchmark: Swap Futures: A New Financial Instrument in London Aims to Get Even with Frankfurt,* THE ECONOMIST, June 16, 2001. *available at* 2001 WL 7319349, Lenny Jordan, *Dealers Claim the Eurex Rules Will Not Stop Squeeze,* THE FIN. NEWS, July 16, 2001. *available at* 2001 WL 12506854, Francis Maguire, *Bundesbank to Counter Bonds Exploiters,* THE FIN. NEWS, September 10, 2001. *available at* 2001 WL 12507672, Jim Kharouf, *Perils of Success*, FUTURES INDUSTRY MAG., Jan./Feb. 2002. *available at* http://www.futuresindustry.org/fimagazi-1929.asp?v=p&iss=121&a=751, Nicholas Lockley, *Deutsche Escapes Bond Market Squeeze with Reprimand,* EFINANCIAL NEWS, May 29, 2002. *available at* 2002 WL 19801765, Sophie Brodie, *Eurex Foils Attempted*

delegate any of its market surveillance functions to an unregistered entity, it should not be permitted to delegate such functions to Eurex Frankfurt. Moreover, insofar as Eurex US will have to coordinate surveillance efforts with Eurex Frankfurt with respect to identical products, whether or not they are fungible, the Commission will likely be required to play a key role (insofar as it can, given its jurisdictional limitations), in light of Eurex Frankfurt's apparent inability to prevent market manipulation.

Despite Eurex Frankfurt's failures, and the importance of preventing price manipulation under the CEA, Eurex US's application makes virtually no showing of its regulatory capacity to prevent manipulation. Other than the hollow assertion that its rules will prohibit manipulation and it will enforce its rules, Eurex US offers no documentation or evidence of its capacity to perform this vital function.

These omissions are particularly troubling given Eurex US's efforts to attract foreign traders and firms to use its markets. Increased participation by foreign market participants on Eurex US would inherently complicate market surveillance due to the Commission's and NFA's lack of direct access to those parties. Although market surveillance would be thus complicated for any electronic market with foreign participants, concerns with regard to Eurex US are heightened given the history of Eurex Frankfurt's difficulty preventing manipulation. Eurex US also may be conflicted in enforcing regulatory dictates against nationals from its parent's home market and may decide not to pursue vigorous self-regulation in order to assist those entities in their trading strategies. These factors all lead to special and well-grounded concerns about Eurex US's ability to prevent manipulation.

The CBOT has a unique concern about any Eurex US failure to prevent manipulation. While Eurex US's application withholds from the Commission the terms and conditions of the contracts Eurex US intends to trade, Eurex US has made no secret of its intention to trade U.S. Treasury Security contracts that would compete with the principal product complex offered by the CBOT. Any failure by Eurex US to prevent manipulation in those markets would likely have repercussions in the CBOT's markets, harming our market participants and reputation.

XI. Trading Procedures and Trade Practice Surveillance - Designation Criterion 3 (Fair and Equitable Trading); Core Principle 2 (Compliance with Rules); Core Principle 9 (Execution of Transactions); Core Principle 12 (Protection of Market Participants)

A. Trading Procedures

1. Transparency is the foundation of U.S. futures markets

Transparency is the essential foundation of customer protection and market integrity in U.S. designated contract markets. In a transparent market, potential participants come to a centralized pool of liquidity to assess the market and determine the best bid/offer, based on

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Market Squeeze, EFINANCIAL NEWS, October 24, 2002. *available at* 2002 WL 100604009. These articles are attached in Appendix J.

the same information that is available to everyone. All bids and offers, orders, and trades are easily understood, readily detected and openly accessible to all market participants. Price discovery is faster, clearer and more efficient because of transparency. Fairness is the end result, and a transparent market serves the best interests of customers. Payment for order flow, which is roiling the U.S. securities industry and European markets, the call-around market that is prevalent in Europe, and unregulated pre-execution discussions are the antithesis of transparency.

Although Designation Criterion 3 permits a contract market to adopt rules permitting non-competitive transactions such as block trades, EFPs and EFSs, the overriding requirement is that rules must be established and enforced to ensure fair and equitable trading. Similarly, Core Principle 9 requires a contract market to provide a competitive and open market. The Commission's Guidance regarding compliance with Core Principle 9, in Appendix B to Part 38, specifically states that a contract market that allows block trading should ensure that such trading does not operate in a manner that compromises the integrity of prices or price discovery for the relevant products. Commission Regulation 1.38 requires that futures and options trading generally must be executed openly and competitively, subject to limited exceptions. Finally, the Commission has stated that alternative execution procedures only comply with the Act's open and competitive execution requirement when they complement and generally preserve the competitive forces available on a centralized market. See "Alternative Executive, or Block Trading, Procedures for the Futures Industry," [1998-1999 Transfer Binder] Comm. Fut. L. Rep. (CCH) ¶27,656, at 48,121 (CFTC Advisory, June 10, 1999). Therefore, the Act and the Commission's Regulations, including the Designation Criteria and Core Principles, all rest upon the basic assumption and the requirement that alternative execution procedures will be the exception, and not the rule. In other words, the U.S. regulatory model for commodity futures and options trading strongly favors transparency.

2. Eurex US is likely to primarily rely upon the same "call-around" market model for its futures options that exists at Eurex Deutschland

Eurex US's rules provide for alternative execution facilities outside the exchange's primary trading system, including Rule 415 (Block Trade Facility), Rule 416 (Basis Trading Facility - Exchange of Futures for Physicals (EFPs)), Rule 417 (Exchange of Futures for Swaps (EFSs) Facility), and Rule 418 (Volatility (Vola) Trading Facility – Exchange of Futures for Options). With the exception of Vola trades, the CBOT, and other U.S. markets, also allow these types of transactions. However, in all existing designated contract markets, the volume of such trades is a very small percentage of their overall volume.

By comparison, at least with respect to futures options trading, Eurex Deutschland relies *primarily* on a "call-around" market, resulting in "OTC" trading of a vast majority of such options transactions, though the exchange's alternative execution facilities.[13] Therefore,

[13] Of course it is possible that some transactions that result from the "call-around" procedure may be executed through the central order book in the primary trading system. However, it is logical to assume that a far greater percentage are executed through the alternative execution facilities where crosses at the agreed-upon prices are assured.

Eurex Deutschland's options markets are quite different from the transparent options markets that have historically protected U.S. market participants.

More specifically, those transactions that are executed through the alternative execution facilities (OTC transactions) are the primary driving force behind options volume on Eurex Deutschland as highlighted below:

Volume figures for 2003 (January-August)

Euro Schatz:	Futures 77,637,697 (Basis Trades 1,797,378, 2.3%) Options 8,766,545 (OTC 8,561,349, **97.7%)**
Euro Bobl:	Futures 102,006,518 (Basis Trades 4,363,548, 4.2%) Options 6,869,541 (OTC 6,594,179, **96%)**
Euro Bund:	Futures 169,704,106 (Basis Trades 6,746,675, 3.98%) Options 20,163,112 (OTC 16,898,721, **83.8%)**

(Source: Eurex August 2003 Monthly Statistics)

Although, the stated objective of Eurex US is to provide a democratic, open market model and a level playing field for all market participants, it is likely that its options markets will be operated in the same manner as Eurex Deutschland, its affiliate exchange, with which it shares a common parent, Eurex Frankfurt. Designating a U.S. contract market that will rely primarily on such a "call-around" model would reduce transparency, and pave the way to institutionalizing internalization and payment for order flow in the U.S. futures options industry.

3. Eurex US's block trading rule does not conform to the "fair and reasonable" pricing standard

The pricing of Eurex US's proposed block trading procedures raises serious issues. Eurex US Rule 415, governing block trades, does not conform to the "fair and reasonable" pricing standard of other approved block trading rules.[14] Instead, the rule only requires that the futures price be within the contract's daily high/low – a range determined over a 20-hour trading day. This standard could promote extreme pricing of blocks toward the end of the trading day. Such a subjective standard that is not circumscribed by relation to the market price or a requirement to first expose the block via an RFQ clearly creates the potential for significant mispricing and, consequently, for numerous regulatory concerns. ranging from frontrunning and manipulation to outright fraud. Significantly, the rule does not appear to

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[14] This standard generally requires that the price of block trades be fair and reasonable in light of the size of the trade, the price and size of other trades in the same contract at the relevant time, and the price and size of trades in underlying cash markets or other related futures markets, at the relevant time.

establish any pricing standard with respect to option blocks, which creates even greater opportunities for market abuses. [15]

4. Eurex US's EFP and EFS rules would permit disorderly contract expirations

Eurex US Rule 416 and 417 governing EFPs and EFSs respectively, present the potential for disorderly contract expirations. While the proposed EFP rule appropriately limits the time period within which such transactions may be executed prior to expiration, the proposed EFS rule does not specify the latest dates on which an EFS may be executed. With respect to both EFPs and EFSs, there are no stated requirements that transactions may only be liquidating during the last two eligible days for such transactions. Cf. CBOT Regulations 1809.02, 2309.02, 2409.02, and 2509.02. The lack of such requirements would permit disorderly contract expirations and threaten market integrity.

5. Vola trades

Rule 418, Volatility Trading Facility, provides for the exchange of futures for exchange-traded or OTC options on a delta neutral (within 10%) basis. This rule allows for the ex-pit execution of volatility trades, essentially a block trade, but without any identified minimum size parameters or stated requirements regarding how soon after execution the transaction must be entered into the Vola Trading Facility. Rule 418 (c) requires that a member receive written acknowledgment from its Clearing Member that the Clearing Member will present the futures portion of the Member's Vola trades for clearing to the Clearing Organization. Again, no mention is made regarding such an acknowledgement with respect to exchange-traded options. Because the same omission was made from Rule 415 (c), as discussed above, the question arises as to whether this was intentional.

6. Order Types

Eurex US's Responses to the CFTC Technical Questionnaire (Exhibit 13) states that orders must be identified upon entry as either orders as principal or on behalf of customer accounts. Identifying orders only as falling within one of these two categories does not appear to comply with Core Principle 10 (Trade Information). Specifically, that Core Principle requires a board of trade to:

> maintain rules and procedures to provide for the recording and safe storage of all identifying trade information in a manner that enables the contract market to use the information for purposes of assisting in the prevention of customer and market abuses and providing evidence of any violations of the rules of the contract market.

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[15] It should also be noted that Rule 415(c) requires that a Member receive written acknowledgement from its Clearing Member that the Clearing Member will present the *futures portion* of the Member's block trades for clearing to the Clearing Organization. It does not require any such acknowledgement regarding permitted options transactions. However, this may have been inadvertent, in light of the fact that Rule 415(i) provides for the reporting of block transactions without distinguishing between futures and options.

The Commission's Part 38, Appendix B guidance regarding Core Principle 10 indicates that an acceptable audit trail should include an electronic transaction history that includes, among other things,

> the categories of participants for which such trades are executed, including whether the person executing a trade was executing it for his/her own account or an account for which he/she has discretion, his/her clearing member's house account, the account of another member, . . . or the account of any other customer.

Since the Commission has identified four categories of orders ("CTI codes") that should be distinguished, Eurex US's plan to categorize orders in only two groups, i.e., principal and customer, does not meet Core Principle 10. This is not just a technical requirement. The appropriate identification of orders directly relates to the usefulness of the audit trail as a tool for identifying trading abuses.

7. Cross Trades and Pre-arranged Trades

Eurex US Rule 406 (Cross Trades and Pre-arranged Trades) allows for the pre-arrangement of trades and trading against customer orders provided that the customer has given consent (including blanket consent) provided that the initial order is exposed for 5 seconds in the case of futures or 15 seconds in the case of options. Importantly, this rule does not require that the customer order be entered first nor does it require that the marketplace be notified of the intent to cross. Further, the rule imposes no obligation to enter the second order and thus allows the market to be gamed to the advantage of the member and to the disadvantage of the customer and other market participants. Consequently, this permitted method of trading simply promotes the internalization of order flow and/or the prearrangement of executions with parties willing to pay for the order flow.

B. Eurex US's "Top Ten" marketing plan will encourage payment for order flow and noncompetitive trading

Although not disclosed in its contract market application, Eurex US has embarked on a precedent-shattering and dangerous financial plan to pay for market share at all costs. Under the seemingly innocuous title of "revenue rebates," Eurex US intends to hold a Survivor-like contest for traders and brokers on its exchange. According to a Eurex presentation (Appendix H, pg. 10) the scheme would work as follows.

In its first year of operation (2004), Eurex US would, on a monthly basis, pay the top ten traders and brokers in U.S. Treasury Security derivatives traded on its exchange. Eurex US would make these payments from a pool of its trading revenue fees from all executed trades (apparently in U.S. Treasury Security derivatives) and then split 50% of that pool among the monthly top ten winners in each category in proportion to their trading volume. The plan creates significant financial incentives for traders and brokers to use the Eurex US market in 2004 in order to qualify to be on the Top Ten list. The 2004 Top Ten traders and brokers would continue to receive payments in 2005 as well. For that year, they would share 25% of the Eurex US fee revenues based on the relative standing of each trader or broker in the 2004 Top Ten list. The amounts of these payments to the contest winners are expected to be

significant -- Eurex U.S. projects a range in 2005 from $8-11 million to $30-40 million in potential pay-out to the Top Ten traders and brokers.

What is wrong with this? Plenty. History has shown, including recent Commission experience with energy trading, that wash sales and noncompetitive trading flow out of volume based incentives. Traders who are trying to earn top ten status will have a significant incentive to create fictitious and other forms of illegal trades. Even more pernicious, brokerage firms will have an incentive to place customer business on Eurex US rather than other Treasury Security markets, like the CBOT, even when Eurex does not offer the best market, in terms of price, liquidity and transparency, for the customer. The Eurex US Top Ten Contest therefore encourages brokers to violate their customers' trust in order to win big money.

The Commission should not tolerate this erosion of basic customer and market protections. Eurex US is attempting to buy volume and market share by paying market participants at the expense of public interests that have long been considered to be fundamental to U.S. futures markets. It is willing to forego revenue for a couple of years in order to crowd all other markets out and assume, as Appendix H, pg. 10 suggests, a 100 percent market share. That conduct is predatory and wrong and should be prohibited by the Commission.

C. Trade Practice Surveillance

Eurex US has indicated that NFA will perform its trade practice surveillance functions. The Commission's Guidance regarding compliance with Core Principle 2, in Appendix B to Part 38 of the Commission's regulations, states that if a contract market delegates the responsibility for trade practice surveillance to a third party, the third party should have the capacity and authority to collect information and documents and to examine the books and records kept by members. The Commission further stated that an acceptable trade practice surveillance program should include routine electronic analysis of trading data. If Eurex US intends to provide a platform for trading euro-denominated products that are fungible with products traded on Eurex Deutschland, and contracts in such products are opened on one Eurex platform and offset on the other, Eurex US cannot comply with this Core Principle through a delegation agreement with NFA, unless the NFA will have the ability to conduct timely electronic analysis of Eurex Deutschland trading data. In addition, in these instances, NFA must have the ability to access documents and records relating to relevant trades executed on Eurex Deutschland. In addition, if trades executed on Eurex US are cleared at Eurex Clearing, NFA would have to be able to obtain information and documents from Eurex Clearing and Eurex Clearing Members. No basis exists for NFA's jurisdiction over such activities.

For each of Eurex US's proposed alternative execution facilities, there is a provision in the relevant Eurex U.S. rule stating that Members must maintain full and complete records, and that on the request of an employee of the exchange's Market Supervision or Compliance Departments, they must produce satisfactory evidence that the transaction was arranged in accordance with the rules. Clearly, as part of Eurex US's trade practice surveillance responsibilities, it must arrange for the review of at least a sufficient sampling of the block trades, EFPs, EFSs and Vola trades effected through its facilities, including a review of cash

documentation and master swap agreements where applicable, to ascertain compliance. It is unclear whether the Market Supervision staff or NFA will be responsible for these reviews.

If Eurex US has delegated this particular function to NFA, NFA will need to significantly expand its resources, especially given the fact that these alternative execution facilities are expected to account for a large proportion of Eurex US's option trades. In this regard, the Commission's Division of Market Oversight ("DMO") recently completed a Rule Enforcement Review of the BrokerTec Futures Exchange's ("BTEX") regulatory programs, which are carried out by the NFA. While the DMO concluded that BTEX maintained an adequate trade practice surveillance program, it noted that NFA opened only 11 inquiries and three investigations during the target period, the first year of BTEX's operation. Only one of the inquiries resulted in a reminder letter, and all three investigations were closed after no violations were found. BTEX's annual volume for 2002 was 2,109,670 contracts. By comparison, Eurex traded over 800 million contracts in 2002. Although no one knows how well Eurex US will fare, its own expectations are that it will have vastly more volume than BTEX had last year. Therefore, the staffing and systems required to adequately conduct all of Eurex US's regulatory programs would be expected to be exponentially greater than what was necessary to conduct such programs for BTEX and the other small exchanges for which NFA currently performs similar services.

In the BTEX review, the DMO specifically found that BTEX, through NFA, did not review an adequate number of block trades or EFPs to ensure compliance with the relevant BTEX rules. Specifically, NFA only conducted one EFP inquiry and one block trade inquiry, as well as one block trade investigation that resulted from a DMO referral, during the one-year period, and did not select any block trades or EFPs on a random basis for review. Clearly, with such transactions expected to constitute a significant portion of Eurex US's volume, NFA will need to have the resources to effectively review an adequate number of these transactions, selected on a random basis.

XII. Financial Rules and Financial Surveillance (Designation Criterion 5 (Financial Integrity of Transactions); and Core Principle 11 (Financial Integrity of Contracts)

Core Principle 11 requires that a designated contract market establish and enforce rules providing for the financial integrity of contracts (including clearance and settlement) and rules to ensure the financial integrity of intermediaries and the protection of customer funds. To the extent that Eurex US trades may be cleared by clearing members of Eurex Frankfurt through a Clearing Link, then such clearing members should be required to comply with Eurex U.S. rules and with Commission requirements regarding minimum capital, segregation, and acceptable investments of customer funds, among other things. The Commission Rule 30.10 relief granted to any Eurex Frankfurt clearing members only applies to transactions executed on Eurex Deutschland and other foreign exchanges, not to transactions that have been executed on a U.S. exchange. Moreover, although Eurex Frankfurt Clearing Members may not be members of Eurex US, to the extent that they clear Eurex US trades, they should be subject to financial surveillance and financial examinations by Eurex US or its third party provider. This raises a number of issues relating to jurisdiction, the ability to obtain books and records, and any relevant financial secrecy laws.

The Commission's Application Guidance for Core Principle 11 (Appendix B to Part 38) states that a DCM should maintain minimum financial standards for its members and non-intermediated market participants and should have default rules and procedures. It also calls for the monitoring of compliance with such minimum financial standards, as well as the routine receipt and review of financial information submitted by members.

Eurex US's application indicates that it has outsourced its responsibilities for trade practice surveillance and market surveillance to the NFA but it is unclear to what extent it has outsourced its audit functions and its obligations to review the financial condition of its members on an ongoing basis through routine financial surveillance to either NFA, or in the alternative, to CC. It is the CBOT's understanding that CC does not currently have the technology to receive electronic filings of financial statements, nor to perform automated financial statement analysis, although such electronic submission and review is the industry standard. Therefore, in the absence of any specific information, the CBOT is guessing that Eurex US is expecting the NFA to analyze its members' routine financial filings. It is unclear which organization will review any daily financial filings that may be required in order to effectively monitor high risk firms, or which organization will review any large trader information in the context of financial surveillance. It is also unclear whether Eurex US plans to participate in the Joint Audit Committee ("JAC") and the Joint Audit Plan.

On February 11, 2003, the Commission's Division of Clearing and Intermediary Oversight ("DCIO") provided its draft SRO Oversight Program for assessing compliance with Core Principle 11 to the CBOT. This Program contains elements relating to how an SRO monitors its members with respect to financial capacity, customer protection, risk management, major market moves, and operational capabilities. In particular, the DCIO has indicated that it expects SROs to review member firms' risk management practices, stress testing, and business continuity planning.

The JAC is continuing its discussions with Commission staff regarding some of these issues. Nevertheless, it should be noted that in correspondence earlier this year between a high-ranking representative of CC and the CBOT, it was made apparent that CC did not have the capacity to perform reviews of the risk management practices of FCMs. Therefore, unless CC has expanded its resources, the CBOT presumes that Eurex US plans to rely on the NFA to conduct risk management reviews of Eurex US's members. However, to our knowledge, the NFA also does not have an existing program to conduct these types of reviews. The CBOT understands that it is the DCIO's view that FCM risk management reviews should not be performed by the same individuals who conduct financial audits of an SRO's member FCMs, but rather by persons who have a risk management background. Therefore, the Commission should ensure that whichever entity is to perform these reviews on behalf of Eurex US has available staff members with the appropriate expertise.

XIII. Ability to Obtain Information – Designation Criterion 8

Designation Criterion 8 for contract markets requires a board of trade to establish and enforce rules that will allow it to obtain any information that is necessary to perform any of the functions required by the other designation criteria, including the capacity to carry out any international information-sharing agreements that are required by the Commission. Eurex

US specifically noted in its application that it will enter into the International Information Sharing Memorandum of Understanding and Agreement of March 15, 1996. Issues regarding Eurex US's ability to obtain information and its participation in international information-sharing agreements are crucial in light of Eurex's planned Clearing Link.

Insofar as any contract market functions have been delegated to NFA and/or CC, it is also essential that those organizations have access to necessary information. However, it is questionable whether Eurex US, and its delegates, will be able to obtain sufficient information from Eurex Frankfurt Clearing Members who clear Eurex US trades through Eurex Clearing, or from Eurex Clearing itself. At the very least, Eurex US should be required to make a substantial showing that it will be able to obtain any information, maintained in Europe, that is necessary to conduct market surveillance, financial surveillance, and trade practice surveillance, and will not be hindered, for example, by blocking statutes, other foreign laws, or any exercise of jurisdiction by foreign regulators.

XIV. Disciplinary Program - Designation Criterion 3 (Fair and Equitable Trading); Designation Criterion 6 (Disciplinary Procedures); and Core Principle 2 (Compliance with Rules)

Eurex Rule 601 states that the Enforcement Staff of the Compliance Department will conduct investigations of possible rule violations, but may contract for the performance of "specified functions" assigned to the Enforcement staff. Rule 205 (b) states that "[t]he Compliance Department shall be authorized to conduct and to oversee surveillance, investigation and rule enforcement activities." There will at least be a Chief of the Compliance Department according to this Rule. These rules leave open questions regarding whether Eurex US will have additional Enforcement Staff, and what such Enforcement Staff will do versus what the NFA will do with respect to investigations and surveillance activities.

Rule 602 states that the Enforcement Staff will prepare a written investigation report after conducting an investigation and present it to the Disciplinary Committee. Rule 603 provides that a notice of charges, if issued, shall be served upon a Respondent by Enforcement Staff. Rule 609 spells out the procedure for disciplinary hearings, and states that the Compliance Department shall present the case.

On page 4 of Eurex US's application cover letter, paragraph E states that NFA will conduct investigations and litigate disciplinary cases. On page 7 of Eurex US's Regulatory Chart, under Core Principle 2 (Compliance with Rules), it is stated that the exchange through its Compliance Department will have the authority to investigate violations and bring charges where appropriate and at the same time it refers to the NFA Regulatory Services Agreement. Eurex US's rules and its representations in its application are contradictory with respect to who will litigate disciplinary cases.

Eurex US's Response to the CFTC Technical Questionnaire (Exhibit 13) states on page 29, that market surveillance will be conducted by NFA professional staff who will be supervised by the Eurex US "Chief Regulatory Officer." Will trade practice surveillance conducted by NFA also be supervised by the Eurex US Chief Regulatory Officer? What is the extent of such supervision? For example, can Eurex US's Chief Regulatory Officer choose to ignore

NFA's findings? With respect to market surveillance, page 30 of the same document indicates that NFA staff will be responsible for identifying possible market congestion and communicating that information to the responsible Eurex US officer, who in turn will report the information to Eurex US's Board and/or take appropriate action within the scope of his authority. Again, will the Eurex US officer be able to choose to ignore the concerns identified by NFA?

The Commission should require that Eurex US clarify the dividing line between the authority and the responsibilities of Eurex US versus NFA with respect to the conduct of trade practice investigations and market surveillance and with respect to the use of the information gleaned from such investigations and surveillance. In any event, whatever the nature of its proposed delegation agreement, Section 5c(b) of the CEA makes it clear that Eurex US will remain responsible for fulfilling the statutory self-regulatory obligations of a designated contract market.

XV. Conclusion

The Commission has decided to remove the Eurex US application from the fast track under Part 38 "in order to ensure that it has an adequate opportunity to consider fully the issues presented by the exchange's application." The Board of Trade commends the Commission for its decision. Nevertheless, the Commission must appreciate the difficulty faced by the public in commenting on this application now since many of the materials submitted with the application have not been made public. Being asked to comment on the application now is like being asked to review a 20-chapter book but only being allowed to read 11 chapters.

Based on the materials available today, we must conclude that the Eurex US application is either wholly inadequate or materially incomplete. As we have shown in this letter, the application's deficiencies run the gamut of self-regulatory responsibilities, from preventing manipulation to providing for financial integrity. The Eurex US application thus does not meet the statutory and regulatory standards for contract market designation and should be denied.

It is possible the application's deficiencies may reflect its incompleteness due to the decision by Eurex US to apply for approval before it has finalized the details of the business model it actually intends to implement -- the model it is actively, publicly and aggressively marketing to the public. To the extent that the deficiencies in the Eurex US application emanate from its material incompleteness and premature status, we would expect the Commission to so advise Eurex US, suspending temporarily the 180 day review period set forth in Section 6(a) of the CEA. After all, the Commission cannot "consider fully the issues presented by the exchange's application" until the Commission has before it the complete application. When it does, we would hope that the Commission would afford the public an opportunity to comment on that application consistent with the goal of promoting a fully-informed and considered agency decision at some future date.

The Board of Trade appreciates the Commission's time and attention to this important matter. We are available to assist the Commission and its staff in connection with any questions you may have about this letter or the Eurex US application generally.

Sincerely,

Bernard W. Dan