DRW TRADING GROUP

DRW HOLDINGS, LLC

10 SOUTH RIVERSIDE PLAZA, 21ST FLOOR

CHICAGO, IL 60606 USA

T 312.542.1000
F 312.542.1083

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VIA ELECTRONIC MAIL

Ms. Jean Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Center
8th Floor
1155 21st Street, N.W.
Washington, D.C. 20581

Re: U.S. Futures Exchange, LLC

Dear Ms. Webb:

I write to express my concerns regarding the application of U.S. Futures Exchange, LLC ("Eurex US"). My comments focus on the issues of transparency, payment for order flow, internalization of orders and general fairness. While my comments relate primarily to options, I will also address certain aspects of futures. My concerns are based on the likelihood that Eurex US will promote a market structure similar to the one Eurex has fostered in Europe, where there is a fragmented market and a complete lack of transparency.

I. Background

A. About DRW

I am the founder and Chief Executive Officer of DRW Holdings, LLC ("DRW"). Through its operating subsidiaries, DRW engages in proprietary trading across a wide range of markets. I have personally traded options in many different markets for fourteen years. My trading has occurred both in Europe and the United States and has transpired both on and off exchange trading floors. During this period, I have seen the development and deterioration of several different markets and exchanges.

DRW is an active participant in options on fixed income futures throughout the United States and Europe. The scope of our involvement includes Eurodollars traded on the Chicago Mercantile Exchange, U.S. Treasury products traded on the Chicago Board of Trade ("CBOT"), Euribor traded on the London International Financial Futures and Options Exchange, and European government bonds (Bund, Bobl and Schatz) traded on Eurex Deutschland ("Eurex Europe"). Through the third quarter of this year, our market shares are: Euribor options 22%; Bund, Bobl and Schatz options 16%; Eurodollar options 17%; and Treasury options 7%. I believe these levels of activity make DRW the largest proprietary trader of options on futures in the world. DRW is also an active participant in the underlying futures markets and has been a significant participant on Eurex Europe since the inception of the exchange.

B. <u>About Eurex Europe</u>

Although Eurex Europe is technically an electronic exchange, options listed on it do not, for the most part, trade electronically. In fact, through the first nine months of 2003, only 10% of the Bund, Bobl and Schatz options traded electronically. The other 90% of the options traded as block transactions either in the "call around market" or through internalization of orders by brokers. A block trade is a privately negotiated futures or options transaction executed apart from the public auction market. Futures transactions may go through the call around market where the transaction is unusually large or the futures strategy is complex, involving more than one futures contract.

The call around market in Eurex Europe products works as follows. A broker that has received an executable order from a customer (either in futures, options or a combination) will call one or more market makers to obtain a price at which the order could trade. The broker then selects one or more market makers with which to cross the order. Sometime thereafter, the broker will notify Eurex Europe that a block trade has occurred. By transacting in this manner, the broker charges brokerage to both the customer and to participating market makers, in effect earning double brokerage.

II. <u>Substantive Issues</u>

A. <u>Payment for Order Flow to Brokers and Internalization of Orders</u>

The call around market described above creates a form of payment for order flow, such that market makers must pay to have brokers trade with them. This process raises several concerns:

1. There is no centralized price discovery mechanism. The result is a fragmented market. Whether on a trading floor or on a computer screen available to market participants, a centralized place for price discovery leads to a transparent market. On Eurex Europe, market participants are unable to make informed decisions as they possess only a portion of the available information.
2. Frequently trades on Eurex Europe are executed in the morning and are not reported to the exchange until the end of the day. This "no tape" environment further precludes market transparency. Market participants are not only unaware

of transactions on a timely basis, but it becomes increasingly difficult, if not impossible, to scrutinize whether trades were done at fair prices.

3. The market makers, from whom the liquidity in any market derives, must pay brokerage to the brokers. This is mandated payment for order flow in that a market maker who refuses to pay brokerage will no longer get calls from brokers and will be precluded from participating. This form of payment for order flow increases the transaction costs of the market makers, and recent experience has shown this increase to be material. The market makers pass this increase along to the customers by quoting a wider bid-ask spread. The result is a less efficient marketplace.
4. The brokers have a conflict of interest. The worse the execution by the brokers, the more market makers are willing to pay in brokerage, ultimately hurting customers.

There is another mechanism by which an order can be executed on Eurex Europe. The broker can, rather than selling an order to market makers in the call around market, internalize the customer's order by taking the other side of it. In this case, the broker clearly has a conflict. The worse the level of execution, the more profit for the broker. On futures exchanges in the United States, this practice is generally prohibited. On Eurex Europe, it is oddly encouraged.

The well-developed call around market and the practice of internalization of orders both result directly from Eurex Europe's rules relating to block trades. The block threshold, i.e. the minimum number of contracts to qualify for a block trade, for Bund, Bobl and Schatz options is 50 contracts per trade. Almost all orders are greater than 50 contracts. Therefore, almost all orders are eligible to be traded as blocks and can go the way of the call around market or be internalized by the brokers.

Eurex US's proposed rules set the block threshold at 50 contracts per trade for Bund, Bobl and Schatz options, and 2,500 contracts per trade for Treasury options. Many strategies in Treasury options contain multiple options. For example, a butterfly spread, a common strategy, contains four options per spread, so that an order for a butterfly would be block-eligible if the quantity of the order is for a minimum of 626 butterflies. Currently, many orders in Treasury options on the CBOT are greater than 2,500 contracts. Thus, if traded on Eurex US, a significant percentage of the total Treasury option volume would be block-eligible. In contrast, the CBOT does not permit block trading in any of its Treasury products (futures or options).

Block trading should be entirely prohibited. It is the primary enabling factor in the existence of the call around market and the internalization of orders. As discussed above, these practices are likely to result in fragmented markets lacking in transparency. Further, brokers will have conflicts of interest. Brokers will be incentivized to route orders to Eurex US rather than to the CBOT as they will be able to either extract payment for order flow or internalize their orders. It is also my concern that Eurex US will lower its block threshold requirements shortly after launch, and these undesired practices will become even more widespread.

B. Cross Trades

Even if block trades were prohibited on Eurex US, the cross trade rule as proposed by Eurex US will facilitate the practices of payment for order flow and internalization. As proposed, a broker that has an executable order could, rather than execute it immediately, solicit an order from a market maker to take the other side of the customer order. Unlike a block in which a broker notifies the exchange of the transaction, in a cross trade, the broker first enters the market maker order electronically in the order book. The broker then waits the required time (15 seconds for options and 5 seconds for futures). Finally, the broker enters the customer order, thereby crossing the customer and market maker orders, thus replicating a block transaction. As an alternative, the broker can take the place of the market maker in this scenario, and thereby internalize the order flow.

C. Payment for Order Flow by Eurex US

Payment for order flow can also go from exchanges to brokers. This is another way in which brokers can be distracted from acting in the best interest of their customers. Eurex US has proposed to set aside certain of its revenues for distribution to its highest volume brokers. This is similar to the strategy that Eurex Europe used to wrest the Bund futures contract from the LIFFE exchange in 1997 and 1998. Around that time, Eurex Europe paid large sums of money to brokers in London with a goal to have them route all of their orders to Eurex Europe. This practice creates yet another conflict of interest for brokers.

Eurex US has also proposed certain incentive payments to liquidity providers. Liquidity providers generally trade for their own account, and, therefore, payments by exchanges to them do not create any conflicts of interest with other market participants.

III. Effect on Eurex Europe Volumes

There is evidence to suggest that the practices discussed above have hampered the growth of the fixed income option markets on Eurex Europe. When Bund futures and options were traded actively on LIFFE in 1995, in an open outcry setting, Bund Options traded 22% of the Bund futures volume. Through the third quarter of this year, fixed income options on Eurex Europe have traded only 10% of fixed income futures volume. As another comparison, CBOT Treasury options have traded 23% of futures volume year to date.

Additionally, from 1999 to the present, while the CBOT's Ten Year Note option volume grew at a rate of 44% per annum, Eurex Europe's Bund options grew at a rate of only 2.4%. This is further evidence that the call around market and internalization of orders inhibits use of the markets.

IV. Conclusion

Although competition among exchanges can be positive for futures markets and their users, it is important that certain issues be carefully considered before approving a new exchange. Paramount is whether an exchange will ultimately provide a centralized, transparent marketplace where prices can be efficiently discovered and all market participants are treated fairly. The Commodity Futures Trading Commission recognizes this by stating in its mission statement that:

> The agency protects market participants against manipulation, abusive trade practices and fraud. Through effective oversight and regulation, the CFTC enables the markets to serve better their important functions in the nation's economy providing a mechanism for price discovery and a means of offsetting price risk.

If Eurex US successfully recreates the market structure of its European counterpart, then these principles will be abandoned. All market participants will be disadvantaged by a lack of transparency. Payment for order flow and internalization of orders will not only create conflicts of interest, particularly towards customers, but will also lead to higher transaction costs for all market participants. As a result, hedging activity will decline, resulting in greater earnings variance, and ultimately lower economic growth.

For the reasons discussed herein, I respectfully request that the 180-day statutory time period for reviewing the application of Eurex US be stopped and restarted only when Eurex US proposes a business model supporting rules and market practices that ensure an open and transparent marketplace.

Should you wish to discuss the foregoing, please feel free to contact me.

Very truly yours,

Donald R. Wilson, Jr.
Founder and CEO
DRW Holdings, LLC