



November 24, 2003

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington DC 20581

Re: Section 5c(c)(2) and Regulation Section 40.5 Submission. Request for Commission Rule Approval of Revisions to Daily Price Limits for Live Cattle Futures and Feeder Cattle Futures. Amendments to CME Rules 10102.D. and 10202.D. CME Submission #03-101.

Dear Ms. Webb:

1. **Request for Commission Rule Approval.** The Chicago Mercantile Exchange (“CME” or “Exchange”) hereby requests Commission approval of amendments to Live Cattle Futures Rule 10102.D. and Feeder Cattle Futures Rule 10202.D. regarding daily price limits. In addition, given the urgency of this matter, the Exchange requests expedited approval of these amendments under Section 40.5(f).
2. **Text of Proposed Amendments.** The text of the proposed amendments is shown below, with additions underlined and deletions bracketed and overstruck:

CHAPTER 101 LIVE CATTLE FUTURES

10102. FUTURES CALL

D. Daily Price Limits

There shall be no trading at a price more than [~~a daily price limit of \$.015~~] \$.030 per pound above or below the previous day's settlement price.

~~[If either of the two contracts nearest to expiration in the even month cycle settles on the limit bid for two successive days or on the limit offer for two successive days, then the price limit shall be raised to \$.030 per pound for all contract months.~~

~~If the daily price limit is \$.030 and either of the two contracts nearest to expiration in the even month cycle settles on the limit bid for two successive days or on the limit offer for two successive days, then the price limit shall be raised to \$.050 per pound for all contract months.~~

~~If the daily price limit is \$.050 and neither of the two contracts nearest to expiration in the even month cycle settles on the limit bid or limit offer, without regard to market direction, then the daily price limit for all contract months shall revert to \$.030 on the next business day.~~

~~If the daily price limit is \$.030 and neither of the two contracts nearest to expiration in the even month cycle settles on the limit bid or limit offer, without regard to market direction, then the daily price limit for all contract months shall revert to \$.015 on the next business day.~~

~~For the purposes of this rule, “two contracts nearest to expiration” may involve different contract months.]~~

CHAPTER 102 FEEDER CATTLE FUTURES

10202. FUTURES CALL

D. Daily Price Limits

There shall be no trading at a price more than ~~[a daily price limit of \$.015]~~ \$.030 per pound above or below the previous day's settlement price.

~~[If either of the two contracts nearest to expiration settles on the limit bid for two successive days or on the limit offer for two successive days, then the price limit shall be raised to \$.030 per pound for all contract months.~~

~~If the daily price limit is \$.030 and either of the two contracts nearest to expiration settles on the limit bid for two successive days or on the limit offer for two successive days, then the price limit shall be raised to \$.050 per pound for all contract months.~~

~~If the daily price limit is \$.050 and neither of the two contracts nearest to expiration settles on the limit bid or limit offer, without regard to market direction, then the daily price limit for all contract months shall revert to \$.030 on the next business day.~~

~~If the daily price limit is \$.030 and neither of the two contracts nearest to expiration settles on the limit bid or limit offer, without regard to market direction, then the daily price limit for all contract months shall revert to \$.015 on the next business day.~~

~~For the purposes of this rule, “two contracts nearest to expiration” may involve different contract months.]~~

3. **Effective Date and Rule Promulgating Authority.** These amendments were approved by the Board of Directors on Monday, November 24, 2003. The Exchange intends to make

these amendments effective following Commission approval, upon notification of market participants.

4. **Operation, Purpose & Effect.** On October 15, 2003, the Exchange took emergency action to adopt expandable price limits in Live Cattle, with an initial 1.5-cent daily limit (for further information, see letter to the Commission dated October 15, 2003 and CME Submission #03-91 dated October 24, 2003).

In the 25 trading sessions since October 15, at least one of the front two contract months in the even month cycle of Live Cattle Futures have experienced 1.5-cent limit settlements on 15 occasions (Table 1). Similarly, during those same 25 trading sessions the front two contract months in Feeder Cattle futures have experienced 1.5-cent limit settlements on 10 occasions (Table 2).

The addition of expanded price limits in Live Cattle, and more recently in Feeder Cattle (see CME Submission #03-93 dated November 6, 2003), was designed to address the problem of lock-limit sessions due to a sustained price move in a particular direction. However, in recent weeks both markets have been volatile, but within relatively broad ranges. This has prevented the Live Cattle expanded limits from being triggered in a timely fashion, and prevented those expanded levels from being sustained for more than a single day. The Exchange believes the same problem would have occurred in Feeder Cattle had expanded limits been in effect.

For example, on three separate occasions since expanded limits were implemented – October 27, November 7, and November 13 – the Live Cattle limits were expanded to 3 cents per pound using the expansion mechanism. Each time the market failed to close at the 3-cent limit, and the price limits reverted to 1.5 cents the following day. However, each time the market reverted to the 1.5-cent limit – October 28, November 10, and November 14 – the market closed at the 1.5-cent limit. These data strongly support the Exchange's belief that the 1.5-cent daily limit is too narrow, and a wider limit without a time lag before it is implemented is needed to allow the market to function properly.

Both Live Cattle and Feeder Cattle prices are at historic highs, so a fixed 1.5-cent price move represents a relatively small percentage change than would be the case at more traditional price levels. In addition, price limits on both Live Cattle and Feeder Cattle are extremely small when compared to those in other commodities, both agricultural and non-agricultural. For example, of the 25 commodities underlying the Goldman Sachs Commodity Index (GSCI), 10 do not have any daily limits whatsoever (Table 3). Of the remaining 15, Live Cattle and Feeder Cattle have daily limits that are by far the smallest percentage of the underlying price, based on the closing prices for Monday, November 17.

Under the current daily price limits structure, the Live Cattle and Feeder Cattle markets are unable to perform their price discovery functions. In addition, market participants are severely disadvantaged by not being able to liquidate. This lack of liquidity is likely to deter

current and potential customers from taking new positions in the future, thereby causing further harm to the market, if these conditions persist.

To address all of these issues, it was suggested that the daily price limits for both Live Cattle and Feeder Cattle should be established at 3 cents per pound at all times. There would be no expansion or contraction of the price limits, and a 3-cent limit is consistent with current price levels and volatility.

An important part of daily volume in Feeder Cattle futures is composed of spread trades in that contract versus Live Cattle contracts. Feeder Cattle and Live Cattle prices have a general tendency to move in the same direction and with a similar magnitude. The price limits for Feeder Cattle and Live Cattle were the same prior to the recent adoption of expanded price limits in Live Cattle. To allow the spread relationships between the prices for these contracts to adjust in a timely fashion, minimize any distortions in the accounting for spread positions and maximize the contribution of spread trades to market liquidity, the price limits in Live Cattle and Feeder Cattle should be the same.

5. **Opposing Views.** The Exchange is not aware of any opposition to larger limits in either market, and has received strong customer support for a 3-cent limit. The only contrary views have been in the way these larger limits should be structured and implemented. For example, there has been some support for an initial 2.5-cent daily limit, expandable to 4 cents after two days of limit moves, instead of a flat 3-cent daily limit at all times. The Exchange feels that this approach has many of the same drawbacks as the current expansion system, particularly the two-day lag before expansion could occur. In addition, since the cash market trades in full-cent increments at these price levels, a 2.5-cent limit is effectively the same as a 2-cent limit. Thus, the Exchange believes that a 3-cent limit is greatly preferable to a 2.5-cent limit.
6. **Necessary Amendments or Interpretations to the Act or Regulations.** The Exchange is not aware that any such amendments or interpretations are needed to accommodate these proposed amendments.

If you have any questions regarding this submission, please contact Mr. Paul Peterson at 312-930-4587 and via e-mail at ppeterso@cme.com, or Mr. Jack Cook at 312-930-3295 and via e-mail at jcook@cme.com. Please refer to CME Submission #03-101 in all correspondence regarding this matter.

Sincerely,



John W. Labuszewski, Director
Research & Product Development