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Chicago Board of Trade

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Thomas R. Donovan
President and
Chief Executive Officer

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OFFICE OF THE SECRETARY

Chairperson Brooksley Born
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D. C., 20581

COMMODITY FUTURES
TRADING COMMISSION
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COMMENT

Dear Chairperson Born:

The Board of Trade of the City of Chicago (CBOT) appreciated the opportunity to appear at the August 11 meeting of the Commodity Futures Trading Commission (CFTC) to discuss some of the serious legal and policy issues raised in the application by the Cantor Group and the New York Cotton Exchange to establish the Cantor Financial Futures Exchange (CFFE).

During the period of time allotted for our presentation, we discussed five substantial issues and framed a sixth significant issue -- the potential negative impact on the government securities market of market fragmentation -- which was discussed by Stanford business school professor Haim Mendelson. However, additional information was presented both at that meeting and in the August 4, 1998 supplement to the application which demands a rebuttal, raises additional issues about both the structure and policy implications of the proposal as well as renewing concerns about the credibility of the applicant and finally creates the need for an additional public comment period.

Attached as Exhibit A is a response to the inaccurate or imprecise information offered in the New York Cotton Exchange August 11 presentation as well as a series of questions (Exhibit B) which the CBOT believes must be addressed as part of the CFTC's deliberations on this precedent-setting application. We ask that these materials be included in the record in an effort to aid the Commission in its analysis.

Developing these materials and organizing our presentation was hampered by the format and timing of the latest submission of CFFE. The August 4 submission includes a cover letter describing 34 issues raised by the Commission staff in discussions with the applicant as well as seven exhibits. In effect, this is a submission of a revised rule and bylaw package which presents several material changes to the application that were never previously included in the public record. A careful review of the material also shows that the applicant has not highlighted all revisions in its marked-to-show change version of its bylaws and rules, raising the question of whether the CFTC was made aware of these changes at an earlier date without providing notice and the changes to the public.

For example, the August 4 submission contains a non-marked change that is very troubling: the revision of tick size for all four contracts from the previously disclosed terms and conditions in the January 7, 1998 document available in the public record. The price basis for contracts on both the 30-year Treasury bond and the 10-year Treasury note has changed from one tick to 1/2 tick. The price basis for contracts on five-year Treasury securities has changed from 1/2 tick to 1/4 tick while the two-year note contract was reduced from 1/4 to 1/8 tick. The CBOT has repeatedly attempted to gather new, relevant information on this application as it trickled in to the Commission. This was done both by regular monitoring of the public file and by using the Freedom of Information Act (FOIA) process. (As we noted in our June 30, 1998 comment letter (see discussion on page 3-4), material information was in some instances only available through FOIA requests.) However, a change in the tick size was never disclosed before August 4. Please confirm what other changes exist in the latest submission that have not been previously disclosed.

The Commission has stated that the public has had 99 days of public comment on the application; however, the reality is that the "work in progress" nature of any application means that the CBOT and other interested parties have analyzed multiple applications and commented on two. For instance, the original application cast the terminal operators who are crucial to each trade execution as performing merely "clerical" functions. They were also described as joint employees of the proposed exchange and Cantor firms. Information supplied in late May, following the close of the initial public comment period, disclosed that terminal operators would now be registered as floor brokers, would be solely employed by the Cantor firms who control the exchange (as would their supervisors) and that the clearing organization had been changed.

The August changes, submitted after the July 16 close of the second public comment period and barely four business days before the August public meeting, again alter the structure and operation of the exchange, introducing an agency concept and changing the tick size, thus creating a third version of the application. This vividly illustrates the problems generated by the Commission's decision to issue the Cantor proposal for public comment before it was finalized (if it is finalized at this time). The piecemeal process is further complicated by a lack of information regarding the Commission staff's synthesis and legal analysis of the application materials and the significant issues they raise.

The Commission is obligated under Section 5a(a)(12) of the CEA to republish for public comment any future changes to the proposed Cantor Exchange By-Laws and Rules that the Commission determines to be of major economic significance. Section 5a(a)(12) requires the Commission to "give interested persons an opportunity to participate in the approval process" for such rules (including rule changes) by publishing notice of such rules in the Federal Register at least thirty days before their approval. Has the Commission staff performed that analysis; when will the results be available?

To reiterate the requests of both the CBOT and the American Stock Exchange at the August 11 meeting, we ask the Commission to republish the application for public comment **when it is finalized and the Commission staff analysis has been completed** so that the public can examine both the application and the analysis to understand and comment on the numerous and precedent-setting issues which the Commission has recognized are presented by a proposal to approve a very different marketplace for futures contracts.

Sincerely,



Thomas R. Donovan

cc: Commissioner Barbara Holum
Commissioner James Newsome
Commissioner David Spears
Commissioner John Tull, Jr.
I. Michael Greenberger, Director
Division of Trading & Markets
Steven Manaster, Director
Division of Economic Analysis
Jean A. Webb, Secretariat

EXHIBIT A

CORRECTING THE RECORD: RESPONSE TO CANTOR EXCHANGE'S FURTHER DISTORTIONS AT THE AUGUST 11, 1998 PUBLIC MEETING

The Cantor Exchanges' sponsors, the Cantor Group and New York Cotton Exchange, are skilled illusionists. They rely on mislabeling and sly use of language as the tricks of their trade -- as their smoke and mirrors -- to create the illusion that the square corners of their application fit into the round holes of the CEA's legal framework.

Their on-going practices were again on display at the August 11 CFTC public meeting on their application, when NYCE's representative attempted to downplay the role of the Cantor Exchange's board of directors and, thus, to downplay the significance of a proven wrong-doer's control of that board through appointing 8 of the 13 directors. His description emphasized that the board's only responsibilities would be in the areas of marketing, contract design and technical support and repeatedly stated that the NYCE would control regulatory, clearing and administration matters for the new exchange. But this description is contradicted by the Cantor Exchange By-Laws and Rules, which give the Cantor Exchange board the express authority to:

- adopt and amend rules and amend by-laws (By-Laws 2, 29 and 30);
- appoint exchange committees responsible for setting certain Exclusive Time and Crossing Session parameters and overseeing settlement prices (By-Law 14);
- approve persons seeking direct telephone access to Terminal Operators as Associate Members (one of several categories of telephone access) (By-Law 35-C);
- set the amount of the Transaction Fees (which are the fixed brokerage commissions) and Execution Fees (By-Law 32);
- replace Commodity Clearing Corporation as the clearing organization (Rule 12); and
- manage the exchange's property and business and hire and set compensation for salaried employees (By-Law 2).

Further, we presume that the Cantor-controlled board would have the authority to amend or terminate the agreement pursuant to which NYCE will perform regulatory compliance for the Cantor Exchange.

One area where the distortions have been most pervasive throughout the entire process, and continued at the August 11 meeting, is the role and oversight of the

Terminal Operators. The Terminal Operators perform functions far beyond the clerical label that the Cantor Group and NYCE persistently seek to apply. ***On the Cantor Exchange, Terminal Operators are the floor trading population.*** They are the only persons who can execute futures trades directly on the Cantor Exchange, and they can simultaneously handle orders for cash Treasury securities. They will form a floor trading population of ***200 to 300*** in number, and will operate in a private trading room belonging to the Cantor Group, where they will have extensive communications with customers and one another and will exercise judgment in handling and executing customer orders for Treasury futures and Treasury securities over the exchange's electronic bulletin board. The Terminal Operators will also be allowed to solicit orders for both Treasury futures and Treasury securities, and, as occurs today in the Cantor Group's cash operations, will likely stay on the telephone with their customers throughout the entire execution and work-up process. This combination of trading and sales activities creates unique, highly interactive dynamics among the Terminal Operators and between the Terminal Operators and their customers, which moves their role far beyond that of a "technician" (and which may facilitate undetectable pre-arrangement.) The applicant's written explanations in response to specific Commission staff questions confirm the activities and interaction we describe. (Please refer to the attached excerpts from the application materials.)

The Cantor Exchange's sponsors try to create the impression that the Terminal Operators will be subject to regulatory oversight at both the exchange and CFTC level which is comparable to oversight of other floor brokers. But this, too, is an illusion. In fact, under their proposal, the Terminal Operators will operate outside much of the legal framework that applies to all other floor brokers (as well as to associated persons) who perform comparable functions.

A prime area of deliberate confusion is whether the Terminal Operators are members of the Cantor Exchange. This issue is important because the CEA requires that all futures contracts "be executed or consummated by or through" a member of the exchange where the contract is traded." CEA § 4(a)(2). This central tenet of futures regulation is designed to ensure that those who execute futures transactions are subject to federally prescribed standards of exchange oversight. Under the CEA-imposed model of self-regulation, exchanges must adopt and enforce a range of CFTC-approved rules governing their members' conduct, such as rules on open and competitive trading and related trade practices, audit trail and trade records, sales practices and ethics training. Exchanges must also maintain effective compliance and disciplinary programs for enforcing those rules against their members.

The Cantor Exchange's sponsors do not want to treat the Terminal Operators as members, and yet want to foster the impression that the Terminal Operators are

subject to meaningful exchange oversight. These conflicting goals explain why they have yet to provide a clear and unambiguous statement as to whether the Terminal Operators are members of the Cantor Exchange.

The CEA defines the term "member of a contract market" to include individuals "holding membership in, or admitted to membership representation on, a contract market or ***given members' trading privileges thereon.***" CEA §1a(15). Based on their responsibilities and privileged status as the only persons allowed to execute futures trades on the Cantor Exchange, the Terminal Operators would seem to fall within this statutory definition. But under the Cantor Exchange's by-laws and rules, the term "Trading Privileges" is turned on its head and defined to mean the right to place orders directly with a Terminal Operator, and Terminal Operators are deemed not to have Trading Privileges.¹ The Cantor Exchange relies on the artificial "Trading Privileges" distinction it has created as the basis, under its formal bylaws and rules, for expressly excluding Terminal Operators from its self-regulatory jurisdiction, that is, as a basis for saying indirectly that the Terminal Operators are not members.

The Cantor Group and NYCE seek to mask the fact that they have intentionally excluded the Terminal Operators from the Cantor Exchange's self-regulatory jurisdiction by representing that the NYCE compliance staff will monitor the Terminal Operators' trading activities and belatedly (August 4 submission) adopting a trade practices rule (but no sales practice rule) for the Terminal Operators. These features are merely part of the illusion, however, because the Cantor Exchange does not have any formal authority or procedures for disciplining the Terminal Operators. Further, because the Terminal Operators are non-members, the Cantor Exchange circumvents CEA § 8c and the CFTC's Part 8 Rules, which would otherwise require it to follow prescribed investigative, disciplinary and CFTC reporting procedures in connection with potential rule violations by the Terminal Operators. ***Despite all their rhetoric, the Cantor Group and NYCE have yet to provide a clear explanation of who may discipline the Terminal Operators, if any one, or under what procedures.***

The Cantor Exchange cites the plans to register the Terminal Operators as floor brokers and their designation as exchange "agents" as important factors that secure the Commission's jurisdiction over the Terminal Operators. But there are legal

¹ But in a further example of smoke and mirrors, the Cantor Exchange by rule also deems that the Terminal Operators have "trading privileges" -- lower case -- for the sole purpose of the CFTC's floor broker registration rules. The Cantor Exchange has said that the Terminal Operators will register as floor brokers. Under the CFTC's rules, a person may only be registered as a floor broker if he is granted trading privileges on an exchange.

gaps in the CFTC's oversight of the Terminal Operators relative to its oversight of other floor brokers, because many of the Commission's Rules as well as certain provisions of the CEA only apply, by their terms, to exchange members (such as CEA § 8c and the CFTC's Part 8 Rules described above), and as explained above, the Terminal Operators are not members of the Cantor Exchange. The Commission staff should prepare a "gap" analysis to understand the extent to which the non-member status of the Terminal Operators will allow the Terminal Operators and the Cantor Exchange to evade federal legal requirements that otherwise would apply.

Finally, the Cantor Exchange has suggested that NFA will have a role in supervising the Terminal Operators. But this is not true. NFA does not oversee floor traders and floor brokers; that is an exchange responsibility. This division of oversight responsibility between NFA and exchanges normally makes sense because on all other U.S. futures exchanges, floor brokers are members subject to exchange rules. NFA regulates sales practices of all registered futures professionals except floor brokers and floor traders, but the Terminal Operators will circumvent this oversight as well by registering as floor brokers instead of as Associated Persons.

**ROLE OF THE TERMINAL OPERATORS:
NON-CLERICAL AND NON-TECHNICIAN EXECUTION OF CUSTOMER ORDERS
AND SOLICITATION OF CUSTOMER BUSINESS**

The NFA has received applications from 200-300 Terminal Operators for registration as a "floor broker." All of these persons are employed and compensated by the Cantor Group. Terminal Operators will operate in a trading room that is part of the Cantor Group's premises. The following descriptions of the Terminal Operators and their activities which the applicant has provided confirm that the Terminal Operators will have extensive communications with their customers and with one another, and that their responsibilities for soliciting and executing customer orders are far from "clerical," as the applicant's sponsors seek to portray them.

CFTC Staff Question and Applicant's Responses from the May 21 Q&A:

EXCERPT 1:

"48. CFFE has stated that all TO's would be registered as government securities representatives ("GSR"), due to their responsibilities in handling orders in the government securities cash market. Under National Association of Securities Dealers Rule 1112, GSRs are permitted to engage in sales and investment advice - functions that are beyond the purely clerical responsibilities TOs would have in handling CFFE orders. Please explain what steps CFFE would take to ensure that TOs are aware that their responsibilities in handling CFFE orders would be much more circumscribed than their responsibilities in handling cash market orders.

The concern expressed in this question is addressed by each CFFE TO being registered as a Floor Broker. Thus, TOs will have a registration status, and **corresponding rights and responsibilities**, that largely parallel those applicable to their role as brokers in the interdealer market for Treasury securities."

(Emphasis added)

EXCERPT 2:

"47. Please address the following questions with respect to the conduct and oversight of CFFE TOs:

The CFFE TOs will assume largely the same role and responsibilities as they presently have in the cash market for Treasury securities. As a general matter, they will not provide any kind of advice to customers. They may, however, perform the functions described below.

- a. *Would TOs be permitted to provide authorized traders with any information regarding market conditions? For instance, could TOs*

express an opinion or even a statement of fact about the direction of the market or the strength of a trend?

Yes.

- b. *Would TOs be permitted to provide authorized traders with information regarding buying and selling interest that was away from the best posted bid and offer? Would TOs be permitted to provide authorized traders with information regarding the identity of buyers and sellers or persons that had expressed buying and selling interest?*

TOs will be permitted to provide Authorized Traders with general information regarding market conditions. Such information will not, however, include the identity of buyers, sellers or persons who have expressed buying or selling interest.

- c. *Would TOs be able to initiate contact with authorized traders or anyone else to advise them of buying and selling interest?*

Yes.

- d. *Would TOs be permitted to initiate contact with authorized traders or other persons under any circumstances? For example, could TOs initiate a call to discuss the cash market and then move on to related futures transactions?*

Yes.

- e. *Would TOs be able to solicit orders or recommend strategies to authorized traders?*

Yes, but it is unlikely that they would do so in practice.

- f. *Would TOs be permitted to handle combination orders for both the Treasury futures and the underlying Treasury securities? If so, please explain any CFFE procedural requirements that would apply to the handling of such orders.*

TOs would be permitted to handle combination orders for both the Treasury futures and the underlying Treasury securities. The exact procedure to be followed in each case is determined by the customer order.

- g. *Would TOs be permitted to use any of the information that they received as a result of handling orders for CFFE futures contracts and/or cash Treasury securities other than to enter those orders into the Cantor trading system?*

No.

- h. *Please explain how, if at all, a TO's role in handling cash market orders would be different from a TO's role in handling CFFE orders.*

The TO's role in handling cash market orders and CFFE orders will be the same.

- i. *What measures would the CFFE take to ensure that TO's are aware of their proper roles and responsibilities handling CFFE orders?*

Each TO will be required to attend certain seminars administered by Cantor Fitzgerald and overseen by NYCE, and to sign a written agreement regarding policies and procedures to be observed in connection with all CFFE trading."

EXCERPT 3:

"41. The Division understands that each TO would be responsible for handling CFFE orders phoned in by authorized traders over a number of different phone lines, dedicated and non-dedicated. Please explain whether TOs would be able to handle orders phoned in simultaneously from multiple authorized traders. Please explain this capability from both a communications standpoint (i.e., how many different phone lines could a TO handle at one time) and an order entry standpoint (i.e., how many different resting orders could a TO have in the trading system at one particular time.)"

Each CFFE TO's phone turret is equipped with two head sets. This enables a TO to listen to one trader while talking to another. Overflow in phone calls will be handled by a TO's supervisor(s) or another TO.

The Cantor System can accept an unlimited number of orders for any particular Contract. It can also accommodate multiple orders for the same account. All of these features have been successfully tested in the cash market for Treasury securities. Accordingly, there is no strict limit on how many orders resting in the Cantor System a TO may have at any given time."

EXCERPT 4:

"42. Would CFFE's communication system have a rollover capability if any authorized trader was unable to reach his or her assigned TO, whether the authorized trader was using a dedicated or non-dedicated phone line? Please explain.

For each Contract, there will be a group of dedicated CFFE TOs. Within each such group, the TOs' phone turrets are set up so that each TO can receive calls relating to another TO's designated account. Cantor Fitzgerald Securities, which uses the same system for its cash trading activities, has found that it can service the active existing accounts in a highly professional manner. CFFE will benefit from the depth of experience already developed in the interdealer market for Treasury securities."

EXCERPT 5:

"53. During the Division's visit to Cantor's trading floor, TOs were observed shouting the terms of orders while communicating with customers. Would CFFE TOs be permitted to so announce the terms of CFFE orders, whether upon entry or execution? If yes, please explain what, if any, measures CFFE would take to prevent Cantor employees or employees of Cantor affiliates from overhearing any such CFFE order information.

Other than the Cantor affiliate that will be set up to manage the error account and the Cantor Fitzgerald FCM (whose personnel will be physically separated from the CFFE TOs, see under 20.a.), no Cantor affiliate will trade on CFFE. Employees of these Cantor affiliates will not be afforded access to the trading rooms. In light of these restrictions, CFFE TOs will be permitted to announce the terms of CFFE orders in the trading rooms. Such verbal communication of price and similar information serves to alert TOs to sudden changes in market prices or to particular trades, which changes or trades will always be reflected on the screen."

CFTC Staff Question and Applicant's Responses from the June 18 Q&A:

EXCERPT 1:

"15. Question 47.e. asked whether TOs would be able to "solicit orders or recommend strategies to Authorized Traders." In response, CFFE stated "yes, but it is unlikely that they would do so in practice." Please clarify your answer by addressing both whether TOs would be able to solicit orders and whether TOs would be able to recommend strategies. Also, please explain why it would be unlikely that TOs would engage in either or both of these activities.

TOs will be permitted to solicit orders from, and recommend strategies to, Authorized Traders. Cantor Fitzgerald's experience in the cash market for Treasury securities and other interdealer markets suggests that TOs generally are not used as

a resource, and rarely (if ever) offer their services as a resource, in connection with the formulation of trading strategies generally or with respect to particular trades. Soliciting business generally, as opposed to solicitation of specific trades, is simply a part of CFFE's general marketing efforts to become a successful and liquid marketplace."

EXCERPT 2:

"18. CFFE promotional material indicated that cash and futures transactions could be conducted in one phone call. How, and by whom, will this be done?"

Where a TO is authorized to handle CFFE orders and orders for the underlying Treasury securities, a customer may place orders for both during the same phone call. In each such case, the customer determines in which order the relevant information should be input into the Cantor System."

EXCERPT 3:

"70. In its answer to question 53, CFFE states that TOs shouting the terms of orders "serves to alert TOs to sudden changes in market prices or to particular trades." If a TO was entering orders for a given contract, would not that TO be aware of any such conditions based on the information on his or her terminal screen? If a TO was not currently entering an order for a customer in a given contract why would they need to have their attention drawn to such activity?"

A TO who is entering an order for a particular Contract will certainly be aware of market conditions relating to such Contract. It should be noted, however, that most TOs will have several distinct responsibilities (with respect to both the cash and the futures markets). Accordingly, the fact that TOs may be shouting the terms of orders and executions provides (i) an audible supplement to ensure that other TOs will be aware of new or resting orders and executions in the Cantor System and (ii) a similar alert for customer notifications."

EXCERPT 4:

"21.b. In its answer to question 59, CFFE also indicates that a TO's compensation would include "a payment/discretionary bonus in respect of their services for CFFE, LLC." Would any portion of their bonus be based upon the volume of trades they execute on CFFE? Please explain. Would it be based on the volume of CFFE trades executed by Cantor Fitzgerald & Co.?"

The discretionary bonus paid to a particular TO will be based upon the overall performance of CFFE as well as the performance of such TO, taking into account (i) customer satisfaction, (ii) compliance with CFFE Rules and other requirements applicable to TOs and (iii) discharge of all responsibilities in connection with his or her

role as a TO. The TOs' functions are unrelated to CF&Co.; accordingly, the volume of CFFE trades executed by CF&Co. is not a factor in determining the discretionary bonus."

Excerpt From the August 4 Transmittal Letter:

7. Role and Function of Terminal Operators. A Terminal Operator:

(a) may accept orders from Authorized Traders, enter such orders into the Cantor System and report trade executions back to Authorized Traders;

(b) may provide publicly available information (whether such information has been solicited or not) including with respect to CFFE and Contracts traded on CFFE to Authorized Traders and Screen Based Traders (such as, for example, information with respect to the aggregate amount of orders resting in the Cantor System and trade executions); and

(c) may solicit orders with respect to Contracts handled by him or her and engage in marketing with respect to CFFE; but

(d) may not provide any advice (whether written, oral or in any other form) with respect to trading on CFFE generally or in any Contract in particular to any Authorized Trader or Screen Based Trader or any customer of such Authorized Trader or Screen Based Trader.

The foregoing prohibition is codified in new Rule 712-A (see Exhibit 1) and will be subject to supervision and enforcement by NYBT's Compliance and Market Surveillance staff. In light of this new Rule, which describes in detail the role and responsibilities of Terminal Operators, there is no need to prepare and submit a Terminal Operator Manual at this time. Therefore, all references to such manual in prior submissions should be deemed removed from the record.

EXHIBIT B

QUESTIONS FOR THE COMMISSION TO CONSIDER IN ITS DELIBERATIONS ON THE CANTOR EXCHANGE APPLICATION FOR CONTRACT MARKET DESIGNATION

1. If a firm is a proven wrong-doer and admittedly committed a disciplinary offense as defined in CFTC Rule 1.63, wouldn't it be contrary to the public interest or CFTC Rule 1.63 to allow that firm to control an exchange by appointing 8 out of 13 members of the exchange's board of directors?

(Note: The Cantor Exchange board's responsibilities extend beyond marketing, contract design and technical support as represented at the August 11 public meeting. The Cantor Exchange By-Laws and Rules give the Cantor Exchange board the express authority to: (1) adopt and amend rules and amend by-laws (By-Laws 2, 29 and 30); (2) appoint exchange committees responsible for setting certain Exclusive Time and Crossing Session parameters and overseeing settlement prices (By-Law 14); (3) approve persons seeking direct telephone access to Terminal Operators as Associate Members (one of several categories of telephone access) (By-Law 35-C); (4) set the amount of the Transaction Fees (which are the fixed brokerage commissions) and Execution Fees (By-Law 32); (5) replace Commodity Clearing Corporation as the clearing organization (Rule 12); and (6) manage the exchange's property and business and hire and set compensation for salaried employees (By-Law 2).)

2. Isn't it contrary to the public interest, including the public interest to be protected by the antitrust laws, for an exchange to bar all floor brokers, except the employees of a single firm, from acting as floor brokers on the exchange?
3. Isn't it contrary to the public interest, including the public interest to be protected by the antitrust laws, for a new exchange to set the commission rates to be charged by all floor brokers on the exchange (called Transaction Fees) when the antitrust laws bar all other exchanges from setting, even indirectly, brokerage commissions?
4. Isn't it contrary to the public interest and to CEA §§ 4(a) and 5(6) for an exchange to propose that none of the transactions on its new contract market would "be executed or consummated by a member of such contract market," thereby circumventing much of the CEA's self-regulatory framework? Shouldn't the Commission require the Cantor Exchange to treat the Terminal Operators as members of the Cantor Exchange, with all the attendant obligations that the

CEA imposes on members of a contract market and on the contract market on which they enjoy members' trading privileges?

5. Isn't it contrary to the public interest and the "open and competitive" execution requirement of CFTC Rule 1.38, for a contract market to be designed:
 - a. To allow traders to execute transactions "even if a bid or offer superior to such trader's bid or offer would otherwise be available" (Cantor Exchange Rule 303 (b)(1))?
 - b. To allow crossing of orders at a randomly assigned match price that "may be inferior to the prices that could otherwise be obtained" (Cantor Exchange draft Disclosure Statement)?
 - c. To allow off-exchange block trading of outright futures contracts through the EFP mechanism by permitting transitory EFPs (see Cantor Exchange Rule 305)?
6. Would allowing a new exchange to engage in routine non-competitive trading practices (through Exclusive Time, Crossing Sessions and transitory EFPs) for Treasury security futures contracts that are largely identical to contracts already competitively traded on a liquid basis on another exchange cause:
 - a. Pricing distortions?
 - b. Market illiquidity?
 - c. Wider bid-ask spreads?
 - d. Inefficient hedging?
 - e. And increased cost to the Treasury (and taxpayers) for financing U.S. debt?
7. Doesn't the Commission's pending Concept Release on Non-Competitive Transactions raise and provide a framework for addressing the very issues covered in 5 and 6? How can the Commission consider approval of the Cantor Exchange's proposed non-competitive trading practices without prejudging those issues? If the Commission does not wait until completion of its broader policy review of these issues, doesn't it risk setting a dangerous, piecemeal precedent it may later wish to retract? Won't the CFTC precipitate a "race to

the bottom" toward non-competitive trading as the norm and away from competitive trading and price discovery if it approves the Cantor Exchange's non-competitive practices?

8. Will the Commission allow the Cantor Exchange to prescribe by exchange rule that Terminal Operators have "trading privileges" solely for purposes of meeting the Commission's eligibility standards for floor broker registration, but expressly not for purposes of the CEA's statutory definition of the term "member of a contract market," thereby circumventing a number of CFTC requirements and CEA provisions that apply by their terms only to exchange members?

(Note: CEA § 1a(15) defines "member of a contract market" to include individuals "holding membership in, or admitted to membership representation on, a contract market or *given members' trading privileges thereon.*" CFTC Rule 1.3(q) sets out the same basic definition.)

9. If so, will the Commission allow other exchanges to follow this precedent of adopting exchange rules that change the plain meaning of definitions and provisions set out in the CEA or in Commission rules to circumvent federal legal requirements they dislike but that otherwise would apply? For example, can other exchanges redesignate their floor brokers as non-member agents of the exchange to avoid our obligations to enforce rules against members, including floor practice violations?

10. Has the Commission staff performed a "gap" analysis to gain a complete understanding of the CEA provisions and CFTC rules, interpretations, guidances and orders which the Terminal Operators will circumvent in their unique status as non-member floor broker "agents" of an exchange that would otherwise apply to them if they were exchange members? What are the results of that analysis? Does the Commission plan to fill any gaps that exist either through interpretation or rule change? If not, what is the justification for exempting the Terminal Operators from the statutory definition of "member of a contract market" and thus from these federal law provisions?

(Note: Exchanges must adopt a range of CFTC-approved rules governing their members' conduct, such as rules on open and competitive trading and related trade practices, audit trail and trade records, sales practices and ethics training. Further, exchanges must maintain effective compliance and enforcement programs for detecting and deterring rule violations by members,

including disciplinary procedures following CEA and CFTC prescribed procedures.)

11. Has the Commission staff performed a “gap” analysis to gain a complete understanding of the CEA provisions and CFTC rules, interpretations, guidances and orders regarding self-regulatory obligations which the Cantor Exchange will circumvent with respect to the Terminal Operators due to the Terminal Operators’ unique status as non-member floor broker “agents” of the exchange that would otherwise apply to the Cantor Exchange if the Terminal Operators were members? What are the results of that analysis? Does the Commission plan to fill any gaps that exist either through interpretation or rule change? If not, what is the justification for exempting the Terminal Operators from the statutory definition of “member of a contract market” thereby exempting the Cantor Exchange from complying with the same federally-imposed obligations as all other U.S. exchanges?
12. The applicant repeatedly represents that the Terminal Operators are subject to regulatory oversight by the NYCE. However, the proposed Cantor Exchange By-Laws and Rules and NYCE rule changes are ***carefully drafted expressly to exclude the Terminal Operators from each exchange’s compliance and disciplinary jurisdiction.***
 - a. What is the basis of the purported disciplinary authority over the Terminal Operators? Does it derive solely from the Terminal Operators’ employment relationship with the Cantor Group? From their “agency” relationship with the Cantor Exchange? If so, is this an adequate substitute for the jurisdiction and disciplinary authority that all other U.S. futures exchanges are required to have over members? Where is the disciplinary authority over Terminal Operators set out? How is it made legally binding on the Cantor Exchange to enforce its disciplinary obligations with respect to the Terminal Operators?
 - b. Who may discipline the Terminal Operators (e.g., any particular NYCE committees?) and under what procedures? Where are these procedures set out? If they are not set out by rule, how will the Commission ensure that the Cantor Exchange and/or NYCE follow these procedures? In other words, how are the procedures legally binding on the Cantor Exchange?
 - c. CEA § 8c and the Commission’s Part 8 Rules prescribe various disciplinary procedures that exchanges must follow. By their terms, these provisions apply only to exchange disciplinary proceedings against

members of the exchange. Will the Commission interpret these provisions to apply to the Cantor Exchange relative to its enforcement of rules against the Terminal Operators? If not, what is the justification for exempting the Terminal Operators from the statutory definition of "member of a contract market," thereby exempting the Cantor Exchange from these federal law provisions?

(Note: CEA § 8c and the CFTC Part 8 Rules are central to the CEA imposed model of self-regulation; they cover investigative fact finding, charges and hearing procedures, as well as important notice requirements to provide for CFTC review of the adequacy of exchange disciplinary actions and to make the public aware of such actions.)

- d. Is the Cantor Exchange required (through the NYCE) to follow the Commission's 1994 Guidance to Self-Regulatory Organizations on sanctions, which provides that an exchange should consider disgorgement of profits in assessing fines for violative conduct? Will Terminal Operators even be subject to fines as penalties? What is the range of penalties that may be imposed?

(Note: The Division of Trading & Markets in its July 28, 1998 Rule Enforcement Review of the NYCE cited the exchange for assessing an inappropriately small fine against a floor broker in that the fine was substantially lower than the profit the broker retained from the illegal conduct.)

- e. If the only available sanction against Terminal Operators is termination of employment, won't that provide an incentive to allow wrong-doing to go undetected and/or unpunished except in the most egregious cases of misconduct given the severity of such penalty?

13. Isn't it contrary to the public interest that the Terminal Operators will not be subject to any sales practice rules or oversight?

(Note: The Cantor Exchange does not have any sales practice rules for the Terminal Operators, and its obligation to enforce rules against the Terminal Operators is questionable in any event. Further, the Terminal Operators will not be subject to sales practice oversight by NFA since they are registering as floor brokers whose sales practices are not examined by NFA.)

14. Apart from the non-competitive trading practices, there are other significant differences between the proposed Cantor Exchange markets and all other U.S. futures exchange markets. The Cantor Exchange will allow an unprecedented integration of what are supposed to be public regulated futures markets with the Cantor Group's privately offered cash markets for Treasury securities. As a consequence, Terminal Operators will be allowed to solicit, handle and execute both cash and futures orders. Further, they can remain in constant telephone communication with their customers while they are executing the customer's orders. In aggregate, these factors may create potential for trading abuses that do not exist in other futures exchange markets. Has the Commission staff evaluated whether the Commission's existing trade practice rules are adequate for this new type of market? For example, should the Commission be concerned that:
 - a. The Cantor employed Terminal Operators may show preferential treatment in the execution of cash orders ahead of futures orders?
 - b. Or that they may show preferential treatment to the Cantor Group's customers (whether for cash or futures trading) over customers who use a firm other than the Cantor Group's FCM as their brokerage intermediary for futures?
15. Terminal Operators may solicit, receive, handle and execute customer orders for both cash Treasuries and for futures contracts and may shout out to one another about trading interest.
 - a. Has the Commission staff evaluated whether this unique trading environment combining cash and futures and trade execution and solicitation raises special intermarket frontrunning concerns?
 - b. Does this situation raise interagency surveillance issues? Has Commission staff consulted with the SEC and/or Treasury staff to discuss whether there are potential intermarket frontrunning issues or concerns that the agencies should resolve together?
 - c. Should the Commission require NYCE to have special compliance programs to detect and deter intermarket frontrunning? Should those programs include an integrated audit trail for both futures and cash market trading activity?

16. In a February 1998 Rule Enforcement Review, the Division of Trading & Markets cited the NYCE for Market Surveillance staffing deficiencies which prevented the exchange effectively from monitoring the markets it offered and from conducting routine surveillance including with respect to EFP transactions. Has NYCE demonstrated that it has corrected these deficiencies? If not, shouldn't the Commission wait until the NYCE has done so before the Commission acts upon the application in light of the Cantor Exchange's obligation to demonstrate that it has the ability to enforce its rules before the Commission may grant contract market designation? (See CEA §§ 5(6), 5a(8) and 6(b).)

17. Echoing the February 1998 Rule Enforcement Review findings, the Division found in its July 28, 1998 Rule Enforcement Review that the NYCE "Compliance staff has lost a number of investigators, which has diminished the Exchange's ability to perform its self-regulatory responsibilities (p. 4) and further, that its "concerns in this regard are amplified by the possibility that the Exchange will have to assume compliance responsibilities for the proposed Cantor Financial Futures Exchange" (p. 8, fn 9). Thus, the Division instructed the NYCE to report back within 60 days of "its plans for hiring additional Compliance investigators, including any plans and timetables for merging the NYCE and CSC Compliance Departments." (P. 4)
 - a. Has the NYCE submitted its staff hiring and merger plan yet to the Division? Has Commission staff evaluated this plan for adequacy?
 - b. Shouldn't the Commission wait until the NYCE has implemented its plan before acting upon the Cantor Exchange application in light of the Cantor Exchange's obligation to demonstrate that it has the ability to enforce its rules before the Commission may grant contract market designation? (See CEA §§ 5(6), 5a(8) and 6(b).)

18. The applicant has represented that the Cantor Group will implement various "firewalls" to prevent flow of confidential trading information from the Terminal Operators to other firms within the Cantor Group or to other Cantor Group employees. The applicant has also represented that the Cantor Group companies and the Terminal Operators will not be allowed to trade futures contracts on a proprietary basis. Where are these various "conflict of interest" protections set out? Shouldn't they be codified either in Cantor Exchange or Commission rules? If not, how are they legally binding on and enforceable against the Cantor Group? Who will enforce these protections and under what procedures?

19. Should the Commission require Cantor Fitzgerald Securities, which employs the Terminal Operators, to register as either a Futures Commission Merchant or Introducing Broker in light of the sales practice activities of the Terminal Operators?
20. Does the Cantor Exchange audit trail meet the requirements of CEA § 5a(b) when it does not incorporate timing data on when orders are received by Terminal Operators? How can the Cantor Exchange (through NYCE) monitor for potential pre-arrangement or preferential treatment of certain customers over others by the Terminal Operators during the period prior to entry of an order onto the Cantor System without this critical audit trail data? How can the Cantor Exchange have an effective trade monitoring program without this audit trail data?
21. Since the audio tapes appear to be the primary, if not only, trade record covering the critical period between a Terminal Operator's receipt of an order and entry of the order onto the Cantor System, why are the tapes only required to be held for 120 calendar days, and not for 5 years as required by CFTC Rule 1.31(a)(1)?
22. On the Cantor Exchange, the Treasury Futures contracts settle at 3:00 p.m. New York time, but the trading day closes at 5:30 p.m. New York time. Has the Commission staff examined how the Commodities Clearing Corporation will handle clearing and settlement of trades that occur between 3:00 p.m. and 5:30 p.m.? E.g., when will margin and settlement payments occur with respect to those positions? What is the overnight risk associated with those positions? How are those positions handled in terms of overall risk monitoring of clearing member firms?
23. Is it contrary to the public interest to allow the Cantor Group to participate in NYCE's ethics training for Terminal Operators given that the Cantor Group would be disqualified from providing such training directly under CFTC Rule 3.34(b)(3)(iii) based on Cantor Fitzgerald's settlement of fraud charges with the CFTC?