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January 13, 2006

Ms. Jean A. Webb  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581

**RE: SECURITY FUTURES PRODUCT RULE SUBMISSION**  
Section 5c(c) and Regulation §41.24 Submission – Exchange Certification of Rule  
Amendments Governing Physically Delivered Single Security Futures.  
CME Submission #06-02.

Dear Ms. Webb:

Chicago Mercantile Exchange Inc. (“CME” or “Exchange”) hereby submits, pursuant to Section 5c(c) of the Commodity Exchange Act (“CEA”) and Regulation §41.24 thereunder, amendments to Rules governing the trade of physically delivered single security futures.

**1. Text of Rules**

CME proposes to amend its Rules governing the trade of physically delivered single security futures as documented in Appendix 1 below with a clean copy of such Rules as amended included in Appendix 2 below.

Note that the Exchange had previously certified its Rules governing the trade of physically delivered single security futures with the Commission by correspondence dated May 4, 2005 (CME Submission #05-45), May 27, 2005 (CME Submission #05-58) and June 28, 2005 (CME Submission #05-68). Per its correspondence of May 4, 2005, the Exchange proposed to list futures based on three Exchange Traded Funds, specifically, the Nasdaq-100 Tracking Stock<sup>SM</sup> (“QQQQ”), Standard & Poor’s Depository Receipts<sup>®</sup> (“SPDR”) and iShares Russell 2000 (“IWM”). Per its subsequent correspondence dated May 27, 2005 and June 28, 2005, the Exchange amended Rules governing the IWM contract to reflect a 2-for-1 split in that security on June 9, 2005.

## **2. Submission to SEC**

Commission Regulation §41.24(a)(3) calls for a parallel submission to be filed with the Securities and Exchange Commission ("SEC") and in accordance with Section 19(b)(7) of the Exchange Act and Rule 19b-7 thereunder. CME has been advised by SEC staff, however, that such submission is unnecessary in this case and, therefore, no such submission has been filed. Note, however, that a copy of this document has been provided to SEC staff.

## **3. Certifications**

Chicago Mercantile Exchange Inc. ("CME" or "Exchange") hereby submits, pursuant to Section 5c(c) of the Act and Regulation §41.24(a)(4) thereunder, certification that the Rule amendments documented herein and the affected security futures product complies with the Act and ruled thereunder.

## **4. Date of Implementation**

Per CME Rule 230.j., the Exchange's Chairman, CEO and President, acting under their authority delegated by the Exchange's Board of Directors per Rule 230.j., jointly approved these amendments on October 15, 2005. Per Commission Regulation §40.6(a)(3)(iii), please note that the Exchange intends to make these Rules effective on January 23, 2006. We acknowledge that the Commission may stay the effectiveness or alter or amend the rule pursuant to section 8a(7) of the Act, as provided in Commission Regulation §40.6(b).

## **4. Purpose and Explanation of Rule Amendments**

The Exchange proposes to amend its Interpretation to Rule 580., GLOBEX TRADE ALGORITHMS such that Security Futures Products (SFPs) based on Exchange Traded Funds (ETFs) shall be traded on the CME® Globex® electronic trading platform per the Exchange's LMM Allocation Algorithm. This includes futures based on the Nasdaq-100 Tracking Stock<sup>SM</sup> ("QQQQ"), Standard & Poor's Depository Receipts® ("SPDR") and iShares Russell 2000 ("IWM").

Previously, the Exchange had applied a First In, First Out or "FIFO" Allocation Algorithm to these contracts. Per CME Rule 580., GLOBEX TRADE ALGORITHMS, the FIFO Algorithm provides that "orders entered into the GLOBEX system will be matched in accordance with an algorithm that gives first priority to orders at the best price and that gives priority among orders entered at the same price based on their time of entry into the system, with the first order entered receiving first priority, the second order entered receiving second priority, etc."

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The LMM Allocation Algorithm provides that Exchange designated Lead Market Makers (LMMs) may be accorded priority in the order queue up to a specified proportion of the incoming opposite order, provided that they match the best bid or offer price and regardless of whether the LMM's order had been entered temporally before orders received from other LMMs. CME currently anticipates allocating a proportion of 20% of incoming opposite orders to each of two designated LMMs, for a total allocated proportion of 40%. The precise allocation algorithm is described in the Interpretation to Rule 580 as shown in Appendix 1 below. The deployment of this allocation technique is intended to provide incentive for designated LMMs to provide liquidity in the market.

Please address any questions that arise during the review and approval process to myself at 312-466-7469 or via e-mail at [jlab@cme.com](mailto:jlab@cme.com). We would be most appreciative if you would reference CME Submission #06-02 in any related correspondence.

Sincerely,



John W. Labuszewski, Managing Director  
Research & Product Development

Att.

cc: Attention: Ms. Florence Harmon  
Office of Market Supervision  
Division of Market Regulation  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-1003

**Appendix 1: Amendments to Exchange Rules**  
*(Additions are underlined while deletions are bracketed and overstruck.)*

**INTERPRETATION OF RULE 580. - GLOBEX TRADE ALGORITHMS**

**Pro Rata Allocation Algorithm**

[unchanged]

**Implied Order Algorithm**

[unchanged]

**Lead Market Maker (LMM) Allocation Algorithms**

The Exchange may designate, per the provisions of Rule 581, GLOBEX Lead Market Maker Program, multiple Lead Market Makers (LMMs) in specified futures and option markets traded on the GLOBEX Electronic Trading System. The Exchange has determined to use either LMM Allocation Algorithm (Option A) or LMM Allocation Algorithm (Option B) as described below to match orders in such specified markets. Two-, Five- and Ten-Year Swap Rate futures shall be subject to LMM Allocation Algorithm (Option A). Weather futures, agricultural futures, futures on Standard and Poor's Depository Receipts ("SPDR"), NASDAQ-100 Tracking Stock ("QQQQ"), Russell 2000 iShares ("IWM"), and CPI futures shall be subject to LMM Allocation Algorithm (Option B). All other futures and options contracts, unless specifically referenced in this Interpretation, will continue to use the normal matching algorithm based on price and time priority.

1. The LMM Allocation Algorithm (Option A) operates as follows:
  - After the opening, Time Priority is assigned to the first order at a price that betters the market when the order is received. Only one buy order and one sell order can have Time Priority at any given time. Orders with Time Priority are matched first regardless of whether it was entered by an LMM or non-LMM.
  - An order will lose Time Priority when an order at a better price is entered. Example: An order to buy 50 contracts is entered at 105. This order is the first order in at this price level. Another order comes in and betters the market, buy 25 contracts at 106. The order at the 106 level has Time Priority now. The market sells off and the bid of 25 contracts at 106 is hit. The bid for 50 contracts at 105 does not regain its Time Priority and will be allocated according to the LMM Allocation Algorithm along with all the other 105 bids.
  - After the Time Priority order is filled, the LMM Allocation Algorithm is applied to the remainder of the resting orders at that price level. The LMM Algorithm will attempt to allocate a specified minimum proportion of the trade to the LMM provided that the LMM's bid or offer matches the best available bid or offer. Any contracts still to be allocated after the "LMM Allocation" are allocated based upon the time of order entry.

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- If the allocation to the LMM results in a fraction, the LMM Algorithm will "Round Down" to the nearest integral contract multiple.
  - In the event that the Exchange designates a single LMM in a specified market, the LMM's allocated proportion shall be 40%. In the event that the Exchange designates two (2) LMMs in a specified market, each LMM shall be allocated 20%. In the event that the Exchange designates three (3) LMMs in a specified market, each LMM shall be allocated 15%.
2. The LMM Allocation Algorithm (Option B) operates in a manner similar to Option A as described above, except that LMMs will be allocated a specified minimum proportion of the trade provided that the LMM's bid or offer matches the best available bid or offer regardless of whether the LMM had achieved Time Priority.

**Best Price Priority Allocation Algorithm**

[*unchanged*]

## **Appendix 2: Clean Copy of Rules as Amended**

### **INTERPRETATION OF RULE 580. - GLOBEX TRADE ALGORITHMS**

#### **Pro Rata Allocation Algorithm**

*[unchanged]*

#### **Implied Order Algorithm**

*[unchanged]*

#### **Lead Market Maker (LMM) Allocation Algorithms**

The Exchange may designate, per the provisions of Rule 581, GLOBEX Lead Market Maker Program, multiple Lead Market Makers (LMMs) in specified futures and option markets traded on the GLOBEX Electronic Trading System. The Exchange has determined to use either LMM Allocation Algorithm (Option A) or LMM Allocation Algorithm (Option B) as described below to match orders in such specified markets. Two-, Five- and Ten-Year Swap Rate futures shall be subject to LMM Allocation Algorithm (Option A). Weather futures, agricultural futures, futures on Standard and Poor's Depository Receipts ("SPDR"), NASDAQ-100 Tracking Stock ("QQQQ"), Russell 2000 iShares ("IWM"), and CPI futures shall be subject to LMM Allocation Algorithm (Option B). All other futures and options contracts, unless specifically referenced in this Interpretation, will continue to use the normal matching algorithm based on price and time priority.

1. The LMM Allocation Algorithm (Option A) operates as follows:

- After the opening, Time Priority is assigned to the first order at a price that betters the market when the order is received. Only one buy order and one sell order can have Time Priority at any given time. Orders with Time Priority are matched first regardless of whether it was entered by an LMM or non-LMM.
- An order will lose Time Priority when an order at a better price is entered. Example: An order to buy 50 contracts is entered at 105. This order is the first order in at this price level. Another order comes in and betters the market, buy 25 contracts at 106. The order at the 106 level has Time Priority now. The market sells off and the bid of 25 contracts at 106 is hit. The bid for 50 contracts at 105 does not regain its Time Priority and will be allocated according to the LMM Allocation Algorithm along with all the other 105 bids.
- After the Time Priority order is filled, the LMM Allocation Algorithm is applied to the remainder of the resting orders at that price level. The LMM Algorithm will attempt to allocate a specified minimum proportion of the trade to the LMM provided that the LMM's bid or offer matches the best available bid or offer. Any contracts still to be allocated after the "LMM Allocation" are allocated based upon the time of order entry.

- If the allocation to the LMM results in a fraction, the LMM Algorithm will “Round Down” to the nearest integral contract multiple.
  - In the event that the Exchange designates a single LMM in a specified market, the LMM’s allocated proportion shall be 40%. In the event that the Exchange designates two (2) LMMs in a specified market, each LMM shall be allocated 20%. In the event that the Exchange designates three (3) LMMs in a specified market, each LMM shall be allocated 15%.
3. The LMM Allocation Algorithm (Option B) operates in a manner similar to Option A as described above, except that LMMs will be allocated a specified minimum proportion of the trade provided that the LMM’s bid or offer matches the best available bid or offer regardless of whether the LMM had achieved Time Priority.

**Best Price Priority Allocation Algorithm**

*[unchanged]*