COMMODITY FUTURES TRADING COMMISSION RECEIVED FOR PUBLIC RECORD

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1616 N. Hudson, #10
Chicago, Illinois 60614
April 18, 1998

Jean A. Webb
Secretary of the Commission
Commodity Futures Trading Commission
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

Dear Ms. Webb:

I am submitting these comments in response to the Commission's concept release published January 26, 1998, in the Federal Register under the title "Regulation of Noncompetitive Transactions Executed on or Subject to the Rules of a Contract Market".

I am a self-employed grain futures trader, with sixteen years of experience as a full member of the Chicago Board of Trade, and another eight years prior in the cash grain export business as an employee of Continental Grain Company (five years) and Iowa's regional grain marketing cooperative (three years). Throughout my tenure as a CBOT member, I have been active in grain contract issues. I am a Board member of the National Grain Trade Council, and also a member of the National Grain and Feed Association.

I believe that, based on my level of experience on both the futures and the cash sides of the business, I am well qualified to comment on the Commission's release.

Rather than attempt to answer specifically the myriad questions posed in the Commission's release, I wish to confine my comments to two areas: EFPs and the related EFS/EOP transactions, and block trading.

With respect to EFPs, the exchanges have successfully policed EFP transactions for more than fifty years. The exchanges should be allowed full discretion by the Commission to continue this policing, without the Commission imposing new regulations which might hinder the natural development of the use of EFPs and (recently) the development of EFSs and EOPs. Correlation requirements and similar regulation imposed by the Commission would bring about a new and needless complexity. It is clearly in the best interest of the exchanges to carefully monitor these transactions, so the Commission should rest easy in the knowledge that such transactions will be thoroughly policed without CFTC intervention.

With respect to block trading, in my view there is simply NO PARALLEL between block trading on a securities exchange and block trading of commodity futures.

An equity security represents, literally, ownership of a company. Since only a specific number of shares are authorized and issued at any time, different percentages of ownership may have more or less value in some circumstances. For instance, to the party contemplating accumulation of a large percentage interest in IBM, 100 shares may have less value than 1 million shares. There may well be justifiable reasons to allow such parties to locate block sellers, prearrange the trades, and transact the large block at a premium to the small quantities trading in the open securities marketplace.

Commodity futures contracts are fundamentally different. A commodity futures transaction represents discovery of price via a transfer of risk, not the valuation of an enterprise. Depending on the level of activity in the underlying cash market, futures open interest can go up or down significantly on a daily basis. There is no fixed open interest, as there is a fixed number of shares in a corporation. For a futures market to function, that is, to accurately reflect prices, all transactions must be channeled into it. The larger the order flow and the greater the pool of open interest, the more accurate the price becomes relative to underlying cash markets.

An example of such price "accuracy" is the CBOT's 30-year bond futures contract. In many instances, the bond futures price action leads the cash markets, and following a major report, liquidity in the futures contract is far superior to that in the cash. As another example, in the corn and soybean pits, at any given instant, liquidity is incomparably greater than in the most liquid cash markets (probably the CIF Nola barge markets). Futures transactions representing hundreds of thousands of tons of grain, even millions of tons, take place in an instant with minor price moves. This is inconceivable in any cash grain market worldwide.

This liquidity is no accident, and should not be trifled with or compromised with a mistaken policy of allowing institutional counterparties to locate one another and trade block amounts off-exchange, using exchange prices for referral.

There is no question that allowing block trading of futures would be catastrophic to the effective functioning of what are now vibrant, deep and liquid markets within the pits.

I would also contend that there is no similarity between EFPs and block trades of futures. EFPs are a mechanism allowing parties to a cash trade to conveniently fix futures prices for administrative purposes. In a basis trade priced by an EFP, the CASH price is the price being discovered. The counterparties take on basis risk, not futures price risk. No discovery of FUTURES price takes place.

A block trade of futures is an entirely different transaction from an EFP. Parties to a block trade have no underlying cash transaction as an offset. A block trade creates and discovers a futures price, not in the designated centralized marketplace (the pits), but outside it. Allowing block trades effectively creates another marketplace, or as many additional such marketplaces as there are block trades taking place at a given moment. Thus, trades are not directed into a centralized market to add to the liquidity of the market, but directed elsewhere with the effect of diminishing that liquidity.

It is easy to conceive of a situation in which smaller users like farmers and small grain elevators are denied the opportunity to participate in transactions taking place between institutional parties at a higher price outside the pit. Equal access to the marketplace, by large and small players alike, has always been a central tenet underlying the philosophy of the futures exchanges and you, our regulator. This must never be compromised or cast aside by allowing a practice so harmful as block trading.

Sincerely,

Daniel F. Brophy

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