

October 27, 2004

The Honorable Sharon Brown-Hruska
Acting Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Chicago Board of Trade Metals Futures Contracts

Dear Acting Chairman Brown-Hruska:

The Board of Trade of the City of Chicago, Inc. (“CBOT®” or “Exchange”) hereby responds to the October 5, 2004 letter, submitted to you by the New York Mercantile Exchange, Inc. (“NYMEX”), regarding the CBOT’s electronically-traded 5,000 ounce Silver (“full-sized Silver”) futures contract and 100 ounce Gold (“full-sized Gold”) futures contract (referred to collectively as “full-sized metals contracts”), listed on October 6, 2004.

The CBOT, and/or its now defunct subsidiary, the MidAmerica Commodity Exchange (“MidAm”), have offered futures contracts on Silver and Gold (“metals contracts”) at least since the 1970s. In addition to the CBOT’s full-sized metals contracts, the Exchange currently lists 1,000 ounce Silver futures contracts and 33.2 ounce Gold futures contracts (“mini-sized metals contracts”) on its electronic platform.

The CBOT appreciates NYMEX’s stated intention to refrain from tying the Commission’s deliberations “up in knots through decoy issues”. However, the concerns that it has raised are, in fact, “red herrings”, because they are based upon a fundamental misunderstanding of industry practice with regard to settlement procedures in the context of electronic markets, as well as misinformation about the delivery terms for the CBOT’s metals contracts.

At the outset, the CBOT would like to make it absolutely clear that it derives its settlement prices for all of its metals contracts totally independently of any bids or offers made, or prices traded, on NYMEX’s subsidiary, the Commodity Exchange, Inc. (“COMEX”). Until May 2004, the CBOT’s mini-sized metals contracts were derivative markets, and the Exchange’s regulations required that their settlement prices be consistent with the settlement prices of the corresponding contracts of the primary markets (which at that time were at the COMEX).

On April 19, 2004, NYMEX sent a letter to the CBOT demanding that the Exchange stop using COMEX settlement prices to settle the CBOT’s mini-sized metals contracts. The

Exchange did so. In May 2004, the CBOT converted its mini-sized metals contracts from derivative markets to primary markets, and has been determining independent CBOT settlement prices since that time. Similarly, when the Exchange listed its full-sized metals contracts on October 6, 2004, in the wake of rising volume and open interest in the CBOT's mini-sized metals contracts, the full-sized metals contracts were established as primary markets, with settlement prices that have been determined from the beginning, without any reference to, or reliance upon, COMEX settlement prices.

The trading hours for the CBOT's full-sized metals contracts are 7:16 p.m. to 4:00 p.m., Central Time. The full-sized Silver contract is settled based on CBOT bids and offers at 12:25 p.m., Central Time, and the full-sized Gold contract is settled based on CBOT bids and offers at 12:30 p.m., Central Time. The CBOT's mini-sized metals contracts are settled to the same values as the CBOT's full-sized metals contracts. The CBOT chose settlement time frames that were similar, but not identical, to those utilized by COMEX.¹ The CBOT did not do so in order to utilize COMEX settlement prices, but rather in order to maintain standard industry practice in a manner that would benefit market participants and simplify back office processing for clearing firms.

NYMEX predicts all types of dire consequences that it believes could result from the fact that the CBOT settles its full-sized metals contracts several hours before the end of the trading session for these products. Far from being "aberrational", it is a common practice in the futures industry for settlements to be determined prior to the end of the trading session, for contracts that are traded both by open outcry and on an electronic platform, and for contracts that are traded exclusively on an electronic system. The CBOT has settled its mini-sized Silver and Gold contracts at 12:25 p.m. and 12:30 p.m., respectively, while trading continued until 4:00 p.m., since March 2003. The following chart reflects many other futures contracts at the CBOT and other exchanges that are currently settled while trading continues on an electronic platform:

Futures Contract	Trading Hours	Settlement
<u>CBOT</u>		
30-Year U.S. Treasury Bonds 10-Year U.S. Treasury Notes 5-Year U.S. Treasury Notes 2-Year U.S. Treasury Notes	7:20 a.m.- 2:00 p.m. (Open Outcry) and 7:00 p.m.- 4:00 p.m. (Electronic)	2:00 p.m.
When-Issued 2-Year Treasury Notes	7:01 p.m. – 4:00 p.m. (Electronic)	2:00 p.m.
10-Year Interest Rate Swaps 5-Year Interest Rate Swaps	7:20 a.m.- 2:00 p.m. (Open Outcry) and 7:03 p.m.- 4:00 p.m. (Electronic)	2:00 p.m.
10-Year Municipal Note Index	7:20 a.m.- 2:00 p.m. (Open Outcry) and 7:04 p.m.- 4:00 p.m. (Electronic)	2:00 p.m.

¹ Specifically, NYMEX stated that COMEX settlement prices for its metals contracts are based upon a "closing range period" of 12:29 p.m. to 12:30 p.m., Central Time.

30-Day Fed Funds	7:20 a.m.- 2:00 p.m. (Open Outcry) and 7:01 p.m.- 4:00 p.m. (Electronic)	2:00 p.m.
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mini-sized Dow (\$5)	7:15 p.m.- 4:00 p.m. (Electronic)	3:15 p.m.
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CME

Eurodollars CME Currencies	7:20 a.m.- 2:00 p.m. (Open Outcry) and 5:00 p.m.- 4:00 p.m. (Electronic)	2:00 p.m.
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Eurex US

2 Year U.S. Treasury Notes 5 Year U.S. Treasury Notes 10 Year U.S. Treasury Notes 30 Year U.S. Treasury Bonds	7:00 p.m. – 4:00 p.m.	2:00 p.m.
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Indeed, if NYMEX's logic were followed, futures markets would never be permitted to have a round the clock trading schedule, because they would have to close for a period of time in order to settle their contracts. Any time chosen by a market for settling its contracts provides a "snapshot of market information" that should fairly reflect the market at that time. Moreover, the fact that a particular time is chosen over another does not increase the relevant risks. For example, CME marks CME and CBOT positions to the market at approximately 11:00 a.m. based upon then-current prices, and marks such positions to the market at approximately 3:45 to 4:00 p.m. based on the daily settlement prices.

Notwithstanding the above, CME Rule 813.F., which applies to contracts cleared by CME for other exchanges, provides in part that, "if such settlement price would create risk management concerns for the Clearing House, the Clearing House reserves the right to calculate settlement variation using an alternate price determined by the Clearing House." Accordingly, CME is entitled to use different marking prices for margining purposes in the unlikely event that it believes that it would not be sufficiently protected from a risk management perspective by using the CBOT's settlement prices, e.g., if there were a major metals market move between 12:30 p.m. and 4:00 p.m. During the time that CME has provided clearing services to the CBOT, it has never found a need to utilize different marking prices for any of the CBOT's contracts, including those that settle prior to the end of the trading day.

Given the fact that the CBOT and other U.S. markets commonly settle many of their existing contracts that trade electronically, prior to the end of a trading session, and there has been no evidence of resultant trade practice abuses or financial integrity or risk management issues, it is clear that NYMEX's alarmist rhetoric is based on its lack of understanding of standard industry practice, and its concerns are misplaced. In fact, the concerns raised by NYMEX appear to have less to do with financial integrity, clearance and settlement concerns and more to do with concerns about competition with NYMEX metals contracts.

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NYMEX clearly misunderstands the CBOT's delivery procedures for its metals contracts. It is apparently referring to the Exchange's September 22, 2004 rule certifications that updated and modified various delivery and regularity provisions for the CBOT's mini-sized metals contracts. These amendments did not change the delivery instrument for these contracts. Warehouse depository receipts (WDR) have been used by the CBOT, and previously the MidAm, for many years, in order to permit market participants to deliver the smaller quantities specified for the mini-sized metals contracts. WDRs have no application to the full-sized metals contracts.

Some of the confusion may have been caused by the fact that, as we understand it, NYMEX uses the term "warehouse depository receipt" in the same way that the CBOT uses the term "vault receipt." Vault receipts are issued by depository vaults that have been declared "regular" by the Exchange for deliveries on one or more of the CBOT's metals contracts. The vaults have custody and control of the metals underlying the vault receipts.

Since Silver vaults generally do not issue receipts for quantities less than 5,000 troy ounces, and a mini-sized Silver contract calls for delivery of 1,000 troy ounces, a clearing firm that is obligated to make delivery of fewer than five contracts to any other clearing firm may transfer ownership of a 5,000 ounce vault receipt to the CBOT. The Exchange's Registrar will then give five WDRs, in the form set forth in the regulations, to the clearing firm. Then the clearing firm will be able to deliver one or more WDRs to one or more clearing firms. The Exchange functions as a holder of the vault receipt, and pays the relevant storage charges, until a clearing firm accumulates five WDRs, returns them to the Registrar, and reimburses the Exchange for the storage charges. The Registrar then transfers ownership of a 5,000-ounce vault receipt to the clearing firm. WDRs serve the same function for the CBOT's mini-sized Gold contract. The CBOT's long-standing practice of issuing WDRs to facilitate deliveries of quantities of metals that are smaller than the standard quantities covered by vault receipts has served the industry well over the years, and has not raised any regulatory issues.

In sum, the NYMEX's letter is based on misunderstanding and misinformation, and therefore, the concerns that it has raised have no basis in fact. Please contact me if you would like to discuss any of these issues.

Respectfully submitted,

Bernard W. Dan

cc: Commissioner Walter Lukken

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