4j(a) of the Act upon finding that the trade monitoring system satisfies the requirements of Section 5a(b) of the Act by effectively detecting and deterring dual trading-related abuses. I dissent from the Commission's proposed Order granting the CME a conditional exemption in seven affected markets.

Based on information provided to the Commission, I find that the CME's trade monitoring system as a whole effectively detects and deters dual trading abuses and therefore accomplishes the intended objectives of the Act. Additionally, in 1991 the CME implemented a dual trading restriction as part of its trade monitoring system which the Commission approved. The Commission has reviewed the CME's enforcement of that restriction over the past six years and found it to be effective.

Therefore, I find that CME's trade monitoring system, including its dual trading restriction, meets the standards for an unconditional exemption from the dual trading prohibition.

[FR Doc. 97–29892 Filed 11–12–97; 8:45 am]

BILLING CODE 6351–01–P

COMMODITY FUTURES TRADING COMMISSION

Chicago Board of Trade Petition for Exemptions From the Dual Trading Prohibition Set Forth in Section 4j(a) of the Commodity Exchange Act and Commission Regulation 155.5

AGENCY: Commodity Futures Trading Commission.

ACTION: Notice of intent to condition and proposed order granting conditional exemptions from the prohibition on dual trading in 13 affected contract markets.

SUMMARY: For the reasons set forth in the Proposed Order Granting Conditional Dual Trading Exemptions (''proposed Order''), the Commodity Futures Trading Commission (''Commission'') intends to grant, subject to the stated conditions, the petition of the Chicago Board of Trade (''CBT'' or ''Exchange'') for exemptions from the dual trading prohibition in Section 4j(a) of the Commodity Exchange Act (''Act'') and Commission Regulation 155.5 for its Wheat, Corn, Soybean, Soybean Meal, Soybean Oil, U.S. Treasury Bond, 10-Year Treasury Note, and 5-Year Treasury Note futures contracts and the option contracts on the Corn, Soybean, U.S. Treasury Bond, 10-Year Treasury Note, and 5-Year Treasury Note futures. Pursuant to the Act and Commission Regulation 155.5(d)(8)(C)(iii), CBT may submit written supplemental data, views or arguments and will have an opportunity to make an oral presentation to the Commission before the Commission makes its final determination.

DATES: If CBT intends to make an oral presentation, it must submit its request in writing no later than ten days after receipt of this proposed Order. CBT must submit any written supplemental data, views or arguments within 30 days of receipt of this proposed Order.

ADDRESSES: CBT's request for oral presentation and submission of written supplements are to be sent to the Office of the Secretariat, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581.

FOR FURTHER INFORMATION CONTACT: Rachel Fanaroff Berdansky, Special Counsel, or Duane C. Andresen, Special Counsel, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, N.W., Washington, D.C. 20581; telephone: (202) 418–5490.

SUPPLEMENTARY INFORMATION: A floor broker engages in dual trading when he or she executes a customer's order during the same trading session in which he or she executes, directly or indirectly, a trade in the same contract for his or her own account or an account in which he or she has an interest. Dual trading can afford floor brokers the opportunity to abuse customer orders if audit trail information and surveillance are insufficient to permit the detection of such abuses. Specifically, a dual trading floor broker can directly commit abuses of customer orders such as trading ahead or against those orders and also has an informational advantage for his or her personal trading.[1] Section 4j(a) of the Act and Regulation 155.5 prohibit dual trading and establish trade monitoring standards that must be met in order for contract markets to be exempted from the prohibition.

The Commission intends to issue the following proposed Order granting CBT conditional dual trading exemptions pursuant to Section 4j(a) of the Act and Commission Regulation 155.5. In accordance with Regulation 155.5(d)(8), CBT may submit to the Commission in writing any supplemental data, views or arguments within 30 days of receipt of this Notice and proposed Order. In addition, CBT may request, in writing within ten days of receipt of this Notice and proposed Order, an opportunity to make an oral presentation to the Commission. If CBT submits a request for an oral presentation, the Exchange will be notified by the Commission of the date and the terms under which CBT may make such presentation. Public notice of such an oral presentation also will be provided in accordance with the requirements of the Government in the Sunshine Act, 5 U.S.C. 552b (Supp. I 1995).

Proposed Order Granting Conditional Dual Trading Exemptions

On October 25, 1993, CBT submitted a Petition for Exemption from the Dual Trading Prohibition contained in Section 4j of the Act and Commission Regulation 155.5 for its Wheat, Corn, Soybean, Soybean Meal, Soybean Oil, U.S. Treasury Bond, 10-Year Treasury Note, and 5-Year Treasury Note futures contracts and the option contracts on the U.S. Treasury Bond and 10-Year Treasury Note futures. The Exchange corrected that petition on December 2, 1993. Subsequently, by letters dated March 25 and May 14, 1994, CBT supplemented its petition to include the option contracts on its Corn, Soybean and 5-Year Treasury Note futures since such contract markets had reached average daily volumes of 8,000 contracts and, thus, had become affected contract markets (''affected contract markets'') as defined in the Act and regulations thereunder.[2] CBT updated its petition on January 17, 1997, with respect to all 13 of its affected contract markets. Notice of the public availability of the CBT's updated exemption petition was published in the **Federal Register** on February 20, 1997.[3]

[1] The Commission has previously discussed in several instances, including its November 28, 1994 *Report to Congress on Futures Exchange Audit Trails*, the possible abuses attendant to dual trading. *See also* the Commission's Proposed Regulation Prohibiting Dual Trading by Floor Brokers, 56 FR 13025 (March 9, 1993).

[2] *Affected contract market* means a contract market with an average daily volume equal to or in excess of 8,000 contracts for each of four quarters during the most recent volume year. Commission Regulation 155.5(a)(9). *See* Section 4j(a)(4) of the Act. As noted by the Commission in promulgating Regulation 155.5, a contract market trading on an exchange floor will be considered separate from a contract market in the same commodity trading a screen-based trading system. The Commission further stated that, while not excluding electronic trading from the dual trading prohibition, the Commission was retaining the flexibility to consider the matter further. *See* 58 FR 40335 (July 28, 1993). The Commission is not addressing screen-based trading in this proposed Order.

[3] 62 FR 7754 (February 20, 1997). The Commission did not address the Exchange's dual trading exemption petition in 1994 in large part because of the Exchange's prior representation that it intended to automate the entry of trade execution times by developing a handheld electronic trading terminal. By letter dated June 22, 1994, CBT informed the Commission that the proposed handheld terminal would not be in place by the October 1995 deadline for compliance with the heightened audit trail standards set forth in Section 5a(b)(3) of the Act. Because CBT had not sufficiently demonstrated that its existing audit trail system met current and future standards, the Commission required the Exchange to demonstrate

Continued

Upon consideration of CBT's petition, as supplemented, and other data and analysis, including, but not limited to:

Exchange audit trail test results reconciling imputed times to underlying trade documentation and verifying data on ''window sizes'';

actions taken in response to the Commission's November 1994 *Report to Congress on Futures Exchange Audit Trails*, June 1995 *Report on Audit Trail Accuracy and Sequencing Tests* (''Audit Trail Report''), and August 12, 1996 *Report on Audit Trail Status and Re-Test* (''Audit Trail Re-Test Report'');

Commission trade practice investigations and compliance reviews conducted in conjunction with rule enforcement reviews or other investigatory or surveillance activities;[4]

the Division of Trading and Markets Memorandum dated October 28, 1997;

and upon review of each element of CBT's trade monitoring system and of CBT's trade monitoring system as a whole, the Commission finds that the Exchange's trade monitoring system does not fully satisfy the requirements of Sections 5a(b) and 4j(a)(3) of the Act and Regulation 155.5 in that the audit trail, recordkeeping, and physical observation of trading areas components are deficient. The Commission finds that corrective actions are sufficient and appropriate to meet those standards. In addition, the Commission finds that, based on an analysis of the composition of trading (by transaction size and volume) of certain distant contract expirations and option markets, there is a substantial likelihood that the broad scope of the dual trading prohibition specified under Section 4j of the Act and Regulation 155.5, which applies to a contract market as a whole, would harm the public interest in hedging or price basing in less liquid months of the affected contract markets. Therefore, the Commission has determined to grant CBT conditional exemptions from the dual trading prohibition of Section 4j of the Act and Regulation 155.5 in its 13 affected contract markets.

The Commission is granting the Exchange's petition subject to the Exchange taking the corrective actions specified below and implementing and enforcing the dual trading restriction described in the Appendix to this proposed Order. The Commission has concluded that the proposed dual trading restriction, which imposes a prohibition on dual trading in actively traded months but has no impact on less actively traded back months, is appropriate as a method to deter dual trading-related abuses and other customer abuses. The Commission's limited restriction, as opposed to the statutory dual trading ban, strikes a balance between the need to preserve liquidity in certain low volume months and the need to protect customers from the potential abuses that are associated with dual trading.

The Commission *Hereby Finds* as follows:

Components of Exchange's Trade Monitoring System

Audit Trail System

One-Minute Execution Time Accuracy

The Exchange's audit trail system fails to record ''reliably accurate'' trade times in increments of no more than one minute in length as required by Section 5a(b)(2) of the Act, Regulation 1.35(g), and Appendix A to Regulation 155.5.[5] Specifically, the Exchange has not established for any of its 13 affected contract markets that 90 percent or more of imputed trade times, as assigned by the Exchange's trade timing system, are reliable, precise, and verifiable as demonstrated by being imputed within a timing window of two minutes or less (''90 percent performance standard''). Thus, an impermissible amount of the trade timing data, an integral part of an exchange's trade monitoring system, is not reliably accurate in accordance with that standard and thus negatively impacts the Exchange's surveillance systems and investigatory and disciplinary action programs.

The Commission has made clear that a reliably accurate imputed trade execution time only can be demonstrated by a timing window that narrows the time assigned to the trade to a two-minute period within which the trade is most likely to have occurred. Even where an exchange can demonstrate a trade timing window of two minutes or less, it is not possible to determine where within that window the trade occurred. This underscores the critical need for compliance with the 90 percent performance standard.

CBT's Advanced Computerized Trade Reconstruction (''Advanced CTR'') system imputes an execution time for every trade.[6] Trade times are imputed based upon entry and exit timestamps on order tickets; time and sales reports; trading card numbers and sequence of trades on trading cards; certain handwritten execution times; times that trades were submitted for clearing; 15-minute bracket codes; calculated differentials for spread trades; identification of spread legs and types of spread trades; and any available times resulting from electronic order entry or trading systems. Based on these data, Advanced CTR determines various time spans within which a trade is likely to have been executed and ultimately assigns an imputed execution time for the trade.

The audit trail tests designed and reviewed by the Commission and conducted by the Exchange in response to a November 23, 1994 Commission letter involved a determination of the consistency of imputed trade execution times with all underlying audit trail records and data. Based upon that process, trade timing accuracy and sequencing rates for CBT's imputed system were computed.[7] In reviewing

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its ability to meet the audit trail requirements using Commission-designed tests and, thus, deferred consideration of the Exchange's petition. Subsequent to evaluating the results of the tests, the Commission offered CBT the opportunity to supplement its petition.

[4] A list of the specific documents considered in connection with this proposed Order will be made available to the Exchange upon request. Copies of any documents not originally furnished by CBT also will be made available upon request.

[5] Commission Regulation 1.35(g) requires that ''[a]ctual times of execution shall be stated in increments of no more than one minute in length.'' Section 5a(b)(2) of the Act, among other things, codified that timing requirement by stating that an exchange's audit trail system shall, ''consistent with Commission regulation, accurately record the times of trades in increments of no more than one minute in length.'' Section II of Appendix A to Commission Regulation 155.5 requires that a contract market, in describing its audit trail system in a petition for exemption from the dual trading prohibition, ''[d]emonstrate the highest degree of accuracy practicable (but in no event less than 90% accuracy) of trade execution times required under regulation 1.35(g) (within one minute, plus or minus, of execution) * * *.'' In addition, the contract market must ''[d]emonstrate the effective integration of such trade timing data into the contract market's surveillance system with respect to dual trading-related abuses.'' For contract markets that impute trade execution times, Appendix A requires that the contract market provide a description of the trade imputation algorithm, ''including how and why it reliably establishes the accuracy of the imputed trade execution times.''

[6] An imputed timing system does not capture the actual trade execution time but derives a time from other timing and trade data.

[7] To the extent that the time imputed by a computer algorithm was consistent with required trade documentation, time and sequence data and time and sales information for the subject trade and surrounding trades, that time was deemed accurate. If that imputed time fell within a two-minute level of precision as measured by the size of the final time window determined by such algorithm, that imputed time was considered to be verifiable, reliable and precise. Thus, the Commission stated in its Audit Trail Report, ''90 percent of CBT trade times satisfied the standards [of consistency with underlying data] for Test I. However, for 59 percent of the trade times deemed accurate, available data are not sufficiently precise to verify that the one-minute audit trail time chosen was actually within the minute of execution.'' Audit Trail Report at 17.

Under the 90 percent performance standard, only trade times assigned by the Exchange's imputed timing system within timing windows of two

the results of the test designed to evaluate trade timing accuracy, Commission staff determined that, although 91 percent of CBT's trade times satisfied the standard for consistency with the underlying data, only 41 percent of those trade times had timing windows of two minutes or less and thus could be verified.[8] In March 1996, the Commission conducted a re-test of CBT's audit trail system. Although 92.7 percent of CBT's trade times satisfied the standard for consistency with the underlying data, only 69.2 percent of the trade times had timing windows of two minutes or less and thus could be verified.

Subsequent to the re-test, the Exchange provided windows data for all affected contract markets in response to Commission requests. For December 19, 1996, the overall percentage of trades with timing windows of two minutes or less was 67 percent. For subsequent dates, the Exchange computed windows data separately for each affected contract market in addition to computing overall windows data. The overall percentage of trades with timing windows of two minutes or less was 84 percent on March 26, 1997, and 85 percent on May 28, 1997; June 5, 1997; and June 10, 1997. For those same dates, the percentage of trades with timing windows of two minutes or less computed separately for each affected contract market ranged from 58 to 89 percent on March 26, 1997; 74 to 89 percent on May 28, 1997; 69 to 91 percent on June 5, 1997; and 70 to 90 percent on June 10, 1997.[9] Thus, the Exchange has not demonstrated that its imputed trade execution times are sufficiently reliable, precise, and verifiable in that it has not established that 90 percent or more of such times are imputed within timing windows of two minutes or less.

The negative impact on the components of the Exchange's trade monitoring system resulting from its failure to satisfy the 90 percent performance standard is exacerbated because CBT does not require the recordation of a member's personal and customer trades in sequence.[10] Given the absence of such a recordation requirement, reliably accurate trade times are essential for effective determination of the sequence of trades. Where the sequence of customer and personal trades is not determined, possible dual trading-related abuses, such as trading ahead of customer orders and trading against customer orders, could go undetected.

Other Components of CBT's Audit Trail System

With regard to the requirement that trade data be provided continually to the Exchange in accordance with Section 5a(b)(3)(A)(ii) of the Act, exchange audit trail systems must provide trade data, including trade timing information, on a periodic, but not necessarily real-time, basis.[11] Such information also must be obtained in a timely manner. The Exchange requires that clearing members submit trade data for clearing within one hour after the end of each hour on the half-hour. However, as explained below, the Exchange fails to enforce the requirement that trading cards be collected and timestamped in a timely manner. This failure calls into question the Exchange's ability to assure that trade data are provided continually to clearing.

With regard to unalterability, as mandated by Section 5a(b)(3)(A)(i) of the Act, the Exchange's trade records are unalterable, since they are recorded on trading cards and order tickets in nonerasable ink. Trade corrections also are not permitted to obscure original data.[12]

CBT's imputed timing system, which uses data from sources other than the trader, as well as data provided by the trader, to derive times, also meets the Section 5a(b)(3)(A)(iii) standards for independence, to the extent

minutes or less are reliably accurate. As noted above, Commission staff deems accurate those trades for which the imputed trade times are consistent with all underlying audit trail records and data, as determined by manual review. When comparing windows data for accurate trades and all trades, the Division has found that a higher percentage of accurate trades are assigned imputed times that fall within windows of two minutes or less and thus meet the 90 percent performance standard. However, the resulting percentage difference between accurate and all trades generally has not exceeded one percent. In addition, since the use of all trades data facilitates exchange submission of timing windows percentages because such data do not have to be generated in conjunction with an accuracy test, which requires an analysis of extensive trade documentation, the Commission finds that the use of all trades data provides an acceptable basis for determining windows performance.

[8] In response to recommendations made in the Audit Trail Report, the Exchange modified its trading card procedures such that a member can record only one time bracket per trading card, record no more than six trades per trading card, and use only one-sided trading cards to record for each trader all personal buy and sell trades in sequence. Additionally, the Exchange implemented recommendations that it enforce certain data recordation and submission requirements, requirements to record correct customer type indicator codes, and timestamping procedures for flashed orders.

The Exchange also made a number of improvements to its trade timing system. CBT now requires a trade submission indicator for flashed orders, uses seconds in the imputed timing system, when available, including seconds from order ticket timestamps, requires member firms to input the seconds from order entry and order confirmation timestamps into the trade entry system, reprogrammed CTR to impute proper execution times for trades executed during the close, and upgraded synchronized timestamp clocks to record times to the nearest second. The Exchange also made programming improvements to its timing algorithm.

CBT declined to implement two Commission recommendations: that members record and use manual execution times for at least the first and sixth trades on trading cards, and that the Exchange include the identity of traders in the spread time and sales.

[9] May 28, 1997; June 5, 1997; and June 10, 1997 were selected by Commission staff using a random sampling method. The Exchange also provided similar percentage data for three days of its own choosing. The overall percentage of trades with timing windows of two minutes or less was 87 percent on May 13 and May 20, 1997 and 88 percent on May 15, 1997. For those same dates, the percentage of trades with timing windows of two minutes or less computed separately for each affected contract market ranged from 74 to 90 percent on May 13, 1997; 72 to 91 percent on May 15, 1997; and 68 to 90 percent on May 20, 1997.

The Exchange submitted data indicating that 90 percent or more of the imputed trade times in its Soybean futures contract had timing windows of two minutes or less on one of the three dates selected at random by Commission staff and on all three dates selected by the Exchange. Although the Commission considers timing windows data for all dates provided, the dates selected by persons other those affiliated with the Exchange are accorded greater weight in determining whether an affected contract market attains the 90 percent performance standard. Overall, the windows data for the Soybean futures contract market does not demonstrate consistent compliance with the 90 percent performance standard.

[10] Notably, although there are differences in various systems among the exchanges, the three other exchanges for which the Commission has granted unconditional exemptions from the dual trading prohibition require that customer and personal trades be recorded sequentially on a single trading document. Similar to CBT, one of those exchanges, the Coffee, Sugar and Cocoa Exchange, Inc., also uses an imputed timing system to assign trade execution times. Such sequencing also can be achieved by recording personal and customer trades in sequence on one set of sequentially numbered trading documents. As the Commission noted in discussing the results of CBT's first audit trail test, ''recordation of a member's personal and customer trades in sequence should be the Exchange's objective.'' Audit Trail Report at 20. Section 5a(b)(3) of the Act provides, among other things, that an exchange's audit trail system must record accurately and promptly essential data on all trades, including execution time, through a means that is adequately precise to determine the sequence of customer and personal trades, to the extent practicable as determined by the Commission by rule or order.

[11] See Audit Trail Re-Test Report at 39.

[12] The Commission requires retention of a record of any cancellations, changes, or corrections to trades. Commission Regulation 1.35(d) and the Outtrade Interpretation, 54 FR 37004 (September 6, 1989). The Commission amended Regulation 1.35(d)(7), effective October 21, 1996, to require that the correction of erroneous information on trading records be accomplished in such a manner that the originally recorded information must not be obliterated or otherwise made illegible. 61 FR 42999 (August 20, 1996). In December 1996, CBT amended its Floor Practices Rule 332.05 and 332.07 to comport with the Commission's amendment to Regulation 1.35(d)(7).

practicable.[13] The Exchange's existing system uses, among other things, data generated by both buyers and sellers for personal trades, including trading card numbers and sequence of trades on trading cards, certain execution times required to be entered manually, entry and exit timestamps on order tickets, time and sales data and 15-minute bracket codes to impute trade execution times.

The Exchange requires that personal trades be recorded in sequence, consistent with Commission regulations, by requiring that members record such trades in sequence on pre-numbered trading cards.[14] The Exchange adopted a single-sided trading card on which all personal buy and sell trades are required to be recorded sequentially in response to an Audit Trail Report recommendation. However, as noted elsewhere, the Exchange does not require the recordation of a member's personal and customer trades in sequence. Given the absence of such a recordation requirement, reliably accurate trade times are essential for effective determination of the sequence of trades.

CBT enforces its audit trail requirements and integrates audit trail data into its surveillance system for dual trading-related abuses. However, because the Exchange's trade surveillance system incorporates into its data, including exception reports, an impermissible amount of imputed execution times that are not reliably accurate, the effectiveness of the Exchange's integration of audit trail data is diminished.

As required by Section 5a(b)(1)(B) of the Act, CBT's trade entry and outtrade resolution programs capture certain essential data on cleared trades, unmatched trades, and outtrades.

Finally, with regard to broker receipt times, the Commission finds that it is not practicable at this time for CBT to record the time that each order is received by a floor broker for execution. Immediately executable flashed orders, however, are in substantial compliance with the objectives of Section 5a(b)(3)(B) of the Act, as stated previously by the Commission in its Order on flashed orders and broker receipt times.[15]

Physical Observation of Trading Areas

CBT's trade monitoring system does not provide for physical observation of trading areas in accordance with Section 5a(b)(1)(A) of the Act in that the Exchange does not conduct daily floor surveillance on the open and close to the extent practicable in each affected contract market as required by Appendix A to Regulation 155.5. As part of the Exchange's Market Open/Close Floor Surveillance Program, CBT currently conducts floor surveillance on the open for only half of the affected contract markets and on the close for the remaining half. The Exchange conducts some additional open/close floor surveillance as part of other specialized surveillance programs. The Exchange does conduct floor surveillance at random times and when special market conditions warrant. Information obtained during floor surveillance is integrated into the Exchange's other compliance activities. During 1996, the Exchange initiated two investigations based upon floor surveillance observations.

Recordkeeping System

The recordkeeping component of CBT's trade monitoring system fails to comply with Section 5a(b)(1)(B) of the Act because it does not satisfy the trading record collection and timestamping requirements of Regulation 1.35(j). These requirements are essential to maintaining the basic integrity of trading records used in the Exchange's system to capture essential data on the sequence of transactions in that they ensure the removal of such records from the member's possession in a timely manner and thereby limit the opportunity to alter records, to fabricate trades, or otherwise to use trading records to disadvantage customer accounts. Only approximately 67 percent of the trading cards selected for review by Commission staff were submitted to the clearing member within 15 minutes of the 30-minute trading interval and timestamped promptly to the nearest minute following collection as required by Regulation 1.35(j). The Exchange, however, does use information from the records and violations of recordkeeping requirements to bring disciplinary actions.

In addition, because CBT does not meet the 90 percent performance standard, the system captures an impermissible amount of trade timing data that is not reliably accurate. This circumstance is compounded by the fact that CBT does not require the recordation of personal and customer trades in sequence. As a result, the Exchange's recordkeeping system is limited in its capability to capture essential data on the sequence of customer trades.

CBT generally conducts back office audits of trading cards and order tickets at each clearing member firm twice a year for a representative sample of customer orders and personal trades. CBT also uses a computerized tracking system to monitor member compliance daily with certain trade timing and sequencing requirements, regularly examines trading records during the course of investigations for possible recordkeeping violations, and uses information from these audits to generate investigations. The Exchange requires that the account identifier reflected on the floor order ticket relate back to the ultimate customer account.

Surveillance Systems and Disciplinary Actions

The inclusion of an impermissible amount of trade timing data that is not reliably accurate in the Exchange's trade monitoring system diminishes the capability of the Exchange's trade surveillance system to review trade data effectively, and as a result, possible dual trading-related abuses could go undetected. Further, the lack of reliably accurate trade timing data diminishes the capability of the Exchange's disciplinary program to bring appropriate disciplinary actions against violators. In other respects, the Exchange's trade surveillance system may be capable of reviewing and is used to review trading data on a regular basis to detect possible dual trading-related abuses and other customer order abuses. In addition, CBT did bring disciplinary actions against offenders and issued meaningful penalties against violators.[16] Therefore, CBT has demonstrated the capability to use information generated by its trade monitoring and audit trail systems on a consistent basis to bring appropriate disciplinary action for violations relating to the making of trades and execution of customer orders as required by Sections 5a(b)(1)(C), (D) and (F) of the Act. Further, CBT refers appropriate cases to the Commission.

On a daily basis, CBT reviews Trade Practice Investigation Reports and uses its Sophisticated Market Analysis Research Technology system, a framework for reviewing such data, to detect possible instances of dual trading-related abuses and other trading abuses. All relevant trade data, including account numbers, are

[13] *See* Audit Trail Re-Test Report at 40.

[14] Commission Regulation 1.35(d)(2) requires that each member of a contract market recording purchases and sales on trading cards must record such purchases and sales in exact chronological order of execution on sequential lines of the trading card.

[15] 60 FR 58049 (November 24, 1995).

[16] This proposed Order does not address certain disciplinary actions taken by the Exchange regarding the March 1996 Wheat futures contract expiration. Those matters are before the Commission in a separate proceeding.

included in these reviews. Among the computerized exception reports generated by the Exchange and reviewed daily are those designed to identify such suspicious trading activity as trading ahead of a customer, trading against a customer, preferential trading and wash trading and to review outtrade resolution and U.S. Treasury Bond futures contract broker association top step trading.[17]

During 1996, CBT initiated 309 investigations into all types of trading related abuses. Of the 86 investigations opened and closed during this period, 34 percent were closed within the four-month objective set forth in Commission Regulation 8.06, and an additional 28 percent were closed within four to six months. Thus, approximately 62 percent of the investigations opened and closed during 1996 were closed in six months or less. CBT should improve the timeliness of its investigations or provide the reasons that such investigations require more than four months to complete. During that same period, the Exchange opened and closed 45 dual trading-related investigations, and referred nine of those investigations to a disciplinary committee. CBT assessed substantial penalties in 13 disciplinary actions involving dual trading-related abuses.

Commitment of Resources

The Commission finds that CBT commits sufficient monetary resources to its trade monitoring system to be effective in detecting and deterring violations attributable to dual trading. The Exchange maintains an adequate staff to conduct investigations and to develop and prosecute disciplinary actions. For calendar year 1996, the Exchange reported that it committed 141 personnel to the Exchange's various self-regulatory activities and reported its total self-regulatory costs to be $15,456,317. CBT's reported volume for this period was 222,438,505 contracts, and the number of trades was 17,675,749. However, CBT should allocate its resources as appropriate to improve its trade monitoring system, as discussed above.

[17] Broker association members trading on the top step of the U.S. Treasury Bond pit are subject to trading restrictions. These restrictions limit the amount of customer and personal trades members can execute opposite each other in the most active contract month. Members cannot trade more than 20% of their monthly volume (brokerage and personal trades) opposite members of their broker association. The members also cannot trade more than 20% of their monthly volume against members of a contiguous broker association. In total, the members cannot trade more than 30% of their monthly volume against members of their own and a contiguous broker association.

Accordingly, the Commission *Hereby orders* that:

The Exchange must implement the following corrective actions:

(1) achieve compliance with the 90 percent performance standard,
(2) significantly improve compliance with the requirement that trading records be collected and timestamped in accordance with Commission regulations, and
(3) conduct floor surveillance daily on the open and close for each affected contract market.

The Commission *Further orders* that:

Until such time as the Exchange demonstrates that its trade monitoring system satisfies the relevant standards, the Exchange shall be subject to the following condition: Within 60 days from the effective date of a final Order, the Exchange must implement and enforce the limited dual trading restriction described in the Appendix to this proposed Order, which is less restrictive than the dual trading prohibition of Section 4j of the Act and Regulation 155.5. Such dual trading restriction currently would apply to the following affected contract markets: Wheat, Corn, Soybean, Soybean Meal, Soybean Oil, U.S. Treasury Bond, 10-Year Treasury Note, and 5-Year Treasury Note futures contracts and the option contracts on the Corn, Soybean, U.S. Treasury Bond, 10-Year Treasury Note, and 5-Year Treasury Note futures.

Accordingly, the Commission proposes to grant CBT'S Petition for Exemption, subject to the stated conditions, from the dual trading prohibition for trading in its Wheat, Corn, Soybean, Soybean Meal, Soybean Oil, U.S. Treasury Bond, 10-Year Treasury Note, and 5-Year Treasury Note futures contracts and the option contracts on the Corn, Soybean, U.S. Treasury Bond, 10-Year Treasury Note, and 5-Year Treasury Note futures.

If, at any time, CBT believes that it can demonstrate to the Commission's satisfaction that it meets, for an affected contract market subject to this Order, all of the standards set forth in this Order, including, but not limited to, those in Section 5a(b) and Regulation 155.5, the Exchange may petition for an unconditional exemption to the dual trading prohibition for that affected contract market.

Unless otherwise specified, the provisions of this proposed Order shall be effective on the date on which it is issued as a final Order by the Commission, and the condition shall become effective as stated herein and shall remain in effect unless and until removed, as provided above, or revoked in accordance with Section 8e(b)(3)(B) of the Commodity Exchange Act, 7 U.S.C. 12e(b)(3)(B). Failure of CBT to abide by the condition of a limited dual trading restriction will automatically cause the dual trading prohibition set forth in Section 4j of the Act and Regulation 155.5 to go into effect.

If other CBT contract markets become affected contract markets after the date this Order becomes final, the Exchange would be required, absent submission of a dual trading exemption petition, to restrict dual trading in those affected contract markets in accordance with the dual trading prohibition set forth in Section 4j of the Act and Regulation 155.5. Further, if CBT demonstrates to the Commission's satisfaction that an affected contract market subject to this Order has ceased to meet the Regulation 155.5(a)(9) affected contract market threshold, that contract market no longer would be subject to this Order.

Dated: November 7, 1997.

By the Commission:

Edward W. Colbert,

Deputy Secretary.

Appendix—Dual Trading Restriction

a. Restriction

A floor broker is prohibited from executing customer orders in an affected contract market month, as defined below, during the same pit trading session in which the floor broker executes directly, or initiates and passes to another member for execution, a transaction in any such affected contract market month for (1) the floor broker's own account, (2) any account in which the floor broker's ownership interest or share of trading profits is ten percent or more, (3) any account for which the floor broker has trading discretion, or (4) any other account controlled by a person with whom such floor broker is subject to trading restrictions under Section 4j(d) of the Act to the extent such section is applied by Commission regulation or order.

b. Affected Contract Market Month (Volume)

Affected contract market month means: (1) For each affected non-agricultural contract market, any contract market month with an average daily trading volume of 10,000 contracts or more as determined by, at the election of the Exchange, either (i) trading in a contract month by position in relation to the front month contract, as defined below, during the prior six calendar months or (ii) trading in the previous calendar month; and (2) For each affected agricultural contract market, any contract market month with an average daily trading volume of 10,000 contracts or more as determined by trading in the previous calendar month. For this purpose, daily trading volume means the total number of contracts sold (or bought) in any contract month of an affected contract market during a trading day, with the average computed as set forth above and excluding ex-pit transactions as permitted under

contract market rules that have been made effective under the Act. There will be a two business day allowance at the beginning of each calendar month for computation and member notification purposes.

c. Affected Contract Market Month (Front Month)

Front month means, for each affected contract market, the month which is either the expiration or delivery month which is nearest to expiration or at the Exchange's discretion the expiration or delivery month which is next nearest to expiration when the contract month nearest to expiration is five business days or less from the first notice day or last trading day for cash settled contracts for futures contracts or the expiration date for futures options contracts. If a front month is not subject to a prohibition pursuant paragraph b. above, then it shall, nonetheless, be an affected contract market month and be subject to a prohibition unless, on the basis of historical data, that front month reasonably can be expected to have an average daily trading volume of less than 500 contracts.

d. Exceptions

Dual trading shall be permitted under exceptions consistent with Commission Regulation 155.5(c)(4) in accordance with Exchange rules which the Commission has permitted to go into effect pursuant to Section 5a(a)(12)(A) of the Act and Regulation 1.41.

Notice of Intent To Condition and Proposed Order Granting Conditional Dual Trading Exemptions to the Chicago Board of Trade, Supplemental Statement of Commissioner John E. Tull, Jr.

I am happy to support the Commission's action proposing to grant the CBOT conditional dual trading exemptions for its affected markets. I am troubled, however, by that part of the Commission's Proposed Order which orders the CBOT to conduct floor surveillance daily on the open and close for each affected market when such surveillance is not required by the Act or the Commission's Regulations. Appendix A to Regulation 155.5 states that such surveillance should be conducted to the extent practicable. In my opinion, the Commission should not attempt to instruct an exchange regarding the allocation of its resources with such specificity. Such management decisions are better left to the exchange leadership, which has hands-on, daily contact with the markets at issue. Management should have the discretion to assign exchange personnel as needed to monitor ''hot'' markets or pits with trading activity of concern.

Opinion of Commissioner Barbara Pedersen Holum, Concurring in Part and Dissenting in Part, on the Disposition of the Chicago Board of Trade's Dual Trading Petition

For the reasons set out below, I concur with the findings of the proposed Order but I dissent from the proposed Order's imposition of a Commission-designed dual trading restriction.

Section 4j(a)(3) of the Commodity Exchange Act requires the Commission to exempt a contract market conditionally from the dual trading prohibition of Section 4j(a) of the Act upon finding that: (1) There is a substantial likelihood that a dual trading suspension would harm the public interest in hedging or price basing at the contract market, and (2) other corrective actions are sufficient and appropriate to bring the contract market into compliance with the standards of Section 5a(b) of the Act by effectively detecting and deterring dual trading-related abuses. The Commission has determined that the Chicago Board of Trade's trade monitoring system fails to satisfy the standards necessary for an unconditional exemption, but that it meets the criteria for granting a conditional exemption. In addition, the Commission has determined to impose a dual trading restriction on the CBT a as condition to the exemption. Given these findings, I agree with the majority's view that the CBT should be granted a conditional exemption. However, I dissent from the proposed Order because it would impose a Commission-designed dual trading restriction on the CBT as a condition to the exemption.

Consistent with the statutory framework of self-regulation, I believe that the CBT should adopt its own rules to detect and deter dual trading abuses. When the CBT's trade monitoring system as a whole is determined by the Commission to meet the objectives of the Act by detecting and deterring dual trading abuses, the CBT would be granted an unconditional exemption.

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COMMODITY FUTURES TRADING COMMISSION

Chicago Mercantile Exchange Petition for Exemption From the Dual Trading Prohibition Set Forth in Section 4j(a) of the Commodity Exchange Act and Commission Regulation 155.5

AGENCY: Commodity Futures Trading Commission.

ACTION: Order.

SUMMARY: The Commodity Futures Trading Commission (''Commission'') is granting the petition of the Chicago Mercantile Exchange (''CME'' or ''Exchange'') for exemption from the prohibition against dual trading in its S&P 500 futures contract.

DATES: This Order is to be effective November 7, 1997.

FOR FURTHER INFORMATION CONTACT: Duane C. Andresen, Special Counsel, or Rachel Fanaroff Berdansky, Special Counsel, Division of Trading and Markets, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st St., N.W., Washington, DC 20581; telephone (202) 418–5490.

SUPPLEMENTARY INFORMATION: On October 20, 1993, CME submitted a Petition for Exemption from the Dual Trading Prohibition contained in Section 4j of the Commodity Exchange Act (''Act'') and Regulation 155.5 for its affected contract markets, including the S&P 500 futures contract market.[1] The Exchange corrected that petition on December 1, 1993. Subsequently, the Exchange amended its petition on January 21, 1994. CME updated its petition on January 21, 1997. Notice of the public availability of the CME's updated exemption petition was published in the **Federal Register** on February 20, 1997.[2]

Upon consideration of CME's petition, as supplemented, and other data and analysis, including, but not limited to:

Exchange audit trail test results reconciling imputed times to underlying trade documentation and verifying data on ''window sizes''; actions taken in response to the Commission's November 1994 *Report to Congress on Futures Exchange Audit Trails*, June 1995 *Report on Audit Trail Accuracy and Sequencing Tests* (''Audit Trail Report''), and August 12, 1996 *Report on Audit Trail Status and Re-Test* (''Audit Trail Re-Test Report''); Commission trade practice investigations and compliance reviews conducted in conjunction with rule enforcement reviews or other investigatory or surveillance activities.

The Exchange's S&P 500 futures contract trading restrictions.[3]

[1] *Affected contract market* means a contract market with an average daily volume equal to or in excess of 8,000 contracts for each of four quarters during the most recent volume year. Commission Regulation 155.5(a)(9). See Section 4j(a)(4). The Commission is granting CME conditional exemptions from the dual trading prohibition for its remaining seven affected contract markets. A Notice of Intent to Condition and proposed Order granting such conditional exemptions is being submitted for publication together with this Order.

[2] 62 FR 7755 (February 20, 1997). The Commission did not address the Exchange's dual trading exemption petition in 1994 in large part because of the Exchange's prior representation that it intended to automate the entry of trade execution times by developing a handheld electronic trading terminal. In June 1994, the Commission was informed that the proposed handheld terminal would not be in place by the October 1995 deadline for compliance with the heightened audit trail standards set forth in Section 5a(b)(3) of the Act. Because CME had not sufficiently demonstrated that its existing audit trail system met current and future standards, the Commission required the Exchange to demonstrate its ability to meet the audit trail requirements using Commission-designed tests and, thus, deferred consideration of the Exchange's petition. Subsequent to evaluating the results of the tests, the Commission offered CME the opportunity to supplement its petition.

[3] Under CME Rule 541 (S&P 500 Top Step rule), a member cannot trade an S&P futures contract for his or her own account while on the top step of the S&P 500 futures pit, except to liquidate a position that resulted from an error. Further, a member who has executed a customer order for an S&P 500 futures contract while on the top step of the S&P 500 futures pit may not on the same day trade such contracts for his or her own account.