



Special Executive Report

S-4703

April 15, 2008

CME ADOPTS CHANGES TO REQUIREMENTS CONCERNING PRE-EXECUTION COMMUNICATIONS OF CME OPTIONS PRODUCTS TRADING ON CME GLOBEX

Effective May 11, for trade date May 12, 2008, CME will adopt revisions to Rule 539.C. ("Pre-Execution Communications Regarding Globex Trades") related to pre-execution communications in connection with electronic trading of all CME options products. The revisions require pre-execution communications involving CME options products (including options spreads and combinations and options/futures spreads) to be preceded by the entry of a Request for Quote ("RFQ"). Subsequent to the entry of the RFQ, any trade intended for execution pursuant to a pre-execution communication requires the entry of an additional RFQ followed by the entry of a Request for Cross ("RFC") order, an order which contains both the buy and sell orders.

With the exception of CME equity options, the RFC order must be entered no less than 15 seconds and no more than 30 seconds after the entry of the additional RFQ. In CME equity options, the RFC order must be entered no less than 5 seconds and no more than 30 seconds after the entry of the additional RFQ. The RFQs and the RFC must be entered within the same trading session and failure to enter the RFC order within the time parameters set forth above requires a new RFQ to be entered prior to the entry of the RFC order. In all cases, the entry of the RFC order must comply with the time parameters set forth in Rule 539.C.4. For additional information on the requirements with respect to pre-execution communications concerning electronic trading of CME products, please see today's release of CME Market Regulation Advisory Notice RA0802-2.

In connection with the adoption of revised CME Rule 539.C., CME is adopting necessary changes to CME Rules 584 ("CME Globex Options Volatility Quote Trading"), 585 ("Globex Call Market Trading Algorithm") and the Interpretation of Rule 585. The changes to Rule 584 clarify that trades in volatility quoted options which result from pre-execution communications will be matched pursuant to Rule 585. The changes to Rule 585 clarify that volatility quoted options combinations will continue to be quoted in volatility terms as opposed to net options premium. The changes to the Interpretation of Rule 585 clarify that CME may designate the trade allocation algorithms applicable to a designated set of contracts trading pursuant to Rule 585, and includes specific information on how options trades will be matched when such trades result from pre-execution communications.

The revised rules ensure that all liquidity providers are afforded the opportunity to respond to RFQs in a timely manner, assuring transparent price discovery for market participants. Parties will be prohibited from entering an RFC order for 15 seconds (5 seconds in the case of equity options) after submission of the additional RFQ in order to provide market makers the opportunity to return their best markets. In the event that the price of the RFC order improves both the best bid and best offer in the order book (or if there is no bid/offer in the order book), 100% of the RFC quantity will match at the RFC price immediately upon submission of the RFC.

The revised CME rules and interpretation appear below, with additions underscored and deletions overstruck.

Questions concerning the information contained in this Special Executive Report should be directed to one of the following individuals:

Kathleen Zaino, Associate Director, Market Regulation, 312.930.2341

Jennifer Baum, Associate Director, Market Regulation, 312.341.3124

Robert Sniegowski, Associate Director, Market Regulation, 312.648.5493

Jeff Kilinski, Director – Interest Rate Products, Products and Services, 312.648.3817

David Reif, Associate Director – Interest Rate Products, Products and Services, 312.648.3839

Thomas Boggs, Associate Director – Equity Products, Products and Services, 312.930.3038

539. PREARRANGED, PRE-NEGOTIATED AND NONCOMPETITIVE TRADES PROHIBITED

539.A. General Prohibition

No person shall prearrange or pre-negotiate any purchase or sale or noncompetitively execute any transaction, except in accordance with Sections B and C below.

539.B. Exceptions

The foregoing restriction shall not apply to block trades pursuant to Rule 526 or Exchange of Futures for Related Position transactions pursuant to Rule 538.

539.C. Pre-Execution Communications Regarding Globex Trades

Parties may engage in pre-execution communications with regard to transactions executed on the Globex platform where one party (the first party) wishes to be assured that a contra party (the second party) will take the opposite side of the order under the following circumstances:

1. A party may not engage in pre-execution communications with other market participants on behalf of another party unless the party for whose benefit the trade is being made has previously consented to permit such communications.
2. Parties to pre-execution communications shall not (i) disclose to a non-party the details of such communications or (ii) enter an order ~~through the Globex platform~~ to take advantage of information conveyed during such communications except in accordance with this rule.
3. ~~In the case of futures orders, With the exception of orders entered pursuant to the terms of Section C.5. below, the first party's order must be entered into the Globex platform first and the second party's order may not be entered into the Globex platform until a period of 5 seconds has elapsed from the time of between entry of the first two orders in the case of futures orders or a period of 15 seconds shall elapse between entry of the two orders in the case of option orders.~~
4. ~~With the exception of orders entered pursuant to the terms of Section C.5. below, in any transaction involving pre-execution communications, the first party's order must be entered into the Globex platform first and the second party's order may not be entered into the Globex platform until the time period prescribed in Section 539.C.3. above has elapsed.~~
5. ~~In the case of options orders, a pre-execution communication must be preceded by the submission of a Request for Quote ("RFQ"). In electronic options operated pursuant to Rule 585 ("Globex Call Market Trading Algorithm"), including Eurodollar and Euroyen Options, solicitation of bid(s) and/or offer(s) between market participants through private communication for the purpose of establishing a market or improving the market for an eligible contract or an eligible combination of contracts for futures and options shall be preceded by issuing a Request For Quote ("RFQ") through an eligible terminal.~~

~~Subsequent to such RFQ, a trade intended for execution pursuant to Rule 585 for which there has been a pre-execution communication must be initiated by requires the entry of an additional RFQ; thereafter, a Request for Cross ("RFC") Order which will contains both the buy and the sell orders must be entered no less than fifteen (15) seconds and no more than thirty (30) seconds after the entry of the additional RFQ in order to proceed with the trade, except in equity options where the RFC must be entered no less than five (5) seconds and no more than thirty (30) seconds after the entry of the additional RFQ.~~

~~The RFQs and the RFC Order must be entered within fifteen (15) minutes in the same trading session of the entry of the RFQ. Failure to enter the RFC order within 30 seconds after the entry of the additional RFQ will require a new RFQ to be entered prior to the entry of the RFC order, which must be entered in accordance with the time parameters described above in order to proceed with the trade. fifteen (15) minutes of the entry of the RFQ shall be considered an abandonment of that pre-execution communication. Any subsequent pre-execution communication or attempt to enter RFC orders must be preceded by the entry of a new RFQ.~~

584. CME GLOBEX OPTIONS VOLATILITY QUOTE TRADING

[The first two paragraphs are unchanged.]

Volatility quoted option trades shall be matched at the option instrument level according to the first priority for best price and FIFO matching algorithm described in Rule 580 – **GLOBEX TRADE ALGORITHMS** and its Interpretation, except for trades involving pre-execution communications which must comply with the requirements of Rule 539.C.4. and which shall be matched pursuant to Rule 585 and its Interpretation. Further, volatility quoted option bids shall be matched only with volatility quoted option offers (premium quoted options will not be matched with volatility quoted options). At the time of an options volatility match, CME Globex will utilize standard options pricing models to convert the options volatility trade into a premium quoted option for clearing, and where applicable, create accompanying risk reducing futures contracts as a delta-neutral hedge for the matched position.

[The remainder of the rule is unchanged.]

585. GLOBEX CALL MARKET TRADING ALGORITHM

The following Globex Call Market Trading Algorithm shall be applied to such contract markets as determined by the Exchange, including, but not limited to, ~~the all~~ options on ~~Eurodollar~~ futures. This rule supersedes, if applicable, other Exchange rules governing trading on Globex, including, but not limited to, Rule 580 and its interpretations.

1. For the purpose of Rule 585:

[Section a. is unchanged.]

- b. an eligible combination of futures and options contracts shall be defined by the quantity per combination of each option bought or sold by the combination buyer, and the net long or short futures positions per combination per contract month to be assumed by the combination buyer, with the futures prices for each month defined within the combination. The combination shall be quoted in terms of net options premium, with the futures traded at the defined price, except for volatility-quoted options in which case the combination shall be quoted in volatility terms, which implies the appropriate combination of options premium and futures prices as defined in Rule 584;

[Section 1.c. through Section 3 are unchanged.]

4. Solicitation of bid(s) and/or offer(s) through private discussion for ~~the purpose of establishing a market or improving the market for~~ an eligible contract or an eligible combination of contracts must comply with~~shall be preceded by issuing an RFQ through an eligible terminal. Further, in such cases, the provisions of Rule 539.C.4. Pre-Execution Discussions Regarding Globex Trades, remain applicable.~~

[The remainder of the rule is unchanged.]

INTERPRETATION OF RULE 585 – GLOBEX CALL MARKET TRADING ALGORITHM

Trade Allocation Algorithm pertinent to Globex Call Markets

The Exchange may designate the trade allocation algorithms applicable to a designated set of contracts trading pursuant to Rule 585 – Globex Call Market Trading Algorithm, including without limitation any of the algorithms set forth in Rule 580 – Globex Trade Algorithms.~~per~~

Pursuant to the provisions of Rule 581 – Globex Lead Market Maker Program and Rule 585 – ~~Globex Call Market Trading Algorithm~~, the Exchange may designate multiple Lead Market Makers (LMMs) for a Globex Call Market for a designated set of contracts. Each LMM shall be assigned an allocation

proportion for the purpose of trade matching. Trade allocation in a Call Market with LMMs operates as follows:

[The remainder of the rule is unchanged with the exception of the last four paragraphs.]

~~In the case of a Request For Cross (RFC) entered pursuant to Rule 539.C.4., matching will depend upon whether the RFC price at the time of entry, relative to other orders in the market, improves both the current bid and offer prices, matches the bid or offer price, or is outside of the bid or offer price. a set of matching bid and offer (hereafter referred to as the RFC bid and offer) with the same price and quantity, trading matching of this pair of RFC bid and offer shall be suspended for fifteen (15) seconds in accordance with Rule 539.C. Pre-Execution Discussion. Immediately following the fifteen-second suspension, the RFC bid and offer shall be matched separately against opposing bids and offers in accordance with the allocation algorithm described above. The remainder of the pair of RFC bid and offer shall be matched against each other at a quantity of 60% of the smaller of the remaining RFC bid and offer. The remaining unmatched portions of the RFC bid and offer shall be available for matching against other incoming orders for an additional ten (10) seconds. Thereafter, the remaining RFC bids and offers shall be matched against each other, with the remaining bid and offer joining the rest of the order book.~~

RFC Price Improves Current Bid and Offer Prices in the Market

~~Notwithstanding the preceding trade matching provision, if the RFC price orders (i) represents strict improvement on both the current bid and offer prices at the time of the entry of the RFC, and (ii) remain at the best bid and offer price levels at the conclusion of the fifteen (15) seconds following the entry of the RFC, 100% of the buy and sell orders represented in the RFC orders shall be matched against each other at the RFC price immediately upon submission of the RFC, a quantity of 50% of the original order, with the remaining RFC orders matching against other competitive bids and offers in accordance with the preceding procedure for RFC matching.~~

RFC Price Matches or is Outside the Current Bid or Offer Price in the Market

All Products Excluding Equity Options

If the RFC price matches or is outside the bid or offer price in the market at the time the RFC order is entered, 1) the applicable side of the RFC order will immediately match against orders in the market at a price better than or equal to the RFC price in accordance with the allocation algorithm described above, 2) immediately thereafter, 60% of the smaller quantity remaining on one side of the RFC order will be matched against the opposite side of the RFC order at the RFC price, 3) any remaining unmatched portion of the RFC bid and offer will then be available for matching against other incoming orders for an additional five (5) seconds, 4) any match-eligible quantity remaining on the RFC order will then be matched at the RFC price, and 5) any remaining unmatched balance on one side of the RFC will either be cancelled or will remain in the order book depending on the order instructions entered via the RFC.

Equity Options

If the RFC price matches or is outside the bid or offer price in the market at the time the RFC order is entered, 1) the applicable side of the RFC order will immediately match against orders in the market at a price better than or equal to the RFC price in accordance with the allocation algorithm described above, 2) immediately thereafter, 100% of the smaller quantity remaining on one side of the RFC order will be matched against the opposite side of the RFC order at the RFC price, and 3) any remaining unmatched balance on one side of the RFC will either be cancelled or will remain in the order book depending on the order instructions entered via the RFC.