

# **Relationship-Based Trading in CME Group Agricultural Markets**

November 15th, 2017

**Bob Sniegowski**  
Executive Director,  
Market Regulation

**Steve Stasys**  
Director,  
Agricultural Options

# Agenda

- Introduction
- Block Trades
- Pre-Execution Communications Regarding Globex Trades
- Questions & Answers

# Disclaimer

Neither futures trading nor swaps trading are suitable for all investors, and each involves the risk of loss. Swaps trading should only be undertaken by investors who are Eligible Contract Participants (ECPs) within the meaning of Section 1a(18) of the Commodity Exchange Act. Futures and swaps each are leveraged investments and, because only a percentage of a contract's value is required to trade, it is possible to lose more than the amount of money deposited for either a futures or swaps position. Therefore, traders should only use funds that they can afford to lose without affecting their lifestyles and only a portion of those funds should be devoted to any one trade because traders cannot expect to profit on every trade. All references to options refer to options on futures.

Any research views expressed those of the individual author and do not necessarily represent the views of the CME Group or its affiliates. The information within this presentation has been compiled by CME Group for general purposes only. CME Group assumes no responsibility for any errors or omissions. All examples are hypothetical situations, used for explanation purposes only, and should not be considered investment advice or the results of actual market experience.

All matters pertaining to rules and specifications herein are made subject to and are superseded by official rulebook of the organizations. Current rules should be consulted in all cases concerning contract specifications

CME Group is a trademark of CME Group Inc. The Globe Logo, CME, Globex and Chicago Mercantile Exchange are trademarks of Chicago Mercantile Exchange Inc. CBOT and the Chicago Board of Trade are trademarks of the Board of Trade of the City of Chicago, Inc. NYMEX, New York Mercantile Exchange and ClearPort are registered trademarks of New York Mercantile Exchange, Inc. COMEX is a trademark of Commodity Exchange, Inc. All other trademarks are the property of their respective owners.

Copyright © 2017 CME Group. All rights reserved.

# Relationship Based Trading

The Agricultural complex will allow crossing on CME Globex (Globex) and block trades across all products starting January 8, 2018. This will allow for bi-lateral or brokered conversations prior to the execution of the orders, including discussions concerning price, size and direction.

This will help facilitate :

- Large transactions relative to the existing order book liquidity
- Trading in unique instruments
  - e.g., farther dated contract months, crush options, deep out-of-the-money strikes
- Executing a complex order type
  - strip spreads, broken crushes, multi-legged options
- Sourcing liquidity during “off hours”

# New Types of Relationship Based Trading in Ags

## Blocks

- Convenience of privately negotiating a trade with a selected eligible counterparty
- Ability to execute a large transaction at a fair and reasonable single price
- Security of a trade cleared by CME Clearing
- Designed to meet institutional trading needs
- Minimize the impact of large orders on market liquidity

## R-Cross

- Ensure the full quantity of an aggressing order will be executed in the central limit order book
- Ensure execution of an aggressing order at the cross price or better in the central limit order book
- Notify select market participants around interest in a specific instrument type (farther dated contract, less liquid strike)
- Minimize the impact of large orders on market liquidity

# Block Trades

## General Information

- What are block trades?
  - Privately negotiated trades, either directly between eligible market participants or through a broker
  - Must meet certain minimum quantity thresholds
  - Are executed away from the Exchanges' public auction market (CME Globex/trading pits)
  - Permitted to be executed at any time, including when CME Globex/trading pits are closed
- Who may participate in block trades?
  - Each party to a block trade must be an Eligible Contract Participant (ECP)
  - The definition of an ECP is in Section 1a of the Commodity Exchange Act
  - ECPs include exchange members and member firms, broker/dealers, government entities, pension funds, commodity pools, corporations, investment companies, insurance companies, depository institutions and high net-worth individuals
  - Market participants must ensure they are an ECP prior to engaging in a block trade, either bilaterally or through the services of a broker
- Commodity Trading Advisors (CTAs), Investment Advisors (IAs) and foreign persons performing a similar role may engage in block trades on behalf of accounts under management
  - Provided they have total assets under management exceeding 25 million USD
  - The block trade is suitable for their clients

# Block Trades

## Regulatory Considerations

- A broker may not execute a customer order as a block trade without client consent
- Except for eligible CTAs and IAs, orders for multiple parties may not be bunched to meet the block trade minimum threshold
- Block trade prices must be fair and reasonable in light of
  - The size of transaction
  - The prices and sizes of other transactions in the same contract at the relevant time
  - The prices and sizes of transactions in other relevant markets at the relevant time (including cash markets and related futures markets)
  - The circumstances of the markets or the parties to the block trade
- The price does not need to be within the existing bid/ask on Globex or in the pit
- The price must be consistent with the minimum tick increment for the product
- The block trade must be executed at a single price

# Block Trades

## Regulatory Considerations

- Intra- and inter-commodity spreads may be executed as a block trade provided each product is block trade-eligible
- Minimum quantities for outright and the conventions for meeting the minimum threshold for spreads are available on the CMEG website at:

<http://www.cmegroup.com/clearing/trading-practices/block-trades.html#generallInfo>

- A broker may not execute a customer order as a block trade without client consent
- Block trade prices must be fair and reasonable in light of
  - The size of transaction
  - The prices and sizes of other transactions in the same contract at the relevant time
  - The prices and sizes of transactions in other relevant markets at the relevant time (including cash markets and related futures markets)
  - The circumstances of the markets or the parties to the block trade
- The price does not need to be within the existing bid/ask on Globex or in the pit
- The price must be consistent with the minimum tick increment for the product
- The block trade must be executed at a single price

# Block Trades

## Regulatory Considerations

- Block trades must be submitted via CME Direct or CME ClearPort
- Detailed information on the various methods of registration for access to CME Direct or CME ClearPort is available on the CME Group website:

<http://www.cmegroup.com/trading/cme-direct/registration.html#newFirmUserRegistration>

<http://www.cmegroup.com/clearport/registration.html>

- Complete order records for block trades must be created and maintained pursuant to Rule 536 and CFTC Regulations
- The execution time of a block trade is the time that the parties agree to the trade
- The execution time must be recorded for all block trades and accurately submitted into CME Direct or CME ClearPort
- The date, execution time, contract month, price and quantity of each block trade is automatically reported to the marketplace once it is cleared
- Block trade information is available on the CME Group website:

<http://www.cmegroup.com/clearing/operations-and-deliveries/accepted-trade-types/block-data.html?redirect=/tools-information/blocktrades.html#contractTypes=FUT,OPT,SPD&exchanges=XCBT,XCME,XCEC,DUMX,XNYM&assetClassId=0>

# Block Trades

## Regulatory Considerations

- Parties may not disclose details of block trade solicitations or negotiations to any other party for any purpose other than to facilitate the execution of the block trade
- Parties privy to nonpublic information concerning a consummated block trade may not disclose the information to any other party prior to the public report of the block trade by the Exchanges
- Brokers may not disclose the identity of their customers without the express consent of the customers
- Parties may engage in pre-hedging or anticipatory hedging of the position they believe in good faith will result from the consummation of the block trade, EXCEPT for an intermediary that takes the opposite side of its customer order
- It is a violation to engage in the front running of a block trade when acting on nonpublic information regarding an impending transaction by another person, acting on nonpublic information obtained through a confidential employee/employer relationship, broker/customer relationship, or in breach of a pre-existing duty
- Parties solicited to provide a two-sided block market are not deemed in possession of non-public information provided side of market interest is not disclosed in the context of the solicitation

# Pre-Execution Communications Regarding Globex Trades

## General Information & Regulatory Considerations

- Pre-execution communications (pre-ex) are discussions between market participants for the purpose of discerning interest in the execution of a transaction on CME Globex prior to the exposure of the order to the market
- Rule 539.C. governs pre-ex
- Pre-ex communications allow for size, price and direction to be discussed prior to the entry of orders into CME Globex
- Parties engaging in pre-ex must have permission to do so from their customers
- All market participants are eligible to engage in pre-ex, unlike block trades which require participants to be ECPs
- Applicable cross order entry protocols resulting from pre-ex differ between asset classes, between futures and options, and across CME Group's 4 Designated Contract Markets (DCMs)

# Pre-Execution Communications Regarding Globex Trades

## Current and Future Availability

### CME Agricultural Futures and Options

- Pre-ex is permitted in all CME agricultural futures and options products
  - The Globex Cross (G-Cross) protocol applies to agricultural futures and the RFQ + RFC Cross (R-Cross) protocol applies to agricultural options
- Beginning January 8, 2018, CME will make the R-Cross protocol available for all agricultural futures, in addition to the current G-Cross protocol

# Pre-Execution Communications Regarding Globex Trades

## Current and Future Availability

### CBOT Grain and Oilseed Futures and Options

- CBOT currently prohibits pre-ex in all grain and oilseed futures (except for EU Wheat)
- Beginning January 8, 2018, CBOT will make the R-Cross and G-Cross protocols available for all grain and oilseed futures
- CBOT currently permits pre-ex in all grain and oilseed options during overnight trading hours via the R-Cross protocol
- Beginning January 8, 2018, CBOT will permit pre-ex communications in all grain and oilseed options at all times, eliminating the current permissibility solely during overnight trading hours, with entry via the R-Cross protocol

# Pre-Execution Communications Regarding Globex Trades

## Cross Protocols

### G-Cross

- Available solely in futures
- The order of the party that initiated the pre-ex must be entered into Globex first
- The second party's order may not be entered into CME Globex until a period of five (5) seconds has elapsed from the time of the entry of the first party's order
- G-Cross is not automated

# Pre-Execution Communications Regarding Globex Trades

## Cross Protocols

### R-Cross

- R-Cross currently applies solely in options, but will become available in CME and CBOT agricultural futures on January 8, 2018
- Important terms:
  - Request for Quote (RFQ) - an electronic notification sent by Globex expressing interest in a specific product or strategy
  - Request for Cross (RFC) – functionality on Globex that permits a buy and sell order resulting from pre-ex to be entered via a single entry
- G-Cross requires an RFQ to be entered into Globex for the product and contract month(s) that were the subject of the pre-ex
- Beginning January 8, for pre-ex involving agricultural futures and options, a Request for Cross (RFC) order must be entered into Globex no less than five (5) seconds and no more than thirty (30) seconds after submission of the RFQ
- Until January 8, for permissible pre-ex involving options, including options covered with futures, the RFC order must be entered into Globex no less than fifteen (15) seconds and no more than thirty (30) seconds after submission of the RFQ

# Pre-Execution Communications Regarding Globex Trades

## Cross Protocols

### R-Cross - continued

- Globex processes RFCs via a matching algorithm
- If the RFC price 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
- If the RFC price matches or is outside the best bid or offer in the market, the applicable side of the RFC order will immediately match against the orders in the book at a price better than or equal to the RFC price. Immediately thereafter, 100% of the smaller quantity remaining on one side of the RFC will match against the order on the opposite side of the RFC at the RFC price
- Any unmatched balance on one side of the RFC will remain in the order book unless it is cancelled by the user

# Ag R-Cross

- Executed on Globex
- Available for futures and options
- Open to all Globex participants
- One Globex Request for Cross (RFC) order ticket, with buy and sell order
- Typically facilitated by a broker



RFQ Sent

# Blocks VS. R-Cross

	Block	R-Cross
Bi-Lateral Conversation	Y	Y
Request for Quote (RFQ) Required	N	Y
Reporting Time	Y	N
Volume Threshold	Y	N
Venue	CME Clearport	Globex
Participant	ECP	All
Centrally Cleared	Y	Y

# Questions & Answers

# Next Steps

## We are eager to hear your comments and questions:

If you wish to speak with us about Relationship-Based Trading, please contact us at  
[agrbt@cme.com](mailto:agrbt@cme.com)

## Today's Speakers:

**Bob Sniegowski**  
Executive Director,  
Market Regulation

**Steve Stasys**  
Director,  
Agricultural Options

