

January 13, 2005

## **REMINDER NOTICE AND FAQ**

### **REGULATION 9B.13**

#### **CROSSING ORDERS ON e-cbot / PROHIBITION ON PRE-EXECUTION COMMUNICATIONS**

In September 2004, the CBOT amended Regulation 9B.13 to prohibit pre-execution communications in all products during all hours. The CBOT implemented this amendment following the establishment of an Electronic Market Maker (EMM) program to support the electronic trading of options on CBOT interest rate products during extended trading hours.

The CBOT believes that its EMM program and corresponding regulation changes, in combination with the enhanced functionality offered by the e-cbot platform, has created a more competitive and transparent electronic model that promotes greater liquidity and market growth by encouraging broader market participation and by providing for enhanced price discovery. The four months since the implementation of these changes have been the four highest volume months on record at the CBOT for electronically traded interest rate options, representing an increase of more than 500% over the same period a year ago.

The following questions and answers are intended to provide additional information to market participants regarding the regulations governing electronic trading in an environment in which pre-execution communications are prohibited. It is important that all member firms ensure that their traders, account executives, terminal operators and direct access clients are fully informed regarding this regulation as violation of the regulation may result in disciplinary action by the Exchange.

#### **1. What is a pre-execution communication?**

Pre-execution communications are defined as communications between two market participants for the purpose of discerning interest in the execution of a transaction prior to the entry of an order that is exposed to the centralized market.

**Pre-execution communications are prohibited in all products during all hours in the open auction and electronic environments.**

**2. If a customer has an interest in a particular transaction and requests a market for either an outright or a strategy, how can the salesperson ascertain the market?**

In the open auction environment, a market would be requested from the trading pit. In the e-cbot environment, the salesperson can identify the bid/offer and depth of market posted on e-cbot. Additionally, the salesperson can submit a Request for Quote (RFQ) in the requested outright or strategy for a specified quantity. If no quantity is designated on the RFQ, the Trading Host will use a default quantity of 10 contracts.

In contracts or strategies for which the posted bid/offer is deemed too wide or insufficiently deep, it is recommended that an RFQ be submitted. This action will typically generate additional interest and, in the case of products supported by a market-maker program, market makers are obliged to respond to a specified minimum percentage of RFQs.

**3. What if an RFQ is submitted and there is no response or an inadequate response in terms of the bid/ask or depth?**

In this circumstance, another RFQ should be submitted. With an active RFQ, it is also permissible for the salesperson to contact potential counterparties (i.e. market makers), alert them to the RFQ and ask them to submit a market or to tighten/deepen the existing market. An RFQ is considered active for 60 seconds following submission.

To ensure that such communications do not become prohibited pre-execution communications, the salesperson must not disclose the side of market in which he has an interest or any quantity that has not been disclosed via the RFQ.

**4. If an order has been submitted on e-cbot, are there any restrictions in communicating with potential counterparties?**

With a resting order in the Trading Host, it is permissible to contact potential counterparties to solicit interest in trading against the order. In any such communications, no non-public information (i.e. information not represented in the terms of the order entered in the market) should be disclosed. Just as in the open auction environment, it is only permissible to disclose order information that is in the public domain. For example, if the represented offer is for 250 contracts, it would be improper to disclose that there is another 500 contracts behind it as this information has not been disclosed to the market.

**5. Is it permissible to contact other market participants to obtain general market color?**

Having communications to obtain market color is permissible provided there is no express or obviously implied arrangement to execute a specified trade and no non-public information is communicated regarding an order. The objective of the CBOT electronic market model is to provide a framework for transparent and competitive executions on a level playing field, not to preclude the ability of market participants to speak to one another to obtain general market color.

**6. How should an order for a strategy not supported by the e-cbot platform be handled?**

The e-cbot platform supports a wide array of strategies covering most of the spreads participants commonly trade. Nearly all of these strategies, including the option strategies, have been successfully RFQ'd and executed on e-cbot. There are, however, some types of strategies that are not presently supported by the platform. Outside of open auction hours, an order for a strategy unsupported by e-cbot would have to be legged. RFQs can be submitted for the legs of the strategy to ascertain the levels at which the spread can possibly be legged.

**7. Under what circumstances can orders be crossed on e-cbot?**

- a) Independently initiated orders on opposite sides of the market for different beneficial account owners that are immediately executable against each other may be entered without delay provided that the orders did not involve pre-execution communications and that each of the orders is immediately entered upon receipt.
- b) Opposite orders for different beneficial accounts that are simultaneously placed by a party with discretion over both accounts may be entered provided that one order is exposed on the e-cbot platform for a minimum of 5 seconds for outright futures contracts and a minimum of 15 seconds for strategies and options contracts.
- c) An order allowing for price and/or time discretion, if not entered immediately upon receipt, may be knowingly entered opposite a second order entered by the same firm only if the second order has been entered immediately upon receipt and has been exposed on the e-cbot platform for a minimum of 5 seconds for outright futures contracts and a minimum of 15 seconds for strategies and options contracts.

**8. Assuming there have been no pre-execution communications, is it permissible for a firm to knowingly trade for its proprietary account against a customer order entered by the firm?**

Yes, provided that the customer order has been entered immediately upon receipt and has first been exposed on the e-cbot platform for a minimum of 5 seconds for outright futures and a minimum of 15 seconds for strategies and options contracts.

Questions regarding Regulation 9B.13 may be directed to any of the following individuals in the Office of Investigations and Audits:

Jennifer Baum, Managing Director	(312) 341-3124	<a href="mailto:jbaum@cbot.com">jbaum@cbot.com</a>
Shelly Goodwin, Senior Manager	(312) 347-4123	<a href="mailto:sgoodwin@cbot.com">sgoodwin@cbot.com</a>
Dean Payton, Vice President	(312) 435-3658	<a href="mailto:dpayton@cbot.com">dpayton@cbot.com</a>

Additional information regarding electronic trading on e-cbot, including information on strategies and matching algorithms, can be found on the Exchange website at [cbot.com](http://cbot.com). Functionality questions may also be directed to your Key Account Manager or to Market Operations at 347-4600.

Paul J. Draths  
Vice President & Secretary