

proposed rule would expand the availability of bunching, simplify the process, and clarify the respective responsibilities of account managers and futures commission merchants ("FCMs").

**DATES:** Comments must be received by April 28, 2003.

**ADDRESSES:** Interested persons should submit their views and comments to Jean A. Webb, Secretary, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. In addition, comments may be sent by facsimile transmission to facsimile number (202) 418-5521, or by electronic mail to [secretary@cftc.gov](mailto:secretary@cftc.gov). Reference should be made to "Eligible orders."

**FOR FURTHER INFORMATION CONTACT:** Christopher W. Cummings, Special Counsel, or R. Trabue Bland, Attorney-Advisor, Division of Clearing and Intermediary Oversight, Commodity Futures Trading Commission, Three Lafayette Centre, 1155 21st Street, NW., Washington, DC 20581. Telephone: (202) 418-5430. Email: [ccummings@cftc.gov](mailto:ccummings@cftc.gov) or [tbland@cftc.gov](mailto:tbland@cftc.gov).

#### **SUPPLEMENTARY INFORMATION:**

### **I. Background**

#### *A. Current Regulatory Requirements*

Commission Rule 1.35(a-1), in effect since August 27, 1998, allows bunched orders for eligible customers to be placed on a contract market without specific customer account identification either at the time of order placement or at the time of report of execution. Rule 1.35(a-1) limits the types of customers whose orders may be bunched and requires eligible account managers<sup>1</sup> to make certain disclosures regarding the allocation methodology, the standard of fairness of allocations, composite or summary data of the trades, and whether the account manager has any interest in the bunched order.

Before placing an order eligible for post-execution allocation, the account manager must identify, to the FCM clearing the order, each eligible customer account to which fills will be allocated. Account managers must provide written certification that they have identified the eligible customer accounts to the FCM. Foreign account managers must provide written certification from foreign authorities that they are subject to regulation.

Currently, account managers must create and timestamp an order origination document, identify the order by group identifier on the office or floor order tickets, and identify the transaction on contract market trade registers. The current rule also requires contract markets to adopt audit procedures to determine compliance with Rule 1.35(a-1).

#### *B. Developments Since Current Regulations Were Adopted*

In December 2000, Congress passed the Commodity Futures Modernization Act ("CFMA"). One of the mandates of the CFMA was for the Commission to review its rules relating to intermediaries with an eye to identifying areas where greater flexibility might be warranted. Since the passage of the CFMA, numerous industry participants have stated to Commission staff that the regulations related to bunched orders needed to be revisited for a number of reasons.

For example, enhancements in technology have made it easier for account managers to enter orders directly, thereby making certain aspects of the current requirements less workable. Similarly, as markets become more global in scope, account managers, both domestic and foreign, have claimed that the current bunched order requirements serve as a disincentive to using U.S. futures markets.

On February 2, 2001, the National Futures Association and the Futures Industry Institute issued an industry-wide study of issues associated with order transmission and order entry process by commodity professionals ("Best Practices Study").<sup>2</sup> The study found that although the current rule increased flexibility over previously applicable requirements, many commenters in the study felt that the current rule caused "unnecessary processing delays without adding customer protections that otherwise could be realized through equally effective, less costly procedures."<sup>3</sup> The rule the Commission is proposing today would adopt many of the approaches recommended in the Best Practices Study.

### **II. Proposed Changes to Rule 1.35(a-1)(5)**

#### *A. Eligible Customers*

As noted, the current rule limits eligibility for bunching to certain types

of sophisticated customers. The proposed rule would expand eligibility to all customers who provide written investment discretion to account managers.<sup>4</sup>

Bunched orders can provide advantages to account managers and their customers by facilitating the prompt execution of small orders. Customers can benefit when a bunched order is placed because a bunched order is more likely to be executed at a single price than would be the case for a series of separate orders. In fact, customers may be disadvantaged in the quality of the timing and execution of their order if their orders are not bunched. With proper protections in place under the proposed rule, customers should be assured that their trade allocations are fair and equitable. Thus, the Commission proposes to eliminate existing Rule 1.35(a-1)(5)(ii). Under the proposed rule, all customer orders would be eligible for inclusion in bunched orders and thus all customers that have granted written discretion to an eligible account manager would be able to benefit from the advantages of bunched orders.

The Commission invites comment on whether the proposed expansion of the class of eligible customers is appropriate and whether the rule contains proper protections.

On a related matter, in 1997, the Commission issued an interpretive notice currently found at Appendix C to part 1 which allows bunching under certain circumstances.<sup>5</sup> Specifically, the Commission allows CTAs to bunch orders if they prefile their allocation procedures with a clearing member, NFA, or an exchange. The Commission requests comments on whether this interpretive notice should be modified in any way given the proposed changes to Rule 1.35(a-1)(5).

#### *B. Eligible Account Managers*

The Commission also is proposing to expand the class of account managers permitted to bunch orders. The current rule applies to, among others, commodity trading advisors ("CTAs") and investment advisers ("IAs") who are registered with the Commission or the Securities Exchange Commission ("SEC"). The Commission is proposing to allow CTAs and IAs who are exempt from registration or are excluded from the definition of CTA or IA by operation of law or rule to be eligible account managers. Such entities are generally

<sup>1</sup> The term account manager as used herein includes commodity trading advisors, investment advisers and other persons identified in the proposed regulation, who would place orders and direct the allocation in accordance with the procedures set forth in the proposal.

<sup>2</sup> National Futures Association & Futures Industry Institute, Recommendations for Best Practices in Order Entry and Transmission of Exchange Traded Futures and Options Transactions (2001).

<sup>3</sup> *Id.* at 25.

<sup>4</sup> Rule 1.35(a-1)(5) and NFA Compliance Rule 2-8(a), require that grants of discretionary authority to account controllers be in writing.

<sup>5</sup> 17 CFR part 1, Appendix C (2002), 62 FR 25470 (May 8, 1997).