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Effective Date

(j) This amendment becomes effective on July 16, 2003.

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COMMODITY FUTURES TRADING COMMISSION

17 CFR Part 1

RIN 3038-AB93

Account Identification for Eligible Bunched Orders

AGENCY: Commodity Futures Trading Commission.

ACTION: Final rule.

SUMMARY: The Commodity Futures Trading Commission ("Commission" or "CFTC") is amending Commission Rule 1.35(a-1)(5) ("Rule 1.35(a-1)"), which allows certain account managers to bunch customer orders for execution and to allocate them to individual accounts at the end of the day. The amended rule will expand the availability of bunching to all customers, simplify the process and clarify the respective responsibilities of account managers and futures commission merchants ("FCMs").

EFFECTIVE DATE: July 11, 2003.

FOR FURTHER INFORMATION CONTACT:

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SUPPLEMENTARY INFORMATION:

I. Background

Commission Rule 1.35(a-1), in effect since August 27, 1998 has allowed 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) has limited post-execution allocation of bunched orders to sophisticated customers and required

eligible account managers¹ 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.

In December 2000, the Commodity Futures Modernization Act ("CFMA") was enacted. 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 enactment 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 and the Commission so reported to Congress in its Intermediaries Study in June 2002.

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. In addition, many account managers use "give-up" agreements and multiple FCMs for clearing and execution. Thus, while the current rule requires that an account manager identify eligible customer accounts to which fills will be allocated before placing an order eligible for post-execution allocation, FCMs may not know that an order has been executed for a particular client until that order has been executed and cleared.² Account managers and FCMs have also commented that their responsibilities under the current rule are unclear, especially their respective recordkeeping responsibilities. Therefore, as markets become more global in scope, account managers, both domestic and foreign, and FCMs 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 ("NFA") 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").³ The study reported 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."⁴

Based upon the foregoing, on March 14, 2003, the Commission published the proposed amendments to Rule 1.35(a-1).⁵ The Commission received twenty-five comments on the proposed rule. The commenters included ten FCMs⁶, four exchanges⁷, two industry associations⁸, one commodity trading advisor ("CTA")⁹, seven individuals¹⁰ and NFA. The FCMs, exchanges, industry associations, NFA and the CTA supported the amendments to the rule, generally stating that the essential customer protections would be retained while clarifying the responsibilities of FCMs and account managers. Six individuals submitted comments expressing concern over the possible unfair allocation by account managers. One commenter submitted comments expressing concern over the Commission's ability to monitor for unfair allocation under the amended rule. These comments are discussed fully below.

II. Final Rules

A. Eligible Customers

The current rule limits the post-execution allocation of bunched orders to "eligible customers," who, in essence, are sophisticated customers. In its comment, NFA noted that "[a]ll customers deserve to have their orders filled efficiently and at the most favorable terms under the circumstances." The NFA and other commenters expressed the view that bunched orders can meet these objectives because bunched orders can provide better pricing and execution of orders. The Commission agrees; accordingly, as proposed, the amendments to Rule 1.35(a-1)(5) will expand eligibility to all customers who

⁴ *Id.* at 25.

⁵ 68 FR 12319 (March 14, 2003).

⁶ ABN AMRO, Inc., Bear Stearns & Co., Carr Futures, Inc., Credit Suisse First Boston, Fimat USA, Inc., Goldman Sachs & Co., J.P. Morgan Futures Inc., Lehman Brothers, Morgan Stanley & Co., and Prudential Securities Inc.

⁷ The New York Board of Trade, Chicago Board of Trade, Chicago Mercantile Exchange, and the New York Mercantile Exchange.

⁸ Futures Industry Association ("FIA") and the Managed Funds Association ("MFA").

⁹ John Henry & Company, Inc.

¹⁰ One commenter, Paul H. Bjarnason, Jr., is a former Commission employee. Six other individual commenters submitted identical letters.

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

² 17 CFR Part 1, Appendix C (2002), 62 FR 25470 (May 8, 1997).

³ National Futures Association & Futures Industry Institute, Recommendations for Best Practices in Order Entry and Transmission of Exchange Traded Futures and Options Transactions (2001).