



April 4, 2002

Mr. Jonathan G. Katz, Secretary  
Securities and Exchange Commission  
450 Fifth Street, N.W.  
Washington, D.C. 20549-0609

Ms. Jean Webb, Secretary  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21<sup>st</sup> Street, N.W.  
Washington, D.C. 20581

**Re: S7-15-01, Cash Settlement and Regulatory Halt Requirements for  
Security Futures Products**

Dear Mr. Katz and Ms. Webb:

On behalf of the Steering Committee on Security Futures (“Steering Committee”) established jointly by the Futures Industry Association (“FIA”)<sup>1</sup> and the Securities Industry Association (“SIA”)<sup>2</sup> I am pleased to submit our comment letter with respect to the captioned proposed rulemaking by the Securities and Exchange Commission (“SEC”) and the Commodity Futures Trading Commission (“CFTC”)(collectively, the “Commissions”) governing, among other matters, listing standards for cash-settled security futures products, File No. S7-15-01, “Cash Settlement and Regulatory Halt Requirements for Security Futures” (the “Proposed Rules”).

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<sup>1</sup> FIA is a principal spokesman for the commodity futures and options industry. FIA’s regular membership is composed of approximately 50 of the largest futures commission merchants (“FCMs”) in the United States, the majority of which are also registered broker-dealers. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international.

<sup>2</sup> SIA’s members include more than 740 securities firms (including investment banks, broker-dealers, and mutual fund companies) that are active in all US and foreign markets and in all phases of corporate and public finance. The US securities industry manages the accounts of more than 80 million investors directly and indirectly through corporate, thrift and pension plans.

The Steering Committee generally commends the Commissions for their efforts to promote certainty and uniformity in provisions governing trading in, and the cash settlement of, security futures products during periods of market disruption. Our specific comments on this proposal are summarized below.

### Cash Settlement

The Steering Committee supports the Commissions' focus on minimizing the susceptibility of security futures products to settlement price manipulation. However, we have a concern regarding the Commissions' Proposed Rules applicable to market disruptions resulting in the unavailability of opening prices on a contract's settlement date. Specifically, according to the Commissions:

Proposed SEC Rule 6h-1(b) and CFTC Rule 41.25(b)(1) also would require that, if an opening price for an underlying security is not readily available, the final settlement price of the overlying cash-settled security futures product must fairly reflect the price of the underlying security during its most recent regular trading session. The Commissions believe that, if the opening price for the underlying security is not readily available, a price derived from the most recent regular trading session of that security would be an appropriate substitute.<sup>63</sup> Again, the Commissions' proposal would provide national securities exchanges and national securities associations with some discretion to implement this general rule without dictating how the settlement price for a security futures product is derived. For example, while one national securities exchange or national securities association may decide to establish rules that would use the closing price from the most recent regular trading session if an opening price for a security underlying a security futures product is not readily available, another exchange or association could establish rules that would use a trade-weighted average over some portion of that session in such circumstances.

The Steering Committee strongly disagrees with the approach cited immediately above. We agree with the comment submitted by the Options Clearing Corporation (the "OCC") that a fallback settlement price reference that looks automatically to an earlier trading session is undesirable. As noted by the OCC, this requirement is inconsistent with existing market practice and rules governing a broad range of listed stock index products. Consistency between the markets for related derivatives and the underlying security(ies) is critical. In addition to increasing the basis risk to which firms utilizing one or more of these products in connection with hedging or arbitrage activities are subject, the Proposed Rule would create unnecessary discrepancies between the final settlement prices for security futures products and the markets for the stocks underlying these products, thus impairing their utility for hedging or arbitrage purposes.

Additionally, while the Steering Committee believes that consistency in market practice is extremely important in this context, we do not believe that it is appropriate for the Commissions to prescribe the terms of these pricing conventions. The establishment of consistent and commercially appropriate alternative pricing conventions should instead be resolved, as it is today, by collaboration among the exchanges that design the product and the clearinghouse, with appropriate consultation with their members and participants. The Commissions' role in the establishment of alternative pricing provisions should be limited to ensuring that the conventions established do not unnecessarily exacerbate market disruption and are not unduly susceptible to manipulation.

Accordingly, the Steering Committee urges the Commissions not to require exchanges and associations to adopt prescribed rules addressing the determination of fallback security futures final settlement prices when opening prices are not readily available.

### Trading Halts

The Proposal would **require** that exchanges halt trading in a security futures product when a regulatory halt has been implemented by the market for the underlying security (or, in the case of a narrow-based security index future, when securities representing 30 percent or more of the market capitalization of the narrow-based index are subject to a regulatory halt). Under the Proposal, a regulatory halt would include a "news-pending" halt and a circuit breaker halt.

The Steering Committee supports the application of market-wide circuit breaker procedures to security futures products. The Steering Committee shares the view expressed by the Chicago Board Options Exchange Incorporated ("CBOE"),<sup>3</sup> however, that exchanges should not be **required** to halt trading in a security futures product in circumstances where a "news pending" halt has been imposed by the exchange listing the security(ies) underlying the security futures product. We agree with the CBOE that, consistent with rules governing securities options, an exchange listing a security futures product should have the **discretion** to declare a trading halt in a security futures product during a "news-pending" halt in the underlying security.

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The Steering Committee would be pleased to discuss the foregoing comments with staff of the Commissions at your convenience. Please feel free to contact Barbara Wierzynski of FIA at (202) 466-5460, Jerry Quinn of SIA at (212) 618-0507, or the

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<sup>3</sup> Letter dated October 1, 2001, from Joanne Moffic-Silver, General Counsel, Chicago Board Options Exchange, Inc.

outside counsel for the Steering Committee, Edward Rosen of Cleary, Gottlieb, Steen & Hamilton at (212) 225-2820, if you wish additional information.

Very truly yours,

Jonathan Barton, Chairman  
FIA/SIA Steering Committee on Security Futures

cc: Elizabeth King, SEC  
Jerry Carpenter, SEC  
Alton Harvey, SEC  
Richard Shilts, CFTC  
Tom Leahy, CFTC