

VIA EMAIL TO: SUBMISSIONS@CFTC.GOV

October 18, 2013

Ms. Melissa Jurgens
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Request from CME Group for approval of amendments to existing Rule 538 (Exchange for Related Positions) of the Exchanges' rulebooks and the issuance of CME Group Market Regulation Advisory Notice RA1311-5

Dear Ms. Jurgens,

Transtrend B.V. appreciates the opportunity to comment on the CME Group's ("CME") request to amend Rule 538 (Exchange for Related Positions) in the rulebook of CME, CBOT, NYMEX, COMEX and KCBT (the "Exchanges") and to issue Market Regulation Advisory Notice RA1311-5 applicable to each of the Exchanges. As background, Transtrend B.V. is a commodity trading advisor located in Rotterdam, the Netherlands, and specializes in the design and management of consistent systematic trading strategies by participating in futures markets and OTC markets for its client accounts.

Introduction

We are a great proponent of on-exchange futures trading and central clearing because of the transparent, anonymous and competitive characteristics that a central limit order book offers, combined with the reduced counterparty risk that a central clearing house poses. Although we do understand the importance of controlling and regulating off-exchange trading, we believe that there is a potential dangerous and adverse effect if transitory EFRPs are prohibited in the FX markets. Over the past few years we have witnessed and welcomed a gradual but steady transition of FX trading from the OTC space towards the futures space. This concerns FX clearing as well as execution. We believe that transitory EFRPs have played an important role in this development. By cutting off the transitory EFRP route, the CME will halt this development or even worse, reverse it. FX forwards trading will move back from the futures market to the OTC environment, where FX forwards are bilaterally traded and not centrally cleared.


Background

The FX markets can be traded by market participants, such as ourselves, in three different ways:

- (i) **Execution of a FX futures order on an exchange using the central limit order book resulting in a futures position.** This is, by far, our most preferred way of trading, both from an execution as well as a clearing perspective, because of the open, anonymous and competitive environment of a central limit order book, combined with the reduced counterparty risk of a central clearing house. The only constraint is that this method requires a futures market that shows sufficient liquidity in its central limit order book. If the liquidity cannot be found in the futures market itself market participants must use other means to access the market.
- (ii) **Execution of a transitory EFRP FX order through bilateral communication with a broker-dealer resulting in a futures position.** In this method we execute an order by using the market place where the deepest liquidity in the FX markets can be found: the OTC cash market itself. A transitory EFRP transaction in the FX markets involves three separate, but simultaneously executed, transactions – a bilateral FX forward, and the two components (an FX forward and a futures contract) of an EFRP, in which the futures leg matches the economic terms of the standalone FX forward. The standalone FX forward is fully offset by the FX forward leg of the EFRP. This method is mainly used in FX markets where there is not sufficient liquidity in the central limit order book of an exchange but there exists sufficient liquidity in the underlying OTC cash markets.
- (iii) **Execution of an OTC FX forward order through bilateral communication with a broker-dealer and resulting in a bilateral FX forward position with a broker-dealer.** Futures exchanges have not yet succeeded to list futures contracts on all liquid currency pairs. For those currency pairs where we are confident that a sufficiently liquid underlying cash market exists we trade the currency pair bilaterally with our counterparties as FX forwards (including non-deliverable forwards). The FX forwards are ultimately held bilaterally with a broker-dealer or prime broker.

Advantages of transitory EFRPs

Currently there are several FX futures contracts that do not have a sufficiently deep or active central limit order book (e.g. the Russian ruble/U.S. dollar futures contract on CME). These futures contracts show, most of the time, a much wider bid/ask spread than the equivalent OTC cash markets. Moreover, there are several FX futures contracts without any liquidity in the central limit order book at all (e.g. the Israeli shekel, Polish zloty and Turkish lira futures



contracts on CME). If a market participant wishes to acquire (or to liquidate) a position in such a futures contract it would be very expensive to have its orders executed on exchange, if possible at all. If market participants still want to gain exposure to the futures markets (or liquidate its current positions) the CME offers two alternatives: block trading and (transitory) EFRPs. For both alternatives, market participants can acquire (or liquidate) positions in futures contracts by executing transactions bilaterally, away from the centralized marketplace (and thus by accessing other liquidity pools rather than the central limit order book of the exchange itself). In these circumstances, the possibility to perform transitory EFRPs on CME is thus a useful mean to bring the two liquidity pools together. Market participants can access the underlying liquidity pool in the cash market, where the desired transaction sizes can be accommodated with more ease than in the futures market and simultaneously enjoy the advantages of central clearing in the futures model (as per our preferred choice).

Most importantly, we believe that history has shown that transitory EFRPs have greatly contributed to the transition of many FX markets from a full OTC market towards an on-exchange traded and centrally cleared futures market, by providing a sort of halfway station. To illustrate this statement we can give some insights from our own trading activity. Historically we traded the Russian ruble/U.S. dollar and U.S. dollar/Turkish lira futures contracts in the OTC markets, holding positions bilaterally with broker-dealers (as mentioned in method (iii) above). After the CME introduced futures contracts on these currencies and since we are able to use transitory EFRPs, we have moved away from the OTC markets and clear these currency pairs as futures contracts only. Moreover, in some FX markets that we used to trade solely via the EFRP route (e.g. euro/yen, euro/sterling, New Zealand dollar/U.S. dollar, Australian dollar/yen and Brazilian real/ U.S. dollar) the liquidity of the central limit order book has grown sufficiently that we have started to trade these markets more and more directly in the central limit order book itself. And also the Russian ruble/U.S. dollar is nowadays traded by us more and more directly in the central limit order book, which illustrates the transition from pure OTC via transitory EFRPs to straightforward futures trading.

There are two factors that help explain this catalyzing effect of transitory EFRPs in this development:

- (a) Market participants, such as ourselves, are only willing to put in bids and offers on (potentially or still) less liquid screens, if we are assured that we can always liquidate positions within a reasonable time and at reasonable prices. In other words we do not shy away from taking part in an *illiquid screen* of an exchange, as long as we do not end up with an *illiquid position*. The (potential) use of transitory EFRPs offers this assurance.

- (b) A low open interest in itself is for many other market participants a reason not to trade a futures contract. So, if open interest is built up by some market participants making use of transitory EFRPs, then this could trigger other market participants to start trading the futures contract, thereby potentially enhancing the move away from OTC into the futures space.

Block trading

Although block trading may seem to be a good alternative for transitory EFRPs, the existence of minimum transaction size requirements (“Block Trade Minimum Thresholds”) does not make this alternative a viable one, certainly not for the less liquid FX markets. CME’s current Block Trade Minimum Thresholds range from 50 lots for the non-major currencies to 150 lots for the super-major currencies. With such thresholds, block trading can be a good alternative for trading larger sizes in the more liquid FX markets, where there is sufficient liquidity on screen for smaller sizes. However, for the less liquid FX markets there is no such liquidity for smaller sizes on screen, making block trading no alternative, given the current Block Trade Minimum Thresholds.

Therefore we suggest that any amendment that the CME makes in its rulebook will be dependent on the liquidity of each FX market in its central limit order book. For futures contracts that do not show any activity in the central limit order book (e.g. Israeli shekel, Polish zloty and Turkish lira futures contracts) we suggest that the CME either does not prohibit the use of transitory EFRPs, or adjusts the Block Trade Minimum Thresholds of these FX contracts to one lot. For FX futures contracts that do actually show more activity on the central limit order book, the CME could consider prohibiting transitory EFRPs provided that the Block Trade Minimum Thresholds of such FX contracts are always adjusted in accordance with its activity on screen. Looking at the current liquidity in the screens, this should result in smaller Block Trade Minimum Thresholds for the Russian ruble/U.S. dollar futures contract, while the current threshold for the euro/yen might already be appropriate.

If the CME amends its rulebook as requested, then we believe that trading in the less liquid FX markets (like the Israeli shekel, Polish zloty and Turkish lira futures contracts) will certainly not move towards the futures markets, but worse, will move completely back into the OTC space. We expect such movement back to OTC will also happen for those FX markets where the Block Trade Minimum Thresholds are perceived to be too prohibitive for (potential) traders in these futures markets.

Clearing and additional risks

From a clearing perspective, a consequence of prohibiting transitory EFRPs in the FX markets is that market participants will move their currency trading away from the futures market back to the OTC environment where FX forwards are bilaterally traded and held.

Conclusion

In an environment wherein market participants, such as ourselves, embrace central clearing to reduce counterparty risk and are focused to push towards more centralized trading to make trading as competitive and transparent as possible, we strongly believe that the prohibition of transitory EFRP is a step in the wrong direction and will be in fact counteractive to the global movement of regulators and governments toward central clearing and centralized on-exchange trading. From an execution perspective market participants will lose an important trading tool to gain access to the futures market. A tool that is important to help market participants to make the transition from off-exchange bilateral trading towards centralized on-exchange trading. Therefore we suggest that CME reconsiders its proposed amendments of its Exchanges' rulebooks and does not prohibit the use of transitory EFRPs in all FX markets. For futures contracts that do not show any activity in the central limit order book we suggest that the CME does not prohibit the use of transitory EFRPs or (as an alternative) lowers the Block Trade Minimum Thresholds of these FX contracts to one lot. In any case, we would strongly suggest that the CME always takes into account *activity* and *liquidity* on the central limit order book if it amends its rules relating to transitory EFRP and in determining an appropriate Block Trade Minimum Threshold for each FX contract.

We appreciate the opportunity to share our views on CME's proposed amendments to existing Rule 538 of the Exchanges' rulebooks. If you have any questions about our comment letter, please feel free to contact us by phone (+31(0)10 453 6500) or e-mail (info@transtrend.com).

Sincerely,

Transtrend B.V.

Marc Putter

Trading

Jork Muijres

Product Development