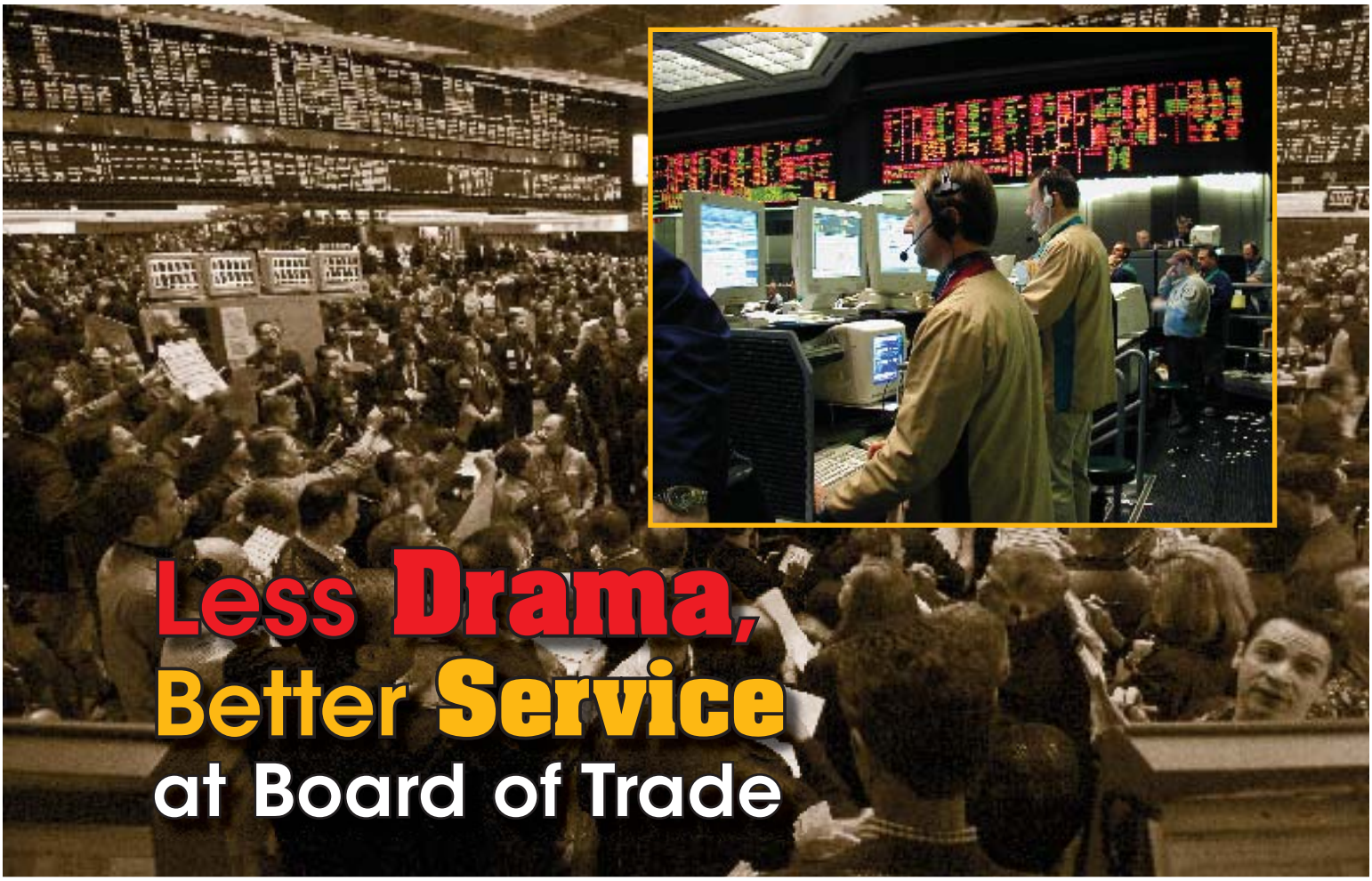
By Diane Klemme



Less Drama, Better Service at Board of Trade

Changes at the Chicago Board of Trade have greatly improved the organization's ability to serve agricultural customers quickly and efficiently.

Remember the old days of the 1970s and '80s at the Chicago Board of Trade (CBOT)? Even after the new state-of-the-art Grain Room opened in 1982, the trading pits were jammed with traders and assistants, surrounded by rows of phone clerks busily writing paper orders handed off to young runners who rushed them to the appropriate pit for execution. Filled order tickets were often thrown out of the pit to be retrieved from the floor by those same runners. The phone clerks called price confirmations to customers when they had a spare minute. On the busiest days there could be a crush of runners struggling to get paper orders to the right broker, and at day's end the trading floor was literally a sea of paper. It made for great TV news footage but not for great customer satisfaction. As recently as a few years ago customers often were forced on busy days to wait hours to find out the price they bought or sold, or would discover the next morning there was a price change. How it all worked as well as it did remains a mystery to most folks.

Visitors today hardly recognize the scene from the visitors' gallery: There are far fewer phone clerks and runners, traders are equipped with headsets and electronic handheld devices, electronic printer/terminals ring the pits, and the absence of paper is striking.

Yet the CBOT has set record daily volume in 2005 and handled it much more efficiently and quickly, although not without minor glitches. The changes have greatly improved the CBOT's ability to serve its agricultural customers quickly and efficiently. But just

how does an order work its way to and from the CBOT these days? Do the new systems benefit you?

What's the same?

For many futures customers, little has changed in their interaction with the CBOT. Hedgers still buy and sell futures and options to manage price and spread risk. Most still phone their orders to a brokerage firm such as a Futures Commission Merchant (FCM). And floor brokers still receive orders during the daytime in the same trading pits as years ago and execute orders by open outcry — the hand waving and shouting we see on TV. All executed trades are then processed through the CBOT/CME Common Clearing Link which becomes the buyer to all sales and the seller to all purchases. Brokerage firms still pay and collect margin funds daily. (Some things never change!)

What's new?

Two processes have changed the methodology of futures trading, without changing the result. These processes are very different but both expedite and simplify futures and options trading.

■ Electronic "black box" trading (e-cbot); — first launched in 1998)

■ Electronic order routing

E-cbot is true electronic "black box" trading — there is no trading pit, no waving or shouting. The CBOT offers agricultural futures and options "after hours" trading on the e-cbot electronic platform, powered by the LIFFE engine. E-cbot orders are executed electronically through algorithms that utilize pro-rata matching rather than "first-in, first-out" sequencing. Trades made on e-cbot are fully fungible with orders traded via daytime open outcry; the contract terms are identical and e-cbot trades also clear through CME/CBOT Common Clearing. Customers phone orders for e-cbot to their brokerage firm, which in turn routes the order to e-cbot using electronic order entry software.

E-cbot has benefited the grain industry two ways. Grain elevators and other commercial firms can lay off price risk from afternoon grain purchases or sales. Second, grain traders now arrive at their offices in the morning without having to guess whether futures will open higher or lower. E-cbot prices tell them!

Electronic order routing

Electronic routing is the process by which an order gets from the customer or brokerage firm (FCM) to the trading pit or to the e-cbot platform for execution. Once a customer phones an order for open-outcry trading to a brokerage firm these days, that broker probably won't phone your order to Chicago. (Very large orders, futures-exchange "versus cash" orders, or unusual spread orders might be phoned to the trading floor.) Your brokerage firm representative will likely turn to a computer terminal and enter the order into software which routes the order electronically to the CBOT. The CBOT will then route the transaction to one of the EC ("electronic clerk") terminals located in and around the trading pits. The order is relayed to the appropriate broker who accepts it for execution. Assuming the order is filled (executed), the price, quantity, and other information will be keyed back into the terminal and transmitted back to the brokerage firm office where your representative confirms the transaction to you.

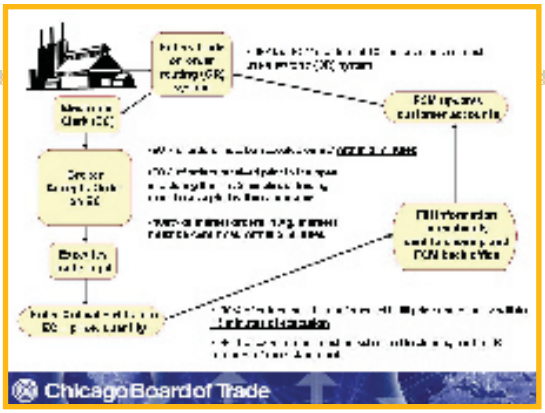
But the customer can't tell whether an order has been entered electronically or phoned to the trading floor. The electronic order entry process is comparable to sending a colleague an e-mail instead of writing a memo and carrying it to their office — e-mail is faster and leaves a precise audit trail, as is true of electronic order routing.

Electronic order routing benefits customers several ways.

■ Brokerage firms can manage large volumes of orders quickly and efficiently with fewer clerks and support staff. This holds down costs and has kept commission rates stable. One person can easily monitor a screen that allows the user to instantly review all executed trades, working orders, etc., by customer name or account number, commodity or price. Your broker usually doesn't need to call the floor to check on an order's status.

■ Price reports on executed trades typically are available quickly, sometimes in less than a minute after the order is entered in the case of "market" orders.

■ Most brokerage firms allow customers access to order entry software. This provides advantages for the customer, while the brokerage firm can still monitor what the customers are doing "real time," which serves as a control.



Why would a customer want to use electronic order entry software? Why not just call your brokerage firm?

■ Some customers will still phone orders to their brokerage firm rep, but also use the order entry software passively in their office.

■ The software makes it simple to track working orders and orders that have been filled (executed).

■ Ideal for multistation firms — a general manager or central merchandiser can monitor overall activity where several people may be authorized to enter orders.

■ Most order software also shows an up-to-the-minute "marked to market" account status page, indicating current Initial Margin requirements, and other financial information.

■ Useful for an overview of rate of purchases on busy days!

■ Speed — Entering futures orders directly from your grain elevator office speeds up the process. On volatile or busy days it cuts the number of phone calls and trims time off every order. It doesn't ensure better fills, but does reduce the lag time where you remain exposed to price risk.

■ As with the passive user, managers who enter their own futures orders have immediate access to trade price reports and a summary of all outstanding orders.

■ Anyone who enters orders directly needs to understand that you bear the cost if you make a mistake on the order.

Order entry/routing software has been available for a number of years, and although use has grown steadily, not everyone was onboard with the concept. The CBOT trading floor had become increasingly streamlined but was still dogged by choke points and delays on high-volume days, or with certain pit brokers. Electronics could only do so much when orders were still routed to humans who might be backlogged and slow to accept the next order. Those delays can cost you money!

Responding to customer feedback and to remedy the problems, the CBOT implemented increasingly tougher standards on floor brokers and traders, starting in 2003. These changes did improve floor operations and benefited hedgers. Orders got into the pits even faster, and fills came back out more quickly, reducing that period where you may be uncertain if an order is filled. "Out-trades" were reduced and customer satisfaction continued to rise. But the extreme volatility of 2004 made it clear that more was needed, and the CBOT stepped up to the plate and delivered quickly. Performance standards were tightened further in 2004 and again in 2005 in January and June.

The January 2005 standards mandated that firms must route or endorse electronically 90% of (ag) orders for 10 contracts or less. It also requires 90% of filled ag orders to have a confirmation to the customer within 15 minutes after the bracket (time) of execution. To expedite clearing, an increasing percentage of floor brokers also have to enter trades into hand-held devices.

But effective June 1, 2005, 100% of ag orders for 20 contracts or less (with limited exceptions) must be routed via Order Routing or the member firm incurs penalties.

Commodity fund volume has been high, and Index Funds have been buying ag futures as part of their portfolio as an inflation hedge. There's also an increase to speculative position limits pending. Be prepared for volatile futures markets — even if supply and demand fundamentals don't seem to warrant such moves. Hedgers want markets where they can lay off price risk quickly and efficiently, and the changes the Chicago Board of Trade has made should benefit the grain industry. ■