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Feed & Grain

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'E' Day Has Arrived

Merchandisers' Corner



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Contributor

History was made on August 1, 2006 when the major grain exchanges launched daytime side-by-side open outcry and electronic trading of their agricultural futures contracts. Industry professionals, floor traders and exchange personnel have debated the pros and cons of side-by-side trading for years, but the growth in markets, success in overnight electronic trading, and the growing "electronification" of the pits combined to make the move a logical leap forward. To the credit of the exchanges and their extensive preparation, many hedgers and speculators may even have been unaware of the transition for a few sessions after August 1, despite press coverage. For the agricultural community the issue of course is what side-by-side trading means for price discovery, risk transfer and order execution.

Background

Side-by-side ("SBS") trading is something of a misnomer. Daytime open outcry trading is still conducted as usual at the three grain exchanges (The Chicago Board of Trade, Kansas City Board of Trade and Minneapolis Grain Exchanges) by traders in the pits using hand signals to indicate bids and offers. The electronic trading for all grain exchanges is conducted on the CBOT's "ecbot" system which is powered by LIFFE CONNECT, on special computers located away from the CBOT trading floor. The ecbot computers do not sit next to the pits. The only thing visible on the Chicago trading floor are 40 large plasma screens surrounding the pits that the CBOT installed to enable floor traders and brokers to monitor all ecbot trading activity. On a recent day in Chicago, aside from the plasma screens and the headsets many brokers wear, the view from the Visitors' Gallery looked much the same — the pits were full of traders in brightly colored trading jackets, clerks were on the floor talking to brokers, and some paper order tickets were still floating around.

The future is here

Volume in daytime ag electronic trading has grown steadily since August 1 in the major commodities (corn, soybeans and wheat) and liquidity has been impressive in many contract months. CBOT's September 15th's recap, for example, shows ecbot volume of 94,000 contracts in corn, and 102,000 contracts traded in open outcry (excluding versus-cash trades, office transfers). It won't be long before electronic daytime activity in corn exceeds pit volume for the first time! Most days, ecbot volume is 20% to 40% of total daily volume, a little lower in rice, oats and soymeal.

Ecbot trading is not the same as electronic order entry. Order entry is the electronic mechanism that routes your order to either the pit or to ecbot. Ecbot is the actual trading system that displays bids and offers, matches orders electronically for execution where possible, reports executions (fill prices/quantities) and displays volume and trade prices to the public. Prior to August 1, electronic agricultural trading on ecbot was available only during the evening and overnight hours.

Futures customers need to know several important features and provisions of SBS.

1. All ecbot trades, whether traded overnight or during the SBS session, are fungible with pit-traded positions. A contract bought in the pits will offset the same contract sold via ecbot, for example.
2. Price quotations, trading symbols, and bids, offers and trade prices for ecbot are separate and distinct from those for pit-trading.
3. According to CBOT regulations, prices traded on ecbot do not elect open-auction orders, and floor brokers cannot be held to prices that were only available on ecbot.

In the example in Chart B, the open outcry order might be unable; \$2.41 was the high of the day in the pit, \$2.41¼ traded only on ecbot. There may have been more orders to sell at \$2.41 in the pit than there were buy orders at the market or at \$2.41, or a bid of 2.41 ¼ may have only been entered as an ecbot order.

4. Orders entered in the afternoon or during the evening for ecbot will work until 1:15 p.m. the following day unless filled or cancelled prior to 1:15 p.m.
5. Orders entered as "good til canceled" for ecbot will work both day and night until either filled or

- until cancelled by the customer.
6. Customers can instruct their brokerage firm whether to route orders to ecbot or to open outcry for execution, or . . .
 7. Customers may designate their brokerage firm agent to decide whether to route an order to open outcry or to ecbot.
 8. The ecbot system does not allow for "market on close" (MOC) orders.
 9. Pit brokers have special handheld terminals "HHT" that allow them to access ecbot in order to fill orders.
 10. The CBOT posts 'time and sales' data for every trade on both open outcry and ecbot on their website. Ecbot time and sales data also shows the volume of contracts traded.
 11. Some price quotation services display continually full ecbot data, including trade volume, and quantity of bids and offers at prices above and below the current market. Many traders find this extra information, called Market Depth, very useful.
 12. Caution — If ecbot trading malfunctions during the day while pit trading is underway, orders will not be automatically routed over to the pit.
 13. Customers who enter their own orders electronically will need to be extra careful. The ecbot system does not screen orders for suitability; an order to sell 25 contracts of soybeans at the market that should have been to sell five contracts (25,000 bushels) will sail right in for immediate execution. There's no human to remind you that's a pretty large order for your business!
 14. A market order on ecbot for a thinly-traded distant month will be matched by the system to the closest possible offsetting price, regardless of how far away that is (within daily price limits).

After 45 days, SBS trading appears useful and successful for market users. The spread between the pit price and ecbot is very tight, typically zero to ¼ cent in the most active contracts. Ecbot market orders for the first two or three contract months typically fill easily. Some distant futures months have low enough volume that it may still be better to route orders to the pit where a human touch may lead to a better outcome. Somewhat surprisingly, futures spread trading has also been very active in daytime ecbot trading.

Interestingly, large speculative and investment-types are routing significant volume to daytime ecbot. They have found using ecbot hides their trading activity — no one can see who's behind an order, information that might cause pit brokers to bid more aggressively or to hold back at times. Some decry this apparent lack of transparency, but what it really means is that the floor now trades on more equal footing with the public traders; they've lost some of their information edge. But this lack of transparency does make it more important than ever to have Commitment of Traders reports from the Commodity Future Trading Commission that fairly and accurately show the market breakdown of commercial market hedgers, index funds, large speculative funds, swaps dealers, and small traders. The CFTC will soon announce their plans to update these reports, and sources indicate the reports will include additional information on the new categories of "big money" where their activity is now lumped in with exporter and processor hedging.

Decisions to make

One feature if you utilize ecbot during the day is that you can now easily work your customers firm offers during both the day and night sessions. (See Point 5) Many county elevators used to tell farmers that firm offers would only work during the day sessions. In any case, decide what your policy will be and post it clearly!

Good for the grain business!

SBS trading has several significant benefits for hedgers. First, customers can now get their execution price instantly on market orders routed to ecbot — no waiting for hours on busy days. (Price limit orders continue to fill only as offsetting bids or offers appear to take the other side.) Another benefit is that the ecbot system doesn't favor the floor broker. A public customer has just as much chance to sell the high of the day or buy the low of the day as any "insider." Smaller hedgers find their spread orders now sometimes fill first on ecbot ahead of orders in the pit! The speed and efficiency of ecbot also raises the odds that last-second orders can be executed; there's no delay of a human broker being unable to process the order before the closing bell. Ecbot's inherent efficiency will mean fewer "outrades", orders where price or quantity do not match for clearing. Outrades sometimes lead to price changes on customer orders, especially frustrating in volatile markets. The abilities to get orders in quickly and accurately for execution, to have a tight bid/offer range, and to execute larger orders with minimal price impact are hallmarks of markets where efficient price discovery and risk transfer occur. So far ecbot trading side by side with open outcry has met the ag community's needs.

For additional information from the CBOT on regulations regarding ecbot, visit their website at www.cbot.com/news/notices . Two notices are of particular interest:

<http://www.cbot.com/cbot/docs/73728.pdf> error policy
<http://www.cbot.com/cbot/docs/73462.pdf> order execution

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