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COMMENT

August 7, 2000

Ms. Jean Webb
Secretariat
Division of Trading and Markets
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: New Regulatory Framework for Multilateral Transaction Execution Facilities

Dear Ms. Webb:

The New York Board of Trade and its subsidiaries ("NYBOT") are pleased to submit this comment letter regarding the new regulatory framework for Multilateral Transaction Execution Facilities proposed by the Commission pursuant to its exemptive authority under Section 4(c) of the Commodity Exchange Act (the "Act"). By their initiative, the Commissioners and staff have laid the foundation for far-reaching changes that will allow U.S. exchanges to maintain a competitive position in the international marketplace. We commend them on taking the aggressive strides reflected by the proposed framework. In many respects, the proposed framework (the "Proposal") strikes a measured balance between self-regulation and federal oversight. However, in certain areas we believe the Proposal falls short of affording needed relief or may require clarification. Those areas are discussed below, along with our comments regarding particular rule provisions.

1. **RFE Status of Successors to Contract Markets**

Existing designated contract markets will be granted RFE status under the Proposal and therefore will not have to follow the application process specified in new Part 38 of the Regulations. In light of the demutualization and restructuring of exchanges sweeping the U.S., it is important that successors to existing designated contract markets (whether by merger, consolidation, sale or other reorganization) be eligible for RFE status without having to make a full application to the Commission. As an example, the second stage of the merger between the Coffee, Sugar & Cocoa Exchange, Inc. ("CSCE") and New York Cotton Exchange ("NYCE") calls for both of those exchanges to be merged with, and into, their common parent, NYBOT, which is not a designated contract market. The RFE status bestowed on CSCE and NYCE pursuant to proposed Rule 38.4 should automatically transfer to NYBOT upon such merger. Other forms of restructuring by exchanges will surely present the same kind of issue over time.

2. **Core Principles for RFEs**

Core principle #7: Transparency, states that the RFE must "provide, appropriate to the market, information to the public regarding bids and offers, including the opening and closing prices and daily range, and information on volume and open interest." Since no further explanation of acceptable practices is given by the Commission, we wish to emphasize the fact that some aspects of market transparency will be affected by whether the market is electronic or open outcry. For example, bids and offers automatically are captured by electronic trading systems but generally not captured or disseminated in open outcry markets. We assume that inclusion of the phrase "as appropriate to the market" in Core principle 7 is intended to acknowledge such differences, and that therefore the inclusion of "bids and offers" in the list of information to be disseminated by an RFE was not intended to impose new burdens on RFEs that trade by means of open outcry. We request that the Commission confirm this to be the case.

Core principle #10: Financial Standards, states that where financial intermediaries (such as FCMs) are permitted, the RFE must have rules addressing "the financial integrity of the intermediary and the protection of customer funds." The explanation provided in the guidance to this core principle specifies that the rules concerning the protection of customer funds "should address the segregation of customer and proprietary funds, the custody of customer funds and the investment standards for customer funds." The Act and the Commission's Regulations currently provide a comprehensive regime for the protection of customer funds, which includes provisions regulating who may handle customer funds, how and where they must be segregated and how they may be invested. All these requirements are subject to verification pursuant to the Joint Audit Program authorized by the Commission under Part 1 of its Regulations. Nothing in the Proposal suggests that an FCM or other intermediary would be relieved of these requirements to the extent that it intermediated transactions on an RFE, versus transactions made on a designated contract market. However, this core principle appears to indicate that RFEs must establish their own regimes for, among other things, the safeguarding of customer funds.

To require RFEs to do so would create new and enormous burdens on them, since exchange rules presently do not purport to regulate intermediaries' handling of customer funds. Moreover, were RFEs required to adopt procedures covering such matters, the result could be chaos for firms that are common members of multiple exchanges, as they would be subjected to different rules and procedures at each exchange. Indeed, in a competitive environment where exchanges no longer maintain their traditional product monopolies, the degree to which an exchange imposes burdens on its members or intermediaries could be a strong factor in determining where the business will go. Surely the Commission does not intend for the safeguarding of customer funds to be vulnerable to the marketing considerations of an RFE. The Commission should continue to regulate the protection of customer funds, with responsibility for enforcement of those regulations shared in the manner currently in place.

3. **Certification of Rules Pursuant to CFTC Rule 1.41**

The Commission's Proposal would allow rules to be placed into effect without prior agency approval (with certain exclusions) pursuant to a Certification procedure in which the submitting RFE or designated contract market attests to certain aspects of the rule. However, the Commission has reserved to itself the authority to stay the effectiveness of a rule so implemented during the pendency of any proceeding to disapprove, alter or amend the rule. NYBOT firmly believes it would be detrimental to let rules take effect under the self-certification procedure and then have the rule suspended during a proceeding brought after the fact. An administrative proceeding to disapprove or alter rules can take many months to resolve, at the end of which time the rule in question might very well be left in place. The uncertainty created by the possibility of a rule being changed after being placed into effect, will deter traders from markets that use the certification procedure and, in turn, will deter markets from using it – thus undermining the goals of the Proposal. We urge the Commission not to implement this aspect of new Rule 1.41.

4. **The Treatment of Enumerated Agricultural Commodities**

In the Proposal the treatment of contracts that are based on agricultural commodities enumerated in Section 1(a)(3) of the Act is bifurcated from the treatment of most other contracts. This is reflected in both the RFE and DTEF aspects of the Proposal.

For example, the rules of an RFE generally do not have to be submitted to the Commission for prior approval before they may be made effective. However, if those rules relate to the terms or conditions of an enumerated agricultural commodity, they must be submitted and approved by the Commission.[1] That process can take 45 days plus the possibility of an additional 30 day extension, at best. NYBOT does not believe such prior approval is necessary or appropriate. The rules relating to the terms and conditions of a contract are not simply created by uninformed exchange officials acting in a vacuum. As the Commission is frequently reminded, contract terms and conditions are critical to the success of any contract. This is particularly so in the case of domestic agricultural products, where the support of the underlying trade means the difference between success and failure. Consequently, exchanges have a very strong incentive to design contracts in a way that is supported by industry users. While it is true that all users of a contract will not necessarily see eye-to-eye on every matter, making the Commission (rather than market forces) the arbiter of which terms are appropriate merely substitutes the agency's judgement for that of the listing exchange. We do not believe that this results in "better"

[1] By requiring that rules relating to terms and conditions be submitted for approval, the Commission has effectively ruled out the possibility of an RFE or designated contract market listing an enumerated agricultural product by self-certification, although Regulation 5.1 does not expressly prohibit such a listing. As a practical matter, the certification would be rendered moot by the submission of the rules setting forth contract terms and conditions and the attendant delay of awaiting Commission approval. Thus, Rules 1.41 and 5.1 appear to be at odds.

contract terms than would otherwise be implemented. Indeed, such a protectionist approach ignores the environment in which contract design occurs and the entrenchment of the trade in that process.

At NYBOT, and presumably other exchanges, contract terms and changes to them typically are generated by a contract committee comprised virtually exclusively of persons who actively use the cash and futures market in that commodity. In light of the high development and marketing costs associated with the launch of a new contract, there is no reason to believe that an exchange would not seek to develop a contract that had broad industry support. Moreover, if the collaborative efforts of the exchange result in a flawed contract, surely another exchange would seize the opportunity to list a better version of the contract, and the liquidity would be diverted to the market which had the "right" terms for the contract. There is no compelling reason not to let the marketplace decide whether or not a contract will fail or succeed. Accordingly, NYBOT urges the Commission to include enumerated agricultural commodities within new Regulation 1.41(c) and exempt them from the rule review procedure requirements of Section 5a(a)(12)(A) of the Act and related regulations.

The second distinction drawn for contracts on enumerated agricultural commodities is with respect to their eligibility to trade on a derivates transaction execution facility, or DTEF. We were pleased to learn that the Commission is willing to consider, on a case-by-case basis, granting DTEF status to non-enumerated agricultural commodities, such as CSCE's World Sugar Contract, on the basis of the surveillance history and other characteristics of the relevant contract. We believe this same approach is appropriate with respect to the agricultural products enumerated in Section 1(a)(3) of the Act. The Commission, by its regulatory reinvention initiative, has rejected the "one size fits all" approach to regulation. Rather than a blanket prohibition against DTEF status, the Commission should recognize that each physicals trade may have different views on this issue and permit DTEF status for agricultural commodities on a case-by-case basis. This would allow for the possibility that, after industry input, a contract on a particular agricultural product may trade under DTEF status while contracts on others, where it is not deemed desirable by the underlying industry users, do not. Surely the interests which the Commission seeks to protect would not be harmed by such a process.

5. **Specific DTEF Rules**

Two aspects of the requirements applicable to DTEFs raise concerns for NYBOT. Specifically, new Rule 37.2(e) provides that a DTEF product traded in a physical trading environment must be traded in a location separate from products traded as designated contract markets, RFEs or MTEFs. This requirement would pose undue burdens on DTEFs that utilize open-outcry trading methods because of the additional, separate space that would have to be provided for these products. Moreover, it would unnecessarily require brokers and traders to choose among products, and would adversely affect their bottom line.

For example, at NYBOT the Sugar 11 (World) contract is traded in the same ring, at the same time, as the Sugar 14 (Domestic) contract. It makes no sense to force brokers to choose between these two contracts, or to require them to run back and forth between rings. We believe that both sugar

contracts could continue to trade in the same ring without confusion and with the appropriate level of oversight, even if one contract were regulated as a DTEF and the other an RFE. This would be true even if the trading rules for the two contracts were vastly different. There currently are many, significant differences in the rules applicable to NYBOT's products depending on which entity is the listing exchange. Nonetheless, common members trade these different products with ease and clearly distinguish the rules applicable to each. There is no reason to believe they could not do so within the physical confines of one ring in which contracts on the same underlying commodity were traded pursuant to different levels of regulation.

The other concern raised by the DTEF rules is the exclusion of registered floor brokers and traders from access to the DTEF unless certain financial requirements are met by them. Rule 37.2 lists as eligible DTEF participants certain of the persons and entities which the Commission previously codified in Rule 35.1(b) as eligible swaps participants. As a result, unless a floor broker or trader has $1 million net worth or $10 million total assets, he "may have access to trade" on a DTEF only through an FCM Clearing member with $20 million capital. As currently written, this provision would force from the floor of our exchanges literally hundreds of the Commission-registered members who earn their living trading on NYBOT. The Commission has given no reason for such a restraint on the ability of these members to earn a living. Even if the phrase "access to trade" is construed to permit the member to trade on the floor without having to place orders through an FCM, the rule could require that floor brokers and traders establish accounts with firms other than those with which they have current or long-standing relationships, and obtain guaranties from those other firms in order to maintain their floor trading privileges. Such a wholesale change in the dynamics of these relationships cannot be justified. The stated basis for requiring access be granted only through a well-capitalized firm is that the broker will be provided with "disclosures and other protections." NYBOT believes that registered floor brokers and traders do not require special disclosures and protections from a financial intermediary because they are sophisticated market users with respect to the futures markets, if not the swaps markets. The Rule 37.2 listing of "eligible commercial participants" should be amended to include registered floor brokers and traders.

6. **RFEs and DTEFs as Agent for Foreign Traders**

Regulations 1.37 and 15.05, as proposed, would require each RFE and DTEF to (a) keep records with the name and other information about each foreign trader and (b) act as agent for purposes of service of process for foreign brokers and their customers. There is an exception to these requirements in the case of trades that "are executed through ... and are maintained in accounts carried" by an FCM or IB. The Commission should make clear in the final rules that the exception applies (and therefore RFEs and DTEFs will not be required to serve as agent and maintain records) in cases where the contracts of the foreign broker or trader are carried by an FCM either directly or through an omnibus account of a foreign broker. In addition, the reference to trades that "are executed through" an FCM should be deleted. This clarification is needed to ensure that the exception would apply in those instances where a foreign broker or trader enters its orders directly to the trading floor (as opposed to "through" an FCM or IB), but nonetheless ultimately carries the resulting position (directly or indirectly) with an FCM or IB.

7. **Section 2(a)(1)(b) Contracts**

The Commission has excluded contracts that are subject to Section 2(a)(1)(B) of the Act from most of the Proposal, presumably because it believes that legislative action amending that provision is the only way to bring about change. We urge the Commission not to rely solely on such possible action, and to consider ways of exercising its authority to provide relief to the markets on which the affected contracts are traded.

8. **Miscellaneous**

Throughout Rules 5.1 and 5.3, references to Rule 5.2 should be corrected to refer to Rule 5.3.

We appreciate the opportunity to again share our thoughts with the Commission and look forward to swift implementation of final rules that are consistent with the views expressed above. If you have any questions regarding the matters we addressed or wish to discuss other aspects of the Proposal, please contact me or NYBOT's General Counsel, Audrey Hirschfeld.

Very truly yours,

Mark D. Fichtel
President and CEO

cc: Chairman William Rainer
Commissioner Thomas Erickson
Commissioner Barbara Pedersen Holum
Commissioner James Newsome
Commissioner David Spears