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April 9, 2001

VIA FACSIMILE AND FEDERAL EXPRESS

Ms. Jean A. Webb  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

Re: Regulatory Reinvention: Proposed CFTC Regulatory Framework for Trading Facilities 66 Fed. Reg. 14262 (March 9, 2001)

Dear Ms. Webb:

The New York Mercantile Exchange, Inc. ("NYMEX" or the "Exchange") appreciates the opportunity to comment, on its own behalf and on behalf of its wholly-owned subsidiary, Commodity Exchange, Inc. ("COMEX"), on the Commodity Futures Trading Commission's ("CFTC" or "Commission") regulatory reform proposals that were recently published for public comment. These proposals, which will be referenced collectively in this comment letter as the "Reform Proposal," are intended to implement the provisions of the Commodity Futures Modernization Act of 2000 ("CFMA").<sup>1</sup>

NYMEX is a for-profit corporation organized under the laws of the State of Delaware. It is a designated contract market for the trading of numerous commodity futures and commodity futures option contracts. NYMEX is the largest exchange in the world for the trading of futures and option contracts based on physical commodities. In 2000, more than 100 million contracts were traded at the Exchange. Public investors in our markets include institutional and commercial producers, processors, marketers and users of energy and metals products.

The Rule Proposal includes proposed new Part 36 ("Exempt Markets"), which would govern exempt boards of trade and exempt commercial markets. By comparison, Part 37 would govern derivative transaction execution facilities ("DTF") and Part 38 would govern trading facilities that have been approved as designated contract markets. Under the Rule Proposal, most of the Commission's existing regulations applicable to trading facilities would be repealed. However, certain regulations as applicable would be reserved for DTFs and for contract markets.<sup>2</sup> In addition to the Commission rules

<sup>1</sup> The Commission previously published for comment in June 2000 a proposed new regulatory framework for trading facilities, 65 Fed. Reg. 39008 (June 22, 2000). The Commission later promulgated final rules in December 2000, 65 Fed. Reg. 77993 (December 13, 2000). Following enactment of the CFMA, which was signed into law on December 21, 2000, the Commission withdrew those rules in order to harmonize its regulations with the CFMA. 65 Fed. Reg. 82272 (December 28, 2000).

<sup>2</sup> Specifically, proposed new Rule 37.2 would provide that the following rules (with the scope of the rule indicated in parentheses rather than the rule title) would remain in effect for DTFs: 1.3 (definitions); 1.31 (books and records); 15.05 (designation for foreign brokers, traders and customers); 33.10 (option

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*The New York Mercantile Exchange is composed of two divisions. The NYMEX Division offers trading in crude oil, heating oil, unleaded gasoline, natural gas, electricity, propane, platinum, palladium, and the FTSE Eurotop 300<sup>®</sup> index. The COMEX Division offers trading in gold, silver, copper, aluminum, and the FTSE Eurotop 100<sup>®</sup> index.*

that would be repealed, the Commission is specifically proposing to delete Part 180 ("Arbitration or Other Dispute Settlement Procedures"); designated contract markets thus would be subject to proposed new Rule 166.5 ("Dispute settlement procedures"). The Commission is also proposing new Part 40, which would govern procedures for the listing of new contracts and the implementation of new rules by DTFs, by designated contract markets and by registered derivative clearing organizations.

In general, the Exchange supports the Rule Proposal. In this regard, it is worth noting that Section 2 of the CFMA listed a number of purposes for that legislation. These statutory purposes include streamlining and eliminating unnecessary regulation for exchanges and other regulated entities, transforming the role of the CFTC to oversight of futures markets, and enhancing the competitive position of U.S. financial markets and institutions. The Exchange commends the Commission for taking the initiative to exercise its discretionary authority in a number of instances to carry out these purposes by going beyond the specific provisions of the CFMA. Such instances include the following:

- o expanding the definition of "eligible commercial entity" to include a registered floor trader or floor broker trading for its own account whose trading obligations are guaranteed by a registered futures commission merchant;
- o allowing a contract market to submit a rule or contract for voluntary approval at any time;
- o processing contract market rules submitted voluntarily for approval in 45 days, half the time permitted under the Commodity Exchange Act ("CEA");
- o allowing a designated contract market to apply to the Commission for review of a rule or policy solely under Section 15(b) of the CEA, including operational rules and the terms and conditions of products listed for trading; and
- o allowing a contract market to forego certification for certain types of rules and either to submit such rules pursuant to a weekly notification filing or to eliminate altogether any filing requirements.

The balance of this comment letter will address the areas where the Commission specifically requested comment or where the Exchange believes that additional clarification or reconsideration may be appropriate.

#### **DTF Application Process**

Proposed new Rule 37.5 provides that a trading facility shall be deemed to be registered as a DTF 30 days after the Commission's receipt of the application if certain specified conditions are met. Proposed new Rule 37.3 permits a trading facility to apply to become a DTF for a commodity "for which the Commission has determined, based on the market characteristics, surveillance history, self-regulatory record, and capacity of the facility, that trading in the contract (or option) based on that commodity is highly unlikely to be susceptible to the threat of manipulation."

It is unclear whether the 30-day timeframe would be applicable to applications requiring the Commission to make such an individualized assessment of a particular contract. If this timeframe will be applicable to such determinations, the Exchange suggests that the Commission clarify this point in its final rules. If this timeframe will not be applicable to such determinations, the Exchange requests that the Commission specify a comparable timeframe for such determinations that would provide for resolution of such applications in a reasonably expeditious manner.

Also, this proposed rule lists eight factors to be addressed in the written submission (to the extent that they are not self-evident). NYMEX offers three points on these proposed factors. First, the Commission should clarify in its release that each of these factors is meaningful only in relative terms, *i.e.*,

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transactions); Part 190 (bankruptcy) and, as applicable to the market, Parts 15-21. Proposed new Rule 38.2 would reserve and thus maintain all of these rules, including all of Parts 15-21, for contract markets. In addition, Rule 38.2 also would reserve Rule 1.38 (execution of transactions) and Part 9 (Commission review of exchange disciplinary and access denial actions).

in comparison to other markets. Thus, for example, it would be useful for the Commission to reword the first factor to reference a "relatively" high level of cash market liquidity.

Second, the Commission should clarify that it is not necessary for a contract to meet all of these factors. For example, the emphasis placed on the absence of frequent, sharp price changes in the sixth factor arguably could be applied so as to rule out a contract for a market with some price volatility. In other words, rather than attempting to rule out any contract that has a hypothetical potential for price distortion, the Commission should consider the totality of circumstances for the contract, including the extent to which one factor might be addressed through appropriate surveillance.

Third, it is likely that over time that the Commission will be faced with a number of applications involving cash-settled and/or index-based contracts. For such contracts, the total deliverable supply of the cash commodity is not as relevant as for other contracts. Accordingly, the Exchange suggests that it may be appropriate for the Commission also to provide guidance in the release accompanying the final rules as to how these factors might be interpreted for such contracts.

As to the process for filing such DTF applications, proposed Rule 37.3 would limit a trading facility to the submission of written data. The Exchange suggests that an oral hearing may be appropriate in certain instances and should be so permitted.

#### **Dissemination of Market Data**

Proposed new Rule 38.3 would provide that a contract market provide "fair, equitable and timely availability to all market participants of information regarding prices, bids and offers." A similar standard is also contained in proposed Rule 37.6 for DTF facilities. This language could be interpreted as requiring dissemination of all bids and offers, which would be a radical departure from established practice for open outcry markets currently providing information concerning only changes in bids and offers. The preamble provides no indication that the Commission was seeking to impose a major change in this area. As suggested by the Chicago Board of Trade in its comment letter, the Exchange strongly recommends that the Commission add suitable qualifying language to these provisions, such as "appropriate to the market" to clarify that this is the case.

With regard to providing information to market participants, the Exchange also believes that it is important for the Commission to provide trading facilities with the greatest possible flexibility in terms of the manner of providing information to participants. For example, the Commission could clarify that it would suffice to make such information available on the website of the trading facility rather than requiring a separate ticker feed. The Commission might further clarify that it would not be necessary in all instances to provide such information on a real-time basis.

#### **Compliance with Core Principles**

In footnote 10 of the Federal Register release, the Commission contrasted a formal notification to a regulated entity of violation of a core principle with an informal request for demonstration of compliance with a core principle. Specifically, Section 5c(d) of the CEA provides a mechanism for notifying contract markets (and other registered entities) that they are violating a core principle. By comparison, the request for a demonstration of compliance operates independently of the Section 5c(d) procedure. The Commission indicated its view that the request for such a demonstration from a registered entity, and the Commission's consideration of the entity's response, "may constitute a useful alternative to the more formal procedures of section 5c(d) of the Act." The Commission also expressed its intent to explore such informal methods of resolving issues of compliance with core principles by registered entities prior to invoking more formal mechanisms.

NYMEX strongly supports this approach. Complying with the flexible and broadly worded core principles should be expected to create a number of questions of first impression in the months and years ahead. The Exchange believes that it is important for the Commission and Commission staff to continue to maintain and further to foster constructive dialog with regulated entities on these types of issues and to resort to informal means of addressing questions prior to invoking formal procedures.

### **System Security**

In the guidance provided in the Rule Proposal for DTF Core Principle #4 ("Disclosure of General Information"), the Commission suggests that, among other things, a DTF should disclose its system security. While recognizing that such guidance is not establishing a mandatory means of compliance with this core principle, NYMEX agrees with the Chicago Mercantile Exchange that any such disclosure could provide persons with information that could be used to harm the system. Therefore, the Exchange suggests that such system security information not be subject to disclosure. Instead, DTFs individually should be permitted to exercise their business judgment to determine whether to provide any general information in this area to their market participants.

### **Minimum Financial Standards**

In the guidance provided to designation criterion #5 in Appendix A for designated contract markets, the Commission indicated that a designated contract market should maintain the financial integrity of its transactions by maintaining minimum financial standards for "users and/or members." Similar guidance was provided to Core Principle #11 of Appendix B for a designated contract market as to minimum financial standards for its members. The Exchange requests that the Commission clarify that a FCM guarantee of trading obligations would satisfy these standards.

### **Emergency Actions**

Proposed new Rule 40.6 would provide that rules implemented pursuant to an emergency action by a designated contract market or by a derivatives clearing organization must be filed with the Commission at the time of implementation, if implementation is sooner than the next business day. NYMEX believes that the first priority of a regulated entity during such an emergency should be to address the emergency itself and that requiring a contract market to make such a filing on the same day could detract from its ability to address fully the emergency situation. Accordingly, the Exchange proposes that the Commission instead provide that such filings be submitted as soon as practicable following implementation.

### **Anti-Fraud Rule for Certain Foreign Exchange Transactions**

One of the enumerated purposes of the CFMA was to "clarify the jurisdiction of the Commodity Futures Trading Commission over certain retail foreign exchange transactions and bucket shops that may not otherwise be regulated." In response, the Commission has proposed new Rule 1.1 ("Fraud in or in connections with transactions in foreign currency subject to the Commodity Exchange Act"). In the preamble of the Federal Register release for the Rule Proposal, the Commission indicated its belief that this new rule will benefit market participants and the public by deterring illegal behavior. The Exchange agrees and strongly supports the proposed new rule.

### **Arbitration**

In the preamble, the Commission noted that Section 110 of the CFMA removed the CEA's previous requirements for contract market designation, including former Section 5a(11) of the Act, governing exchange arbitration proceedings. Accordingly, as noted above, the Commission is proposing to delete Part 180 of its rules and to repropose its withdrawn Rule 166.5, incorporating certain amendments required by the new legislation. Specifically, the reproposed version provides that an FCM may require an eligible contract participant to sign an agreement waiving the right to reparations as a condition to using the FCM's services.

The Commission also noted the CFMA is silent as to whether pre-dispute arbitration agreements must be entered into voluntarily, and concluded by stating that the proposed rule retains this requirement that arbitration be voluntary for all customers who are not eligible contract participants. However, a number of other provisions of the CFMA can be expected to increase the regulatory and business ties between the futures industry and securities industry, where mandatory arbitration provisions in customer agreements are permissible. For example, it is expected that a number of contract markets and DTFs will seek to offer trading in security futures. In order to do so, such facilities will need to complete a notice filing with the SEC in order to be registered as a national securities exchange. Moreover, transactions in

security futures must be effected through entities that are registered both with the SEC as broker-dealers and with the CFTC as FCMs. In light of these changes, the Commission may wish to consider whether it would be appropriate to provide exchanges and FCMs with additional flexibility in this area.<sup>3</sup>

#### **DTF Liquidity Providers**

In the preamble of the Rule Proposal, the Commission noted that it had been suggested that electronic markets may have functional counterparts to floor brokers and floor traders, and that these persons should also be included within the definition of eligible commercial entity. Therefore, the Commission requested comment on the following:

“how and by whom this market making function may be performed on electronic trading facilities, the similarities and differences in this market making function and its regulation when performed on an electronic platform rather than in a physical trading environment, and whether such persons should be included within the definition of eligible commercial entity.”

The Exchange believes that it is likely that established and new trading facilities will launch a variety of electronic trading platforms based on a number of contrasting business models, and that some models may well involve market liquidity being provided by individual traders. There is an obvious line-drawing issue regarding the degree of liquidity that an individual would need to provide to qualify as an eligible commercial entity for a commercials-only market. Rather than attempting to establish a rigid rule at this time, NYMEX suggests that the Commission may wish to make such determinations over time on a case-by-case basis for each facility seeking regulatory relief in this area.

#### **Disclosure by Exempt Markets**

As noted in the release, consistent with the CEA, the proposed rules prohibit exempt boards of trade and exempt commercial markets from representing that they are registered with, designated, recognized, licensed or approved by the Commission. The Commission requested comment on whether the rule also should require that such exempt entities affirmatively disclose to traders that the facility and trading on the facility are not so regulated or approved by the Commission. Given the number of trading facilities that will be offering trading to market participants in the various, assorted new regulatory tiers, the Exchange believes that such disclosure would be both reasonable and appropriate.

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<sup>3</sup> In this regard, in promulgating the final rules for trading facilities last year that were ultimately withdrawn, the Commission justified maintaining CFTC Rule 1.31 by noting that its provisions are consistent with SEC record-keeping requirements and by noting the high number of Commission registrants that must also comply with similar SEC requirements. Arbitration may be another area where harmonization of applicable futures and securities regulatory provisions also would be appropriate.

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NYMEX thanks the Commission for the opportunity to submit comments concerning its Reform Proposal and would be pleased to furnish additional information in this regard. If you have any questions, please do not hesitate to contact the undersigned.

Respectfully submitted,



Neal L. Wolkoff  
Executive Vice President

cc: Acting Chairman James E. Newsome  
Commissioner Thomas J. Erickson  
Commissioner Barbara P. Holum  
Commissioner David D. Spears