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September 30, 2004

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

COMMENT

Re: SRO Governance

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"), to the Commodity Futures Trading Commission ("CFTC" or the "Commission") on the series of questions on self-regulatory organization ("SRO") governance and self-regulation contained in the CFTC's June 9, 2004 Federal Register release ("Release").

NYMEX is a for-profit corporation organized under the laws of the state of Delaware. It is the chief operating subsidiary of NYMEX Holdings, Inc. , ("NYMEX Holdings"). Although NYMEX Holdings' shares are not listed on a national market or exchange, they are registered with the Securities and Exchange Commission ("SEC"). As a result, although not publicly listed, NYMEX Holdings is subject to the rules and regulations of the SEC, including the obligations to file quarterly and annual reports on SEC Forms 10-Q and 10-K respectively. NYMEX is a designated contract market and regulated derivatives clearing organization for the trading and clearing of numerous commodity futures and commodity futures options and other products. NYMEX is the largest exchange in the world for the trading of futures and option contracts based on physical commodities and has been providing a neutral forum for commodities trading since it was first founded over 132 years ago. Participants in our markets include institutional and commercial producers, processors, marketers and users of energy and metals products.

I. Introduction

There is a long history of self-regulatory governance in commodity markets. Futures exchanges engaged in SRO activity throughout the last century and indeed did so even before the implementation in 1922 of the Grain Futures Act, the first federal regulation of commodity markets. Federal oversight of centralized markets that serve a price discovery role is demonstrably a valuable and important complement to the exchanges' own SRO activities.

The modern era of derivatives regulation dates back to the initial passage in 1974 of the Commodity Exchange Act ("Act" or "CEA"). Since that time, CFTC staff has engaged in extensive direct oversight of commodity markets as well as monitoring SROs' own activities. CFTC oversight of a designated contract market's ("DCM") SRO oversight activity is reflected in part in detailed and thorough "rule enforcement reviews," which are prepared on a periodic basis by the CFTC's Division of Market Oversight and are made available to the public. Beyond these periodic reviews, NYMEX staff is in regular contact with CFTC regulatory and enforcement staff and indeed during certain periods may coordinate with them on a daily basis.

New York Mercantile Exchange, Inc.
World Financial Center
One North End Avenue
New York, NY 10282-1101
(212) 299-2000

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

Strong SRO governance has long been a priority at NYMEX, and it is safe to presume that it is also a priority of other regulated entities as well. Effective and efficient regulation of the markets is at the core of the CFTC's mission. As stated in Section 3 of the Act, the purposes of the CFTC's statutory authority focus upon deterring and preventing price manipulation and market disruption, ensuring the financial integrity of regulated transactions (and the avoidance of systemic risk) and protecting market participants from fraudulent or abusive practices. As the Commission thus noted in its August 30, 2004 statement on natural gas markets, "[u]nder the Commodity Exchange Act, the primary and chief responsibility of the CFTC is to ensure that the markets that it regulates are free of manipulation and fraud." (emphasis added.)

We believe in and support the CFTC's mission and consequently also thus believe that NYMEX and the CFTC have a strong shared interest in effective regulation of our markets. We also believe that an ongoing and constructive dialog can only enhance our efforts and the CFTC's efforts to carry out our respective regulatory responsibilities.

As noted in the Release, in 1992, as part of the Futures Trading Practices Act of 1992, Congress implemented specific requirements concerning greater diversity of representation on SRO boards and disciplinary committees, fitness standards for service on boards and conflict of interest procedures. The Release then goes on to point out that, through the passage of the Commodity Futures Modernization Act of 2000 ("CFMA"), Congress replaced all of these specific provisions from the Act with far more general "core principles" in these areas.

Thus, for example, with respect to board composition, Core Principle #16 for Designated Contract Markets is limited by its terms to "mutually owned" contract markets and provides generally that the "board of trade shall ensure that the composition of the governing board reflects market participants." In this connection, it is our understanding that limiting the scope of this core principle to mutually owned markets was a tacit reflection by Congress that demutualized markets would often be subject to other corporate requirements, including as applicable the listing standards for publicly traded companies.

We appreciate the opportunity to respond to the broad policy questions posed by the CFTC in its Release. Consistent with its past practice, we presume that the CFTC also would publish for comment any proposed guidance that it may formulate in the future for the specific core principles that form the basis for its statutory authority on SRO governance. We would consequently appreciate the opportunity to comment on such proposed guidance and to maintain active discussions and dialog with the Commission, Commission staff, and other important constituencies of the derivatives industry on these important public issues.

II. Executive Summary

As noted, regulated exchanges and clearing organizations currently are subject to a number of general performance standards as articulated in core principles that were enacted into law in late 2000. Under this regulatory approach, regulated entities are ultimately responsible for meeting and satisfying the applicable performance standards; in doing so, they are given broad flexibility with respect to how they go about complying with these regulatory requirements. Consequently, regulated markets strive to comply with these standards by committing a substantial level of resources to SRO governance and more generally to corporate governance as well. This carefully considered regulatory approach would seem to be particularly appropriate to exchanges and clearing organizations that need sufficient flexibility to respond to the needs of the rapidly evolving derivatives markets.

NYMEX is always willing to engage in reasoned and constructive dialogue on relevant regulatory topics. In the specific area of SRO governance, we believe strongly in the effectiveness of our current SRO governance structure and mechanisms. We also simply do not believe that any case has been made for any type of restructuring of SRO governance in the futures industry. We continue to believe that Congress struck the right regulatory balance by applying a "smart regulation" regulatory approach in this area.

In other words, Congress included core principles on SRO governance that were related to and consistent with the CFTC's core mission. Congress in its wisdom directed that NYMEX and other regulated entities are provided with broad flexibility in how we operate our lines of business and in how we comply with the performance standards. But Congress also made clear that regulated entities retain accountability and responsibility at all times

for meeting these core SRO directives. We appreciate the flexibility, and we likewise fully accept the consequent responsibility.

II. Summary of Recent Exchange Governance Enhancements

Since its demutualization in November 2000, NYMEX has steadily implemented a good number of SRO and corporate governance initiatives in the intervening years. These initiatives have resulted not only from the Exchange's proactive efforts to comply with the applicable regulations of the SEC but also from a careful examination of successful corporate governance principles. Accordingly, before turning to the specific questions posed by the Commission in the Release, it may be helpful to summarize the more significant of these initiatives. NYMEX governance enhancements implemented in the last couple of years would at a minimum include the following changes:

- creation of new independent Exchange Audit Committee and creation of a related committee charter (copy attached);

Note: The Audit Committee is comprised of the five Public Directors who serve on the Exchange's Board of Directors and this committee conducts oversight review of the financial reporting process; the system of internal controls; the performance of the internal audit function; the qualifications, independence and performance of the independent auditors; and the Exchange's process for monitoring compliance with laws and regulations and a code of conduct.

- creation of new independent Exchange Compensation Committee and creation of a related committee charter (copy attached);

Note: The Compensation Committee is comprised of the five Public Directors who serve on the Exchange's Board of Directors. This committee has the responsibility, power and authority to set the compensation and annual incentive bonus for the Chairman of the Board, Vice Chairman of the Board, President of the Exchange, Executive Committee of the Board and employees of the Exchange who are Vice Presidents and, in doing so, may confer with other directors or employees of the Exchange. The committee also reviews and recommends to the Board all director fees/stipends; annual and long-term performance goals for the Chairman, Vice Chairman and President; and additionally administers any compensation plans.

- creation of new Exchange Corporate Governance Committee and creation of related committee charter (copy attached);

Note: The Corporate Governance Committee is presently comprised of the five Public Directors who serve on the Exchange's Board of Directors as well as seven other Board members who provide a balanced representation of the various membership categories by which candidates qualify for service on the Board. This committee has broad authority to review policies and practices concerning corporate governance and to monitor the implementation of such policies and practices. This committee thus is responsible for making recommendations to the Board on a regular basis on any proposed improvements in the governance process.

- establishment of a new NYMEX Office of Corporate Governance;

- establishment of revised and enhanced NYMEX Board Director Orientation and Continuing Education programs;

- formulation of new Exchange "whistle-blower" procedures;

- formulation of a new Code of Ethics and Policy Statement for Exchange Principal Executive Officer and for Senior Financial Officers;

- formulation of a new NYMEX Company Disclosure Policy;

- initiation of a comprehensive review, documentation and assessment of Exchange internal controls, procedures and

processes, which is being undertaken in part through the use of an outside service provider;

• amendment of conflicts of interest rules to extend to specified Exchange consultants;

• delegation to Exchange staff of sole responsibility for determining NYMEX settlement prices for products listed for trading only on NYMEX ClearPort(sm) Trading and/or listed only for clearing through NYMEX ClearPort(sm) Clearing;

• addition of one Exchange employee as a voting member in the NYMEX Settlement Committee for the Natural Gas futures contract; the PJM electricity futures and option contracts; all calendar spread option contracts; all NYMEX average price option contracts and all crack spread option contracts (with final authority in all instances to veto and to override price determinations made by the committee);

• creation of new internal due diligence procedures for preparation of annual SEC Form 10-K and quarterly Form 10-Q reports to the SEC and other external financial reporting; and

• Board approval at the September 2004 meeting of a new pilot program to include Exchange staff on NYMEX Floor Committees.

III. CFMA's Use of Core Principles and Congressional Intent

As noted previously, in the CFMA, Congress replaced detailed provisions in the Act concerning, for example, board composition and conflict of interest, and instead implemented far more general "core principles" in these areas for DCMs. The Release correctly notes this change in the applicable standards. Yet, the nature of this statutory change was so dramatic and so fundamental that it warrants further emphasis before addressing the specific questions included in the Release.

Congressional passage of the CFMA marked a true sea change in U.S. derivatives regulation. While much of the commentary focused upon the codification of legal certainty for OTC derivatives, it is also generally understood that Congress intended to and indeed provided major regulatory relief to futures exchanges as well. In part, this relief took the form of giving both new and existing markets greater flexibility with respect to the level of regulation that would be applicable to their markets based, among other things, on the type of products to be listed for trading and the nature of eligible market participants for that market. The underlying rationale for establishing various regulatory tiers of markets was that a move away from a "one-size-fits-all" approach to a more flexible structure would give derivative markets greater opportunity to innovate. Indeed, Section 3 of the Act now includes as one of the purposes of the CEA "to promote responsible innovation and fair competition among boards of trade, other markets and market participants."

An equally significant change was in the nature of the regulation that would be applicable to contract markets and to derivative transaction execution facilities. Specifically, with respect to contract markets, the passage of the CFMA in large part resulted in the shift of the CFTC from a "command and control" agency to an "oversight agency." The Act as amended by the CFMA no longer requires advance CFTC approval for all rule changes and contracts and now permits use of new self-certification procedures. The CFMA also replaced detailed regulations with broadly worded core principles. Through the use of the broad core principles, Congress established general performance standards while also providing broad flexibility to the regulated markets with respect to how they satisfy these performance standards. Through the use of core principles, Congress shifted from a "one-size-fits-all" approach and implemented a more flexible regulatory structure deemed to be more appropriate for rapidly changing markets that in turn are placing substantial (and increasing) reliance on rapidly evolving technology.

In implementing and enforcing the new core principles, the CFTC staff moved quickly to provide guidance to regulated entities and to the marketplace on these broad core principles. In fulfilling this necessary service, there was a risk that the staff guidance could have become so specific and detailed with respect to "how" designated contract markets and other regulated entities comply with the general standard that the agency might have committed "regulatory creep"; i.e., through the issuance of "guidance", the CFTC staff *sub silentio* would have engaged in administrative rule-making and in effect implemented specific requirements and regulations inconsistent with the spirit of the CFMA. The shift from a command and control regulatory structure to an oversight structure clearly

necessitated a shift in regulatory approach by the regulatory staff, and yet (in our judgment), the CFTC staff has largely successfully navigated this shift and so avoided the hazard noted above. We remain confident that the CFTC and its staff, in moving forward on its SRO review, will continue to follow this disciplined approach in providing any further guidance to the marketplace on SRO issues.

In this regard, the regulatory streamlining and modernization included in the CFMA occurred in part because of a delicate compromise that was struck among many constituencies. The use of core principles as general performance standards is a major component of these regulatory reforms. We have seen no evidence to date of any significant problems at DCMs or other regulated entities concerning SRO issues since the passage of the CFMA. Consequently, we see no basis to date for second-guessing and undermining the Congressional wisdom on SRO issues reflected in that landmark legislation.

IV. Responses to Specific Questions

A. Board Composition

1. What is the appropriate composition of SRO boards to best protect the public interest and serve SROs' needs? If you believe that SRO boards should consist of market participants, what participant communities should be represented and how should representation be allocated among those communities (e.g., quotas, volume-based)? Should the composition of SRO boards be different for the various types of SROs (e.g., DCM or DCO)?

As noted in the introductory section of this comment letter, Core Principle 16 for DCMs by its terms is limited to mutually owned markets. Given the broad scope of the CFTC's questions in this area, it is not clear to us whether the CFTC is looking beyond the specific terms of Core Principle 16. We continue to believe that Congress struck the right balance in the CFMA on this point in light of the board composition standards that are applicable under other laws and regulations, such as listing standards on stock exchanges. We also agree with the implicit judgment that Congress made in 2000 that, where such specific standards as listing requirements are not applicable, SRO board composition is best determined by the SROs themselves.

Turning back to the specific terms of Core Principle 16, we believe that the existing structure now in place at NYMEX and described below reflects our market participants and also promotes diversity of membership on the Exchange's Board of Directors. Accordingly, although NYMEX itself is no longer a mutually owned market, we would respectfully suggest that our approach may serve as one possible model for CFTC staff to consider in providing guidance on Core Principle 16.

At NYMEX, the Certificate of Incorporation ("COI") of NYMEX Holdings, Inc. provides that the directors of its board be comprised of 25 directors composed of a Chairman and Vice Chairman and that directors be divided into the following groups of membership: Floor Broker, Futures Commission Merchant ("FCM"), Trade, Local, Equity Holder and At Large. In addition, the COI stipulates that the Board of Directors shall have five Public Directors. As specified in the COI, "[i]n order to qualify as a Public Director, a person must be knowledgeable of futures trading or financial regulation or otherwise capable of contributing to the deliberations of the Board of Directors and may not be a member of the Exchange or affiliated with any member of the Exchange or an employee of the Exchange." Therefore, the Board of Directors is comprised of a Chairman, Vice Chairman, three Directors in each of the following groups (Floor Broker, FCM, Trade, Local, Equity Holder and At Large) and five Public Directors. Through these diverse membership categories, the Exchange has a mechanism in place that effectively provides for hearing the views of the various market participants.

Core Principle 16 by its terms provides that the board of trade for such markets "shall ensure that the composition of the governing board reflects <u>market participants.</u>" (emphasis added.) NYMEX thus believes that it is relevant to note that NYMEX historically has relied upon and continues to rely upon feedback provided to the Exchange by a significant number of standing Exchange advisory committees. In addition to advisory committees dealing with specific Exchange product lines, other NYMEX committees are directly targeted at obtaining ongoing and frequent input from specific constituencies, including for example the FCM Advisory Committee and the Clearing Committee. Moreover, Exchange marketing staff is in daily contact with all segments of the Exchange's market users and this department also has staff dedicated to providing service to the FCM community.

The final question (in this set of questions) regarding different SRO board composition for different types of SROs seems to presuppose, among other things, that DCMs and DCOs will always be stand-alone entities. While this structure is now possible under the CFMA, there are nonetheless several entities, including NYMEX and including the Chicago Mercantile Exchange, Inc., ("CME") that provide both types of services. Consequently, establishing separate standards for DCMs and DCOs at a minimum would be very impractical for a number of exchanges and indeed could very well be unworkable.

Having directly addressed each of the specific questions posed in this set, the Exchange would like to close its response on a broader note. With respect to any future issuance of guidance on Core Principle 16 for mutually owned markets, we would respectfully suggest that the Commission first carefully consider whether, and if so how, SRO board composition is linked to the CFTC's core regulatory mission. We trust that any guidance provided by the CFTC on this core principle will be carefully tailored to the specific terms of that particular performance standard.

2. How and by whom should SRO boards be nominated and elected? If directors should represent particular communities, should each community nominate and/or elect its representatives to the board? If the board consists of independent directors, what nomination and election procedures are necessary to ensure independence?

First, we wish to state upfront that we stand by and support our current procedures for nominating and electing members of our Board of Directors. While this process is detailed below, perhaps the key points to note about this process are that, notwithstanding the separate qualifying categories for directors, <u>any</u> stockholder may nominate any eligible person for <u>any</u> of the listed categories. Moreover, at the Annual Meeting, <u>all</u> stockholders can vote for candidates in <u>all</u> of the categories (including even the Public Director category). In other words, a candidate running for the NYMEX Board in the Floor Broker category not only would need to seek support from other floor brokers but also would need to build support from all stockholders, including for example FCM and Equity Holder stockholders.

Second, on a broader policy level, we also believe strongly that procedural matters concerning a SRO's board of directors are best determined and thus should be left to the judgment of the individual SRO. In NYMEX's case, our procedures for nomination and election to our Board of Directors are contained in NYMEX Rule 3.22 ("Membership Committee") and a related NYMEX Board Resolution that appears immediately after Rule 3.22 in the Exchange's rulebook. A copy of each of these documents is included as an attachment to this comment letter.

In general, stockholders elect individuals to serve as Board Directors at the Annual Meeting of Stockholders ("Annual Meeting") held on the third Tuesday each March and Board vacancies may be filled by a stockholder vote at a Special Meeting of Stockholders. There is a subcommittee of the Membership Committee ("Subcommittee") (comprised of members of the Membership Committee who are not seeking election and are stockholders or lessees of the Exchange for at least one year as provided by NYMEX Rule 3.22 ("Membership Committee")) that has jurisdiction over the categorization of persons nominated for election to the Board. All directors have three-year terms. Public Directors presently have term limits and cannot serve more than two consecutive terms until one year has elapsed from the date of the expiration of the last term. Also, not more than one partner, officer, director, employee or affiliate of a member of the Exchange or any member firm of the Exchange, of any affiliate of a member of the Exchange or of a member firm of the Exchange, is eligible to serve as a Director at one time. NYMEX has a nomination procedure that is essentially open to anyone who wishes to be nominated. This procedure applies to the nomination of both public and non-public directors.

At least seven weeks prior to the Annual Meeting, the Subcommittee holds an open meeting and accepts recommendations of proposed nominees from stockholders. A stockholder may submit a nomination for herself or himself. It should also be noted that any stockholder may challenge the categorization of a candidate in a certain category and may provide relevant information to the Membership Subcommittee.

Other SROs use different processes to nominate and elect their board of directors, which appear to be effective for those institutions, and we make no judgments about the relative merits of any of these other approaches. As noted at the outset of this response, we have found our own procedures to have served us well over the years.

Because the interests of certain categories may diverge on various issues from those of other categories, we have found it helpful both in the election process and in the governing process for individuals to have an incentive to undertake a broader perspective that will best benefit the overall institution. In sum, it is our view that determinations regarding procedural matters regarding the director election process should be left to the individual exchanges.

3. Should SRO boards include independent directors and, if so, what level of representation should they have? What are appropriate definitions of "independent director" and "public director?" Should all independent directors be public directors? Please address whether SRO members can be considered independent. Also, please address whether the New York Stock Exchange's definition of independent--the requirements include independence from the exchange's management, members, and member organizations--is an appropriate model for the futures industry.

The CEA as amended by the CFMA does not require SRO boards to have either "independent" or "public" directors. In any policy analysis that may be undertaken by Congress in the future, we presume that, before assessing the appropriateness of the various possible terms and definitions, Congress will first consider whether any change is necessary and only thereafter consider and identify the specific regulatory ends to be achieved through the application of the new particular requirement.

We value having diversity in composition on our governing board and on our disciplinary committees. Consequently, five of the 25 members of the Exchange's Board of Directors are required to be "Public Directors" as we have defined that term internally. It has been our experience that this ratio of public directors on our governing board has served the Exchange quite effectively. In addition, we have found that the interests of the Exchange are well served by the balancing of interests that occurs at the Board level through the various categories by which candidates are nominated and elected to the Board. Indeed, in actual practice, this balancing of interests in the governing process can perhaps be as effective on SRO issues as a board composed solely of non-affiliated directors. More fundamentally, we are the experts on our own markets. It is thus our view that we should continue to have the authority and responsibility to decide how to run our businesses and to decide who should serve on our governing board.

We suspect that any possible future Congressional consideration of the various possible terms likely will highlight the pros and cons of these various approaches. For example, the purpose of the New York Stock Exchange's ("NYSE") listing standards on independence is essentially to ensure that a company's directors are independent from and not subject to the influences of the <u>management</u> of that company. In this regard, without taking a position on the merits of this particular approach, we would simply note it, like the other possible approaches, will offer its own set of trade-offs. Thus, as we understand it, because of the emphasis under this approach on independence from the management of the listed company, it is possible, for example, for markets subject to these listing standards to reasonably conclude that members of such markets could still qualify as independent directors under these standards.

Finally, this set of questions indicates that the NYSE itself, with regard to service on its own Board of Directors, now excludes from service on its board any person who is not independent from members and member firms as well as also independent from the NYSE. The implicit question seems to be whether the NYSE's listing standards and the NYSE's own additional restrictions should be borrowed by the CFTC from the securities world and imposed across the board by the Commission on <u>all</u> futures exchanges, regardless of whether or not they have equity securities listed for trading on a stock exchange. In response, we wish to make clear our view that, with respect to the listing standards themselves, extending standards in this manner that were intended by the SEC for a particular category of companies to a broader category (for which such standards were not intended or designed) would seem to be overreaching regulatory policy.

As to the NYSE's own restrictions, while such a strict requirement may be feasible in the securities context, commodity trading is a far more specialized business, and we believe that such a draconian restriction could very well have a dramatic effect upon the ability of regulated futures exchanges to attract and retain a sufficient number of persons with the necessary expertise to make a contribution to the board of a futures exchange. Thus for example, because of the nature of our product lines, our board benefits from expertise in cash and OTC energy and metals markets as well as on NYMEX and on other regulated markets. Adoption of the NYSE's approach seemingly

would exclude any participation by FCMs that are member firms here at the Exchange and so would seem to run counter to the oft-expressed interest of major FCMs to play a prominent role in futures exchange affairs.

B. Regulatory Structure

4. Are the governance standards applicable to listed companies sufficient for futures exchanges or their listed parent companies? Or, given that futures exchanges are not typical corporations in that they bear self-regulatory responsibilities, should they adopt higher governance standards, particularly with respect to self-regulatory activities? Please explain.

As we understand it from discussions with CFTC staff, this question is focusing only upon futures exchanges (or their parent companies) whose stock is in fact listed for trading on a stock exchange. However, this question does not make clear the CFTC's statutory basis for imposition of higher governance standards on this subset of regulated futures exchanges. The question also does not clarify how such an action could be related to the CFTC's core regulatory mission and additionally does not explain how this approach would be applied to non-U.S. institutions that are seeking to be designated by the CFTC as contract markets. Moreover, the question does not indicate the benefits and costs that would need to be weighed in such a broad expansion of CFTC regulation. We would respectfully suggest that the Commission carefully consider all of the possible consequences of imposing detailed requirements on the internal governance structures of regulated entities, which historically has not been an area of focus or expertise of the Commission.

5. Should SRO's regulatory functions be overseen by a body that is internal to the SRO, but independent of management, members, and business functions? If so, what specific functions should fall within its purview (e.g., regulatory budget; personnel decisions; compensation of regulatory staff; compliance and disciplinary programs; other aspects of self-regulation)?

Once again, consistent with the regulatory philosophy embodied in the CFMA, we believe strongly that SROs should be accorded substantial flexibility and discretion with respect to the manner in which they comply with the general performance standards set forth in the applicable Core Principles. In other words, the internal corporate structure of a SRO should be derived following an individualized determination made by the SRO itself. The SRO's governing board members, in exercising their best business judgment, presumably could consider a number of factors in making such a determination. These factors might possibly include, among other things, the relative size of that SRO and its regulatory track record. For example, a broad regulatory fiat establishing a new "one-size-fits-all" requirement in this area may prove to be far more burdensome for smaller exchanges, where it will be more difficult to delineate between the exchange's various functions.

NYMEX is cognizant that there exists some concern by certain industry participants that there may be some undue influence by the business management over the SRO/DSRO functions at exchanges and clearing houses. These concerns appear to be rationalized by speculative assertions that the possibility of abuse by exchanges and clearing houses "cannot be dismissed." We encourage the Commission to look at the facts.

NYMEX's Compliance Department has a demonstrated history of effective implementation of its SRO functions. The Compliance Department and the Exchange's reporting lines have been structured to provide the Compliance Department and its management with sufficient independence of its operations to eliminate the appearance that its functioning can be compromised. Moreover, the compensation of senior Compliance management (as well as all other senior management) is determined by a Compensation Committee wholly comprised of Public Directors. It is also important to note that NYMEX has significant reputational (and consequently commercial) interest in the quality and integrity in the fulfillment of its SRO responsibilities. In addition, the fulfillment or non-fulfillment by NYMEX of its SRO responsibilities also may well have reputational and commercial consequences on member firms themselves, including FCMs. Consequently, NYMEX Board Members affiliated with member firms have an additional economic incentive to ensure strong compliance by the Exchange of its regulatory responsibilities.

NYMEX does believe, however, that any corporation can and should engage in self-examination. An informed self-critical process should be the source of change; change should neither be forced nor should it be based upon speculative assertions. As we noted previously, the Exchange has created a Corporate Governance

Committee, which was described in Section II. of this letter, to review corporate governance issues. In addition, NYMEX also uses a second standing committee, the Compliance Review Committee, to provide a general review of the Exchange's compliance programs and policies. This committee is generally comprised of Exchange members serving on the Exchange's various disciplinary committees and includes the chairpersons of each of NYMEX's major disciplinary committees.

Our SRO regulatory structure has been tested by a number of market situations in recent years, such as Enron's financial crisis, and it has met the challenge in every instance. We are unaware of any specific instance where our present SRO regulatory structure has been identified as impeding or otherwise having any deleterious impact on our SRO obligations and on compliance with the applicable core principles.

In light of this track record, we believe that NYMEX and the other exchanges should continue to be provided the freedom and flexibility to innovate and to adjust in order to find the right mix of controls and oversight that are appropriate for their institutions. While we continue to review our internal procedures on an ongoing basis, we believe that the guidance provided by our Corporate Governance Committee and the SRO governance provided by our Compliance Review Committee provides the Exchange with thoughtful and balanced perspectives on our SRO mission.

6. Please address whether any rule enforcement, disciplinary, or other functions currently performed by exchanges should be performed instead by an independent regulatory services provider.

As previously noted, the underlying philosophy of the CFMA moved the CFTC's regulation of trading facilities away from a "one-size-fits-all" approach and gave regulated markets considerable discretion in the manner by which they would comply with general performance standards. Accordingly, NYMEX believes that decisions regarding outsourcing of SRO regulatory functions by an independent provider are best made by the individual exchanges.

The case for self-regulation is sometimes premised upon the high level of expertise that an exchange market will have regarding the activities of its own markets. Usually, this argument is framed not as a critique of government staff or resources but rather as an acknowledgment that regulatory staff sometimes must work under a lag in available information relative to the information that is more readily available to the SRO. (Of course, close cooperation between the staff of the regulated market and the regulatory agency can substantially reduce this regulatory lag, and historically the NYMEX Compliance Department staff has demonstrated the ability to work cooperatively and constructively with CFTC staff).

However, a start-up exchange may not enjoy the same level of expertise or the same established level of communication with CFTC staff that is in place at a more established exchange. Consequently, it may prove to be more efficient for a newer exchange to outsource one or more of its regulatory obligations to an independent regulatory services provider. Under the application guidance for DCM Core Principle 2 ("Compliance with Rules"), the Commission has noted that if a contract market delegates the function of trade practice surveillance to a third party, such third party should have the capacity to carry out this function, and the contract market should retain "appropriate supervisory authority" over the third party. We support this guidance.

NYMEX further notes that under the terms of Section (b) of CFTC Regulation 8.05 ("Enforcement Staff"), which applied to futures exchanges prior to the implementation of the CFMA, each exchange remained responsible for the enforcement of all of its disciplinary rules regardless of whether its enforcement staff consisted of employees or persons hired on a contract basis. We believe that a contract market similarly should have the flexibility to use independent services providers so long as that market retains the final responsibility for the performance or nonperformance of those obligations.

C. Forms of Ownership

7. What impact do varying business models have on SRO's self-regulatory behavior? Consider for-profit/not-for profit, member-owned/shareholder owned, and publicly traded/privately held business models.

This question seemingly will elicit quite a bit of conjecture and speculation from a variety of quarters. The Exchange will restrict its own comments to a few core considerations. First, the increasingly competitive environment for derivatives markets generally should increase incentives for SROs to undertake aggressively proactive self-regulatory behavior. Second, any possible impact of the varying business models on SRO's self-regulatory behavior is muted (if not totally negated) by the CFTC's oversight of SRO programs and the CFTC's own investigation and enforcement programs.

As to the first point, while the increasing use of technology and greater globalization are trends that are well underway in derivatives markets, it is clear that that they are nonetheless a long way from running their full course. Both of these trends would seem to be pro-competition trends in that expanding use of technology creates at least the potential for lowering barriers to entry, and the globalization of derivatives markets also expands the potential number of markets offering similar products and services. In addition, as the number of financial products continues to proliferate, including both exchange-traded and off-exchange products, the possibility increases of products coming into favor that can serve as acceptable (if not pure) substitutes for listed futures contracts. Thus, a number of trends are coalescing that will provide competitive pressures on derivatives markets on an indefinite basis.

Such an increasingly competitive environment increases incentives on SRO financial markets to distinguish their products and markets from those of others. However, it follows that as markets place greater emphasis on developing their distinctive company and product brands, the consequences of damage to these brands and to the company's general business reputation dramatically increase. In other words, the importance of protecting the company's business reputation will continue to increase over time, and an SRO's governance and compliance policies and programs will need to take into account the need to minimize reputational risk to the company.

The need to address reputational risk issues would seem to be applicable for most business models in the face of heightened competition. However, this issue may be of greater relevance to companies operating under a for-profit business model and for companies that are publicly traded, as the consequences for ineffective SRO programs may be greater for such firms with respect, for example, to possible harm to shareholders and consequent litigant exposure of the company from actions undertaken by shareholders.

It is our sense that it is now generally accepted that there are both competitive and complementary components in the economic relationship between standardized OTC swaps and standardized futures contracts listed for trading on a DCM. While many of the product specifications may be the same or virtually the same, one means of differentiating these products is with respect to the level of regulation to which these similar products are subject. For various reasons, certain segments of derivatives market users may actually prefer to trade in the more regulated product because of greater price transparency, lower credit risk, etc. The attractiveness of trading on regulated markets would appear to apply regardless of whether the market is a for-profit or not-for-profit enterprise. However, one can make the case that a for-profit enterprise has a greater incentive to strengthen and enhance its SRO programs in order to solidify the product differentiation of its products from unregulated products and thereby increase the relative demand for those products.

8. More specifically, is an SRO subject to new influences in the performance of its self-regulatory functions when it converts from a member-owned, not-for-profit organization to a publicly traded, for-profit company? Might a for-profit, publicly traded SRO attempt to attract volume or increase its profits through lax self-regulation? Or, is it more likely that the SRO will seek to protects its brand and add value through effective self-regulation?

At the time that NYMEX and the CME demutualized and became for-profit companies several years ago, there was some speculation at the time that a new focus on maximizing profit would lead exchanges to give short shrift to core functions such as compliance oversight responsibilities. However, the subsequent history of demutualized futures exchanges has not borne out this concern. Unlike the CME, NYMEX has not yet become a publicly listed company. But we both nonetheless have maintained a solid commitment to our SRO responsibilities. In particular, the CFTC staff can take into account its own assessments and judgments made in the context of rule enforcement reviews of SROs that have demutualized in recent years. These reviews, which are also available to the public, continue to find that SRO programs of demutualized exchanges are "adequate" and thus support the conclusion that futures exchanges have maintained their commitment to effective SRO regulation.

A SRO's commitment to its regulatory functions also could be measured using a variety of obvious yardsticks, such as commitment of staffing resources, technology resources and, more general, overall SRO budgetary expenses. This commitment also could also be measured by less tangible measurements, such as the focus directed to regulatory functions by senior staff and by the board of directors. Using any or all of these measurements, NYMEX's commitment to its SRO regulatory functions has either remained at comparable levels or in fact increased since its demutualization.

More specifically, to use one simplified measure, prior to the Exchange's demutualization in November 2000, NYMEX's annual SRO budgetary commitments, as reflected by Compliance Department budgets and related Information Technology support, totaled approximately $4.8 million. This total does not reflect, among other things, legal resources in the Exchange's Office of General Counsel devoted to SRO issues nor does it include Floor Department staff resources devoted to maintaining orderly markets. Even so, using the same measure, current SRO budgetary commitments now average approximately $5.4 million on an annual basis. (This total also does not include the costs of the special long-term project noted in the next paragraph below.)

NYMEX's commitment to governance is even more pronounced when one broadens the scope of the analysis to consider corporate governance issues as well. For example, as part of its responsibilities to comply with the Sarbanes-Oxley Act of 2002 provisions regarding internal controls, the Exchange hired an outside consultant to participate in an exhaustive review of all applicable Exchange internal controls and procedures. Beyond the hundreds of NYMEX staffing hours that have already been devoted to this project, the out-of-pocket expenses to date have been quite substantial.

Because NYMEX is not presently a publicly listed company, we cannot address from our own experience whether or not a publicly listed company is subject to any additional influences in the performance of its SRO functions. On a more general level, though, the general obligation of any for-profit enterprise is to create additional value for its owners over time. Some of this value can occur through expansion of existing products and services. However, there may be practical limits on the ability to grow products that are in a mature stage of development, as has been suggested is the case for many of the futures contracts that were first listed for trading by futures exchanges 20 or 30 years ago. Thus, much of the new value necessarily will need to occur through the creation of new markets, products and services, and such efforts may well entail constructive business partnerships, such as strategic alliances and joint ventures, with businesses offering complementary assets from around the world. All of these activities underscore the need to maintain and to enhance a strong brand for the SRO.

D. Disciplinary Committees

9. How should SRO disciplinary committees be structured so as to ensure both expertise and impartiality?

NYMEX wishes to note three general points before responding in more detail below to this question. First, NYMEX's rules and procedures reflect the Exchange's general commitment to diverse disciplinary committee composition that incorporates the various market constituencies at NYMEX as well as representation by unaffiliated public members. Second, in response to question #14 of the Release, the Exchange has provided a detailed description below of the safeguards and procedures that have long been in place to address possible conflicts of interest concerning governing boards as well as disciplinary committees at the Exchange. It has been our experience that these safeguards have proved to be very effective in minimizing the possibility of voting by interested members of such boards and committees. In other words, our conflict of interest procedures are structured to provide impartial panels for individuals and firms brought before such panels. Third, we believe that our current disciplinary committee structure provides a good balance of the competing policy goals and do in fact generally ensure both impartiality and expertise.

Turning to the specific structure of the Exchange's various SRO disciplinary committees, in implementing the CFMA, the Commission promulgated new Parts 38 and 39, and both of these new parts exempt DCMs and DCOs from the specific CFTC regulation that had formerly applied in this area, CFTC Rule 1.64 ("Composition of Various Self-Regulatory Organization Governing Boards and Major Disciplinary Committees"). However, the Exchange has continued to recognize the value of diversified composition in various SRO disciplinary committees, and so our Business Conduct Committee ("BCC"), which meets to review Compliance Dept.

investigation reports and determine whether or not to issue a formal complaint, and the Adjudication Committee both continue to provide for diversity in committee composition across various representative categories.

Thus, for example, NYMEX Rule 3.13 governing BCC composition provides that membership on a panel reviewing a particular matter shall be comprised of Members or persons employed by Member Firms that are "balanced as equally as practicable" among the various representative categories specified in the rule. These categories include: Floor Broker, Local, Trade and FCM (off-the-floor). In addition, every BCC panel also shall include at least one person who is neither a member of the Exchange nor employed by a Member or Member Firm (i.e., a "Public Committee Member"). The definition for Public Committee Member in the Exchange's BCC rule is consistent with the terms of the CFTC's former regulation. Regulation 1.64(c) had provided in certain instances for participation in a disciplinary committee proceeding by at least one member "who is not a member of the self-regulatory organization."

NYMEX Rule 3.11A, the Exchange's rule for hearing procedures at the Adjudication and Appeals Committee level, takes a slightly different approach than the BCC regarding the definition of public members, the type of cases necessitating participation and finally the diversity of composition on the committee. With regard to types of cases, Rule 3.11A parallels the requirements of former CFTC Regulation 1.64, which had provided that participation by such a public committee member was required when:

(a) the subject of the disciplinary action was a member of the SRO's governing board or one of the SRO's major disciplinary committees;
(b) there was alleged manipulation or attempted manipulation; or
(c) there was alleged conduct directly resulting in financial harm to a non-member of the contract market.

For such cases, Rule 3.11A provides for participation by "at least one Public Director of the Board, and/or at least one Public Committee Member" of the applicable committee. Finally, Rule 3.11A also tracks the former CFTC regulation on committee composition by requiring that more than 50% of the applicable disciplinary committee panel must be comprised of persons representing different membership interests than that of the subject of the proceeding. The list of categories of membership interests provided by Rule 3.11A is consistent with those found in Regulation 1.64.

Beyond the considerations noted above, the Exchange's BCC also establishes separate criteria for panels involving NYMEX and COMEX Division cases. Panels for NYMEX Division cases are to be comprised (in addition to one or more Public Committee Members) of 70% NYMEX Division representation and 30% COMEX Division representation. COMEX Division panels likewise are to be comprised (in addition to one or more Public Committee Members) of 30% NYMEX Division representation and 70% COMEX Division representation. Similar provisions apply in NYMEX Rule 3.10 with respect to Adjudication Committee panels, while Rule 3.11 provides that Appeals Committee panels involving a COMEX member shall consist of at least one COMEX Division member.

In conclusion, as stated at the outset of this response, NYMEX's view is that continuing to utilize the conflict of interest and committee composition provisions that were in place at the Exchange prior to the implementation of the CFMA have served and will continue to serve the Exchange effectively in ensuring both expertise and impartiality in each disciplinary proceeding. Of course, other exchanges may have determined to undertake different approaches that nonetheless adequately satisfies these public policy goals. We would simply suggest that our own practice and experience provide one appropriate model of how to address this policy concerns. As part of our ongoing internal self-examination, we review our disciplinary practices and committee structures on a continual basis. Accordingly, we may make adjustments from time to time in our discretion when we conclude that it is appropriate and necessary to do so.

We also note that the processes and actions of the Exchange's disciplinary committees are included within the scope of CFTC staff's periodic rule enforcement reviews of NYMEX's SRO programs. Disciplinary committees are thus aware that their actions eventually will be reviewed by CFTC staff, and the CFTC's oversight role can also consequently serve a useful role with respect to the impartiality of disciplinary panels. Moreover, mindful of the time and effort devoted by CFTC staff to such reviews, NYMEX also carefully considers any recommendations that may arise from such reviews.

10. Please address whether SRO disciplinary committees should have independent, non-SRO member chairs and/or committee membership. Should the level of representation for independent, non-SRO members vary according to the type of disciplinary case?

With respect to the issue of SRO member chairs, we believe that this determination is best left to the judgment of the individual SROs. At NYMEX, we have not used independent non-member chairs because it has been our experience that the self-regulatory mission of these committees is most successfully carried out by placing a greater emphasis on expertise, experience, leadership and accountability. Accordingly, the chairs of our SRO committees generally have been long-time Exchange members who are also currently serving on the Exchange's Board of Directors.

As elected members of the Board of Directors, these SRO chairs are accountable to the entire membership. In addition, because all major actions of the SRO committees such as settlements and disciplinary sanctions issued at the end of the disciplinary process are subject to the approval of the Board, these SRO chairs also must be accountable at Board meetings for the recommendations to the Board made by their individual committees.

With respect to service on SRO committees by independent, non-SRO members, as previously noted, NYMEX procedures continue to provide for service at every level of the disciplinary process by at least one public member for various types of disciplinary cases. As noted above, the Exchange's current practice is to require participation by at least one Public Committee Member in <u>every</u> BCC matter. Moreover, in recent months, there have been two occasions where two Public Committee Members served on a BCC panel.

It is reasonable to anticipate that the Commission likely will receive a broad range of views on the question of the level of representation by non-SRO members for various types of disciplinary cases. We are willing to engage in reasonable and constructive dialogue on this issue, including the possibility of increasing the level of public member participation on SRO disciplinary panels. However, it is important for the Commission and for the industry generally to understand that disciplinary cases can vary greatly in their scope and complexity and the consequent need for expertise in the relevant practices and issues. In a routine audit trail matter, where a floor member has not met a specified percentage in timely submitting required trading records over a period of time, a determination as to whether or not the percentage has been met should be a straightforward consideration.

On the other hand, some disciplinary cases can involve reviewing dozens of trades among a considerable number of floor members in a substantial number of complex trade sequences. The investigation reports for such cases are typically quite fact-intensive and are assembled by Compliance Dept. staff over an extended period of time. Moreover, the defenses provided by subjects of the investigation report similarly can include details of extremely complex trading strategies. Such cases place a premium on the ability to analyze, assess and interpret a large quantity of supporting trade record documentation. Under the Exchange's current procedures, a BCC panel presented with such a case would be comprised of a variety of committee members "balanced as equally as practicable" among the various representative categories (including the FCM representative) along with the mandatory inclusion of at least Public Committee Member, and the panel would be chaired by a person who would be accountable to the entire membership as well as to the Board. In practice, this balancing of interests has served the committee process reasonably well, and we suggest that, without further analysis, it would be wrong to assume as fact that increasing the number of public or independent members on the SRO committee automatically would result in better outcomes in any and all instances.

Indeed, in some cases, decreasing the number of SRO committee members with extensive trading experience could undermine the fundamental fairness of the SRO committee process. Thus, for example, if either of the investigation report or a respondent's defense involved extensive analysis of a complex trading strategy, the diminishment of expertise and practical experience on the panel could possibly unfairly prejudice either that respondent or the Compliance Department.

11. How and by whom should SRO disciplinary committees be appointed? Should the terms of committee members be limited? Please explain.

At NYMEX, SRO disciplinary committee members are appointed by the chairpersons of the respective committee, consistent with the restrictions on committee composition noted above and consistent with the Exchange's restrictions on service by persons with prior disciplinary histories. All proposed appointments are subject to the approval of the Exchange's Board of Directors. The committee chairs also receive input from Exchange staff and from the Compliance Review Committee. These chairpersons as noted also serve as members of the Board.

SRO committee membership may fluctuate somewhat during the year as members are added or deleted from the committee because of changes in status, work situations, family responsibilities, etc. However, as a broad generalization, SRO committee members generally serve for one-year terms, typically on a May-May basis. It is possible for SRO committee members to be appointed for more than one term. In addition, a NYMEX Board Resolution that is listed in the Exchange's rulebook as Exchange Resolution VI. provides that, with respect to Adjudication and Arbitration Committee panel members, any member of these committees who is serving on a panel in a particular matter shall continue to serve on the panel for such matter after the end of the member's scheduled term even if the committee member is not reappointed to the committee for the succeeding year's term.

In our experience, this relatively informal process has worked reasonably well. There is a modest level of turnover from year to year that brings new vitality and openness to the SRO committees; yet, there is also usually a subgroup of committee members who will serve several successive terms and thereby provide the SRO committees with a relatively stable core of experience and judgment in the work of the applicable committee. Other exchanges may determine to employ different procedures and processes. In the end, we believe that these process issues are best left to the discretion and judgment of the SROs themselves.

E. Other Issues

12. What additional information, if any, should SROs make available to the public to increase transparency with respect to their governance and regulatory structures (e.g., board member affiliations; regulatory staffing and budget; disciplinary committee membership and affiliations, etc.)?

There is already a good deal of information on governance and regulatory structure that is currently being made available to the public by SROs. At NYMEX, for example, NYMEX's bylaws and rules are displayed on the Exchange's website. These provisions provide great specificity with regard to Exchange board composition, board nomination and election procedures, regulatory structure, committee composition, etc. The home page of the NYMEX website includes a heading for a section entitled "Shareholder Relations," this section of the website, which is accessible to the general public, includes a subsection on SEC filings, which contain in PDF format the Exchange's SEC filings as a company with public reporting responsibilities. Such SEC filings include the Exchange's 10-K annual report and the quarterly 10-Q filings, both of which contain extensive information on budgets and staffing. The Shareholder Relations section of the website also provides the public with an opportunity to review all Exchange notices to members; these notices address a broad variety of topics, including but not limited to election procedures and deadlines and Exchange compliance policies.

In addition, the Exchange's website now includes a number of documents pertaining to corporate governance under a subsection of the website entitled "Standards and Safeguards." Looking forward, to better highlight the Exchange's many recent initiatives in this area, the Exchange will be shifting these documents and creating a new Corporate Governance subsection in the Shareholder Relations section. This new subsection will include, among other things, the code of ethics for the Exchange's principal executive officer and the senior financial officer, the Exchange's whistleblower complaint procedures, and the charters of the Exchange's Corporate Governance, Compensation and Audit Committees.

Beyond the information contained on NYMEX's website, much additional information is also readily available from the CFTC itself. The Commission now regularly posts notice of all DCM and DCO rule changes on its website. Furthermore, as previously noted, the CFTC also makes publicly available the rule enforcement reviews that review in detail an Exchange's SRO staff, programs and actions.

As noted, most of the basic information regarding the Exchange's SRO governance and regulatory structure is reflected in the NYMEX rules, which have been publicly available on our website for several years. We are not aware of anyone who has criticized the current level of transparency at NYMEX in these areas. NYMEX nonetheless believes that greater transparency with respect to SRO governance and regulatory structures may be beneficial in that it may promote better understanding and appreciation by the public and the industry of the many safeguards that are now in place and of the substantial costs currently undertaken by SROs to satisfy their regulatory responsibilities. However, the Exchange also believes that this end would be best achieved not through regulatory fiat establishing new prescriptive regulations but rather through ongoing and constructive dialogue between the Commission and the respective SRO in a manner that would provide the SRO with an opportunity to provide input and feedback to the Commission with respect to the type of information that would be most relevant and most appropriate for public dissemination.

13. Would additional core principles for SROs help to clarify their responsibilities with respect to governance, or would regulatory guidance be more appropriate.

NYMEX believes strongly that regulatory guidance regarding existing core principles would be more appropriate. This approach, which we presume would be similar in function to the illustrative, non-exclusive application guidance currently provided by the Commission, would seemingly be more consistent with the regulatory approach and process established by Congress under the CFMA.

14. What steps should be taken to manage or eliminate conflicts of interest involving SRO board and disciplinary committee members?

In general, the Exchange utilizes established policies and safeguards as described below to minimize conflicts of interest involving SRO board and disciplinary committee members. We believe that our current procedures effectively manage conflicts of interest involving SRO board and disciplinary committee members. The Exchange's policies are reflected in NYMEX's "Ethics Guidelines", which are included as part of the Exchange's rulebook and which were implemented by the Exchange's Board of Directors many years ago. The Exchange's policies in this area also reflected in the terms of NYMEX Rule 3.04 ("Voting by Board and Committee Members on Certain Matters"). With respect to contracts or transactions entered into by the Exchange, Rule 3.04 serves as a complement to NYMEX Board Resolution VIII ("Resolution of Board of Directors Concerning Exchange Contracts with Interested Members or Entities"). A copy of each of these documents is included as an attachment to this comment letter.

NYMEX Rule 3.04 was implemented in March 1999 in conformance with the requirements of new CFTC Regulation 1.69 ("Voting by Interested Members of Self-Regulatory Organization Governing Boards and Various Committees"). Under the CEA as modified by the CFMA, NYMEX is now subject to Core Principle 15, which requires boards of trade to "establish and enforce rules to minimize conflicts of interest in the decision-making process of the contract market and establish a process for resolving such conflicts of interest." Part 38 of the CFTC's rules makes clear that, as a result of this new Core Principle, NYMEX is no longer subject to the specific provisions of CFTC Regulation 1.69. Notwithstanding this shift in the applicable regulatory requirement, the Exchange has nonetheless maintained NYMEX Rule 3.04 in effect without change. We have found the procedures set forth in our attached rule to provide an appropriate and effective mechanism to manage and to minimize conflicts of interest.

In Appendix B to Part 38, the Commission provides guidance on acceptable practices in compliance with the Core Principles. (Appendix B clearly states that the guidance provided is "illustrative only of the types of matters a board of trade may address, as applicable, and is not intended to be a mandatory checklist.") In the application guidance to Core Principle 15, the CFTC notes that the contract market

> "should provide for appropriate limitation on the use or disclosure of material, non-public information gained through the performance of official duties by board members, committee members and contract market employees or gained through an ownership interest in the contract market."

In this regard, NYMEX has also maintained in effect NYMEX Rule 3.02 ("Restrictions on Governing Board Members, Committee Members, Consultants, and Other Persons who Possess Material, Non-Public Information"), which previously was implemented in compliance with CFTC Regulation 1.59 ("Activities of Self-

Regulatory Organization Employees and Governing Members who Possess Material, Nonpublic Information"). In addition, NYMEX also maintains in effect NYMEX Rule 6.31A ("Trading Prohibitions for Exchange Employees"), which both prohibits employees from trading any futures contracts or cash commodity but also generally prohibits employees from disclosures of material, nonpublic information. It should be noted that the Exchange amended both rules several years to expand the scope of the rules to include NYMEX consultants as defined in the rules.

In conclusion, NYMEX does not mean to suggest that our current procedures should be imposed on other SROs, which may have developed different approaches that are nonetheless suitable for their organizations. But we believe our approach does adequately address current potential conflicts of interest. Of course, as with other areas of SRO governance, NYMEX continues to review its internal procedures on an ongoing basis and is committed to adjusting this approach if and when it is deemed to be warranted by future conditions.

15. Should registered futures associations that are functioning as SROs also be subject to governance standards?

NYMEX finds no principled basis for generally exempting registered futures associations functioning as SROs from being subject to governance standards. In recent years, this category of SRO has seen an increasing level of activity in the role of a commercial service provider to other SROs, and we believe that it is timely and appropriate to update governance standards to reflect this new reality. Accordingly, we would support such an initiative.

V. Conclusion

* * * *

NYMEX thanks the Commission for the opportunity to submit comments concerning the Release 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,

Mitchell Steinhause
Chairman

cc: Acting Chairman Sharon Brown-Hruska
Commissioner Walter Lukken

EXCHANGE RULEBOOK

3.22 Membership Committee

(A) The Membership Committee shall be a Regular Committee and shall consist of such number of Members as the Chairman may appoint, subject to the approval of the Board. The Membership Committee shall be divided into two panels, a Class A Membership Panel to review applications of Class A Members, the composition of which shall be left to the discretion of the Board of Directors (but will include the Vice Chairman of the COMEX Division Membership Panel), and COMEX Division Members, which shall be comprised of 70% COMEX Division Members and 30% Class A Member, and shall be chaired by the Chairman of the Class A Member Panel or his designate.

(B) The Membership Committee shall have jurisdiction on all matters relating to applications for membership, conferring of membership privileges on firms and the transfer of memberships. In addition, any proposed amendment to Rules §§2.70-2.73A (relating to leasing of trading privileges) (or any successor rules thereto) shall be submitted to the Membership Committee no later than 5 business days prior to its submission to the Board for approval. The Membership Committee shall review the proposed amendment and vote to recommend to the Board approval or disapproval of the proposed amendment; provided that such recommendation shall be advisory only and shall not be binding on the Board. The Membership Committee may at any time recommend to the Board any amendment to Rules §§2.70-2.73A, as it deems appropriate. The Membership Committee's recommendations pursuant to this clause (B) shall be submitted to the Board along with any statement of facts which are relevant to the proposed amendment and which may assist the Board in its consideration of the proposed amendment.

Resolution Relating to Rule 3.22 and to Rule 3.03
A subcommittee of the NYMEX Division Membership Panel (as defined in the Rules) of New York Mercantile Exchange, Inc. ("NYMEX Exchange") comprised of those members of the Panel that have been stockholders and lessees of Class A memberships of NYMEX Exchange for at least one year prior to the meeting referred to in paragraph (1) below (the "Membership Subcommittee") shall also have jurisdiction over the categorization of persons for nomination for election to the Board of Directors of the Corporation. In that regard, the Membership Subcommittee shall implement the following procedures:

(1) The Membership Subcommittee shall invite from the stockholders, at an open meeting to be held not later than seven (7) weeks prior to the annual meeting of stockholders, recommendations of proposed nominees. Recommendations may be made either by the proposed nominees themselves (if such person is a stockholder) or any other stockholder including members of the Membership Subcommittee. Recommendations must state whether a proposed nominee is being recommended for the position of Director, Chairman of the Board or Vice Chairman. A stockholder may only recommend one proposed nominee for each such position, except that a stockholder may recommend one proposed nominee for each Director category as set forth in Article VI of the Certificate of Incorporation of the Corporation. Stockholders may appear before the Membership Subcommittee to present such recommendations. The Membership Subcommittee shall also consider the recommendations of stockholders submitted to it in writing at or before this meeting.

(2) On the morning after the open meeting of the Membership Subcommittee, the Membership Subcommittee shall post on the bulletin board of NYMEX a list of all persons who were recommended as proposed nominees. The list shall include the position, and in the case of a proposed nominee for Director, the category, as set forth in Article VI of the Certificate of Incorporation of the Corporation, for which each proposed nominee has been recommended.

(3) Not later than three (3) days after the open meeting of the Membership Subcommittee, stockholders may submit in writing to the Membership Subcommittee additional recommendations of proposed nominees. All such recommendations must include the position, and in the case of a proposed nominee for Director, the category, as set forth in Article VI of the Certificate of Incorporation of the Corporation, for which the proposed nominee is being recommended.

(4) On the morning after the three-day period that is set forth in paragraph (3) of this Resolution, the Membership Subcommittee shall post on the bulletin board of NYMEX a list of all persons who were recommended as proposed nominees in accordance with paragraphs (1) and (3) of this Resolution. The list shall include the position, and in the case of a proposed nominee for Director, the category, as set forth in Article VI of the Certificate of Incorporation of the Corporation, for which each proposed nominee has been recommended. No person whose name is not included on this list will be permitted to stand for election to the positions of Director, Chairman of the Board or Vice Chairman at the annual meeting of stockholders.

(5) Not later than five (5) weeks prior to the annual meeting of stockholders, the Membership Subcommittee shall

determine whether each person who has been recommended as a proposed nominee is eligible for the position or positions for which he was recommended. It shall assign the proposed nominee to his proper category or categories, as set forth in Article VI of the Certificate of Incorporation of the Corporation, regardless of the category or categories for which he was recommended. The Membership Subcommittee shall hold such meetings and consider such information as it deems appropriate; provided, however, that any stockholder or lessee of Class A memberships having information concerning the eligibility of a proposed nominee may present such to the Membership Subcommittee for its consideration no later than one week after the closing of the period for recommending proposed nominees that is set forth in paragraph (3) of this Resolution; and, provided further, that any proposed nominees for Director as to whom the Membership Subcommittee is considering changing the category shall be notified of such in writing and shall have the right to appeal before the Membership Subcommittee. The Membership Subcommittee shall immediately notify the stockholders of the position or positions and/or category or categories for which each proposed nominee is eligible to be nominated.

(6) Nominations:

(a) Only those persons who were recommended as proposed nominees for election to the positions of Chairman or Vice Chairman of the Board pursuant to paragraphs (1) or (3) of this Resolution shall be eligible to be nominated for election to these positions.

(b) Persons who were recommended as proposed nominees for election to the positions of Director, Chairman of the Board or Vice Chairman pursuant to paragraphs (1) or (3) of this Resolution shall be eligible to be nominated for election to a Director position, and then, in only one of the categories of Director service to which they were assigned by the Membership Subcommittee pursuant to paragraph (5) of this Resolution.

(c) Notwithstanding the determination of the Membership Subcommittee as to the category to which a proposed nominee is eligible to be nominated, any person who has been recommended as a proposed nominee or submitted his name as such in accordance with paragraphs (1) or (3) of this Resolution and who falls within the Director categories set forth in Article VI(d)(i)-(v) of the Certificate of Incorporation of the Corporation, shall be eligible to be nominated as a Director in the At Large category that is set forth in the Certificate of Incorporation of the Corporation. No person eligible to be nominated in the Equity Holder category or the Public Director category shall be eligible to be nominated in the At Large category.

(d) Not later than four (4) weeks prior to the annual meeting of the stockholders, a person eligible to be nominated pursuant to this Resolution must file with the Office of the Secretary of the Exchange a nomination declaration which states that category in which the person intends to stand for election. Failure to submit a nomination declaration within this time frame will render the proposed nominee ineligible to run in any category.

(7) No person may serve on the Membership Subcommittee beyond the date referred to in paragraph (3) of this Resolution, if such person's name is recommended as a proposed nominee for election. In the event that the names of both the Chairman and Vice Chairman of the Membership Subcommittee have been recommended as proposed nominees for election, the Subcommittee shall choose from the members of the Subcommittee its own acting Chairman to manage the process contemplated by this Resolution.

(8) The ballot for the annual election shall list alphabetically candidates in each category, noting incumbency, where appropriate.

3.04 Voting By Board and Committee Members on Certain Matters

This Rule 3.04 shall apply to the Board of Directors of the New York Mercantile Exchange Inc., the COMEX Governors Committee and to each Disciplinary Committee and Oversight Panel when the Board, the Governors Committee, or any such Disciplinary Committee or Oversight Panel takes any significant action as defined by this Rule 3.04 or has under consideration a matter as to which a member of the Board, the Governors Committee, a Disciplinary Committee or Oversight Panel, as the case may be, is, or is related to, a named party in interest.

The decision that any action is subject to this Rule may be made by the Chairman of the Board or the Governors Committee or the Chairman of the affected Disciplinary Committee or Oversight Panel or by a third of the Board, Governors Committee, Disciplinary Committee or Oversight Panel members present.

(A) Definitions: For purposes of this Rule:

(1) "Disciplinary Committee" means any person or committee of persons, or any subcommittee thereof, that is authorized to issue disciplinary charges, to conduct disciplinary proceedings, to settle disciplinary charges, to impose disciplinary sanctions, or to hear appeals thereof in cases involving any violation of the rules of the Exchange except those cases where the person or committee is authorized summarily to impose minor penalties for violating rules regarding decorum, attire, the timely submission of accurate records for clearing or verifying each day's transactions or other similar activities. The term "Disciplinary Committee" shall include but is not limited to the Adjudication Committee, the Business Conduct Committee, the Control Committee, the Appeals Committee and the Floor Committee.

(2) A person's "family relationship" means the person's spouse, former spouse, parent, stepparent, child, stepchild, sibling, stepbrother, stepsister, grandparent, grandchild, uncle, aunt, nephew, niece or in-law.

(3) "Board" means the Board of Directors of the New York Mercantile Exchange Inc. or any subcommittee thereof.

(4) "Governors Committee" means the COMEX Governors Committee or any subcommittee thereof.

(5) "Oversight Panel" means any panel, or any subcommittee thereof, authorized by the Exchange to recommend or establish policies or procedures with respect to the self-regulatory organization's surveillance, compliance, rule enforcement, or disciplinary responsibilities. The term Oversight Panel shall include, but is not limited to, the Compliance Review Committee.

(6) "Member's affiliated firm" is a firm in which the member is a "principal," as defined in Commission Regulation §3.1(a), or an employee.

(7) "Named party in interest" means a person or entity that is identified by name as a subject of any matter being considered by the Board, Governors Committee, Disciplinary Committee, or Oversight Panel.

(8) "Significant action" includes any of the following types of actions or rule changes that can be implemented by the Exchange without the Commission's prior approval:

(a) any actions or rule changes which address an "emergency" as defined in Commission Regulation §1.41(a)(4)(i) through (iv) and (vi) through (viii); and,

(b) any changes in margin levels that are designed to respond to extraordinary market conditions such as an actual or attempted corner, squeeze, congestion or undue concentration of positions, or that otherwise are likely to have a substantial effect on prices in any contract traded or cleared at the Exchange but does not include any rule not submitted for prior Commission approval because such rule is unrelated to the terms and conditions of any contract traded at the Exchange.

(B) Relationship with a Named Party in Interest

(1) A Member of the Board, the Governors Committee, a Disciplinary Committee or Oversight Panel must abstain from any deliberations and vote on any matter involving a named party in interest where such member:

(a) is a named party in interest;

(b) is an employer, employee, or fellow employee of a named party in interest;

(c) is associated with a named party in interest through a "broker association" as defined in Commission Regulation 156.1;

(d) has any other significant, ongoing business relationship with a named party in interest, not including relationships limited to executing futures or option transactions opposite of each other or to clearing futures or option transactions through the same clearing member; or,

(e) has a family relationship with a named party in interest.

(2)(a) Prior to the consideration of any matter involving a named party in interest, each member of the Board, Governors Committee, Disciplinary Committee or Oversight Panel, as the case may be, must disclose to the Exchange Employee designated by the Chairman of the Board, Governors Committee, Disciplinary Committee or Oversight Panel for such purpose whether or not he or she has one of the relationships listed in subparagraph (B)(1) of this rule with a named party in interest.

(b) In addition, taking into consideration the exigency of the Board's, Governors Committee's, Disciplinary Committee's or Oversight Panel's action with regard to a named party in interest, the Exchange Employee shall review any records which are held by, and reasonably available to, the Exchange to ascertain whether any Board, Governors Committee, Disciplinary Committee or Oversight Panel member has a relationship of the type set forth in subparagraph (B)(1) of this Rule with a named party in interest. Upon completion of the disclosure required by this Rule and any review of Exchange records, the Exchange Employee shall report to the Chairman of the Board, Governors Committee, Disciplinary Committee or Oversight Panel any member's relationship with a named party in interest.

(3) Any Board, Governors Committee, Disciplinary Committee or Oversight Panel member having a relationship with a named party in interest of the type set forth in subparagraph (B)(1) above or who chooses not to make any such disclosure shall abstain from deliberating and voting on any matter involving a named party in interest and withdraw from the meeting until such time as the matter involving the named party in interest has been disposed of.

(4) In any case where an issue as to whether or not a Board, Governors Committee, Disciplinary Committee or Oversight Panel member has a relationship with a named party in interest exists, the Board, Governors Committee, Disciplinary Committee or Oversight Panel shall appoint an ad hoc committee composed of at least three members who have no relationship with the named party in interest who shall then determine based on the information obtained pursuant to subparagraph (B)(2) of this Rule whether such member has a relationship with a named party in interest and therefore must abstain from deliberating and voting on any matter involving such named party in interest.

(C) Financial Interest in a Significant Action

(1) A member of the Board, the Governors Committee, a Disciplinary Committee, or an Oversight Panel must abstain from any deliberations and vote on any significant action if the Board, Governors Committee, Disciplinary Committee or Oversight Panel member knowingly has a direct and substantial financial interest in the result of the vote based upon either Exchange or non-Exchange futures or options positions that could reasonably be expected to be affected by the action.

(2) Prior to the consideration of any significant action, the Board, Governors Committee, Disciplinary Committee or Oversight Panel, as the case may be, shall determine the number of positions that may be held in any commodity's delivery month or months which may be affected by the significant action that shall be considered a de minimis position such that a member shall be deemed not to have a direct and substantial financial interest in the result of the vote of such action.

(3) Each member of the Board, the Governors Committee, a Disciplinary Committee or Oversight Panel shall disclose to the Exchange Employee designated by the Chairman of the Board, Governors Committee, Disciplinary Committee or Oversight Panel for such purpose the following futures and options position information with respect to any commodity's delivery month or months affected by the significant action that is known to him or her at the time:

(a) gross positions held at the Exchange in the member's personal accounts or "controlled accounts," as defined in Commission Regulation 1.3(j);

(b) gross positions held at the Exchange in proprietary accounts, as defined in Commission Regulation §1.17(b)(3), at the member's affiliated firm:

(c) gross positions held at the Exchange in accounts in which the member is a principal, as defined in Commission

Regulation §3.1(a);

(d) net positions held at the Exchange in "customer" accounts, as defined in Commission Regulation §1.17 (b)(2), at the member's affiliated firm; and

(e) any other types of positions, whether maintained at the Exchange or elsewhere, held in the member's personal accounts or the proprietary accounts of the member's affiliated firm that the Board, Governors Committee, Disciplinary Committee or Oversight Panel reasonably expects could be affected by the significant action.

(4) In addition to the position information disclosed pursuant to subparagraph (C)(3) above, and taking into consideration the exigency of the significant action, the Exchange Employee shall obtain and review with respect to any Board, Governors Committee, Disciplinary Committee or Oversight Panel member who makes a disclosure of position information the following information:

(a) the most recent large trader reports and clearing records available to the Exchange; and

(b) any other pertinent information that is held by, and reasonably available to, the Exchange.

The Exchange Employee shall then report such position information to the Chairman of the Board, Governors Committee, Disciplinary Committee or Oversight Panel.

(5) Upon a review of the position information obtained pursuant to subparagraph (C)(3), and subparagraph (C)(4) of this rule, any Board, Governors Committee, Disciplinary Committee or Oversight Panel member holding more than a de minimis position or who chooses not to make the disclosure required by subparagraph (C)(3) shall be advised that he or she must abstain from deliberating and voting on the significant action and shall withdraw from the meeting until such time as the matter involving the significant action has been disposed of.

(6) In any case where an issue whether a Board, Governors Committee, Disciplinary Committee or Oversight Panel member has a direct and substantial financial interest in a significant action as defined by this rule exists, the Board, Governors Committee, Disciplinary Committee or Oversight Panel shall appoint an ad hoc committee of at least three members holding no positions or a de minimis position in any commodity's delivery month or months which may be affected by the significant action. The ad hoc committee will review the position information obtained pursuant to subparagraph (C)(3) and subparagraph (C)(4) of this Rule and advise the Board, Governors Committee, Disciplinary Committee or Oversight Panel whether such member has a direct and substantial financial interest in the significant action and therefore must abstain from deliberating and voting on such significant action.

(D) Participation in Deliberations

(1) Notwithstanding any other provision of this Rule, the Board, Governors Committee, Disciplinary Committee or Oversight Panel may permit a member to participate in deliberations prior to the vote on a significant action for which the member would otherwise be required to abstain if such participation is consistent with the public interest and the member does not vote on such action.

(2) In making a determination as to whether to permit a member to participate in deliberations on a significant action for which he or she otherwise would be required to abstain, the Board, Governors Committee, Disciplinary Committee or Oversight Panel, as the case may be, shall appoint an ad hoc committee of at least three members which shall consider the following factors:

(a) whether the member's participation in deliberations is necessary for the Board, Governors Committee, Disciplinary Committee or Oversight Panel to achieve a quorum in the matter; and

(b) whether the member has unique or special expertise, knowledge or experience in the matter under consideration.

(3) Prior to any determination pursuant to this subparagraph, the ad hoc committee appointed by the Board, Governors Committee, Disciplinary Committee or Oversight Panel must fully consider the position information which is the basis for the member's direct and substantial financial interest in the result of a vote on a significant action obtained pursuant to subparagraph (C)(3) and subparagraph(C)(4) of this Rule.

(E) Documentation of Determination

The Board, Governors Committee, a Disciplinary Committee and Oversight Panel and any ad hoc committee appointed pursuant to this rule, shall reflect in its minutes or otherwise document any determinations made with

respect to a member's ability to participate in, or abstain from, the deliberations and vote on any significant action.

Such documentation shall include:

(1) the names of all members who attended the meeting or who otherwise were present by electronic means;

(2) the name of any member who voluntarily recused himself or was required to abstain from deliberations and/or voting on a matter and the reason for the recusal or abstention, if stated; and

(3) any position information that was reviewed for each member, and

(4) the names of all members of any ad hoc committee.

VIII. Resolution of Board of Directors Concerning Exchange Contracts with Interested Members or Entities

At a regular meeting of the Board of Directors on June 3, 1987, the Board, having considered the actual or potential conflict of interests, the appearance of impropriety or other harm to the Exchange or its members which might arise from a contract or transaction between the Exchange and a Member of the Board, an Exchange Committee Member or other Member of the Exchange or other person or entity associated or affiliated therewith in which such Member or other person or entity has a substantial financial interest hereby:

RESOLVES, to prohibit the Exchange, its Directors, Officers or others acting with authority or under color of authority for or on behalf of the Exchange from entering into a contract or transaction between the Exchange and any person or entity described in the preamble to this Resolution who has a substantial financial interest in such contract or transaction unless the material facts concerning such interest are fully disclosed to the Board and the Board, by majority vote, authorizes such contract or transaction. Any person with an interest in the contract or transaction is not entitled to vote thereon but may be counted for the purpose of determining the presence of a quorum at the meeting which considers the approval of the contract or transaction.