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Mercantile Exchange

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August 23, 1999

## COMMENT

### VIA FACSIMILE AND FEDERAL EXPRESS

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

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Re: Proposed Rulemaking Concerning Pilot Procedure for Contract  
Market Designation Applications 64 FR 40528 (July 27, 1999)

Dear Ms. Webb:

The New York Mercantile Exchange ("NYMEX" or the "Exchange") appreciates the opportunity to comment, on its own behalf and on behalf of its wholly-owned subsidiary, Commodity Exchange, Inc. ("COMEX"), on the Commodity Futures Trading Commission's ("CFTC" or the "Commission") rule proposal to establish a pilot program, initially for two years, under which a board of trade, subject to certain conditions, could list a futures or option contract for trading prior to receipt of Commission approval of that new contract ("Proposal").

NYMEX is a not-for-profit corporation organized under the laws of the State of New York. It has been designated by the Commission as a contract market for the trading of numerous commodity futures and commodity futures option contracts. NYMEX is the largest exchange in the world for the trading of futures and option contracts based on physical commodities. Public investors in our markets include institutional and commercial producers, processors, marketers and users of energy and metals products.

The Proposal represents a significant departure from the Commission's oft-repeated prior stance that contracts must be reviewed and approved by the CFTC prior to being listed for trading. NYMEX believes that this proposed rulemaking may be suggestive of a greater willingness on the part of the CFTC to work with the industry to address a badly outmoded regulatory regime. When viewed in this light, the Proposal may be seen as a good first step.

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

The basic premise underlying the Proposal is that Commission approval of all contract market designation applications is still necessary. If one were to accept that basic premise and view the Proposal on its own terms and in isolation from any other regulatory reform initiative, the Proposal contains a few provisions that are consistent with the logic of the Proposal. Thus, for example, the Proposal would provide that predesignation listing be available only when an exchange already is a designated contract market for at least one nondormant contract. The CFTC justified this provision in the release by noting that the initial designation of a board of trade as a contract market often entails a more lengthy review which includes analysis of its trading and clearance systems and its self-regulatory programs. NYMEX agrees with the Commission that such start up exchanges are not appropriate candidates for the proposed immediate listing rule.

However, from the standpoint of the proper perspective for regulatory policymaking, the Proposal is best viewed not in isolation but rather in the context of other regulatory reform initiatives that are under consideration by the Commission. Specifically, on June 25, 1999, NYMEX, together with the Chicago Mercantile Exchange and the Chicago Board of Trade (collectively, the "Exchanges") jointly submitted a petition for exemptive relief pursuant to Section 4(c) of the Commodity Exchange Act ("Act" or "CEA"). This joint petition has not yet been published for public comment in the Federal Register. In the petition, the Exchanges sought regulatory relief in three areas:

1. Exchanges should be able to list new futures and options contracts without pre-approval by the Commission;
2. Exchanges should be able to adopt new rules and rule changes after submitting them to the Commission ten days prior to their taking effect; and
3. Exchanges should be allowed to implement trading rules and procedures comparable to those of a competing foreign board of trade, providing that the rules and procedures are limited to only the contracts that are in direct competition to those of the foreign board of trade.

Comparison of the Proposal with the Exchanges' Section 4(c) petition is helpful in highlighting a number of restrictions, conditions and limitations in the Proposal that would severely undercut the attractiveness of using the new pilot program. First, under this pilot program, exchanges would still need to apply for Commission approval within 45 days of the launch, and Commission approval would still be necessary to continue trading the contract. Under Section 6(a) of the Act, the Commission may take up to one

year to approve or deny an application for contract market designation. Thus, uncertainty regarding whether or not a pending application for designation would be approved or denied, or perhaps modified from the original filing under terms dictated to an exchange by the CFTC, could continue for a whole year. Moreover, during the period that Commission approval was pending, a board of trade would have a continuing duty to notify the public in all public references to the contract or its trading months that the contract was trading pending Commission designation.

Second, under the pilot program, until an exchange had received contract market designation from the CFTC, it could not list for trading any contract months for futures or option contracts pending approval under the pilot procedure where either the delivery month or the option expiration, as applicable, would be beyond one year. As noted above, under the statute the CFTC's approval process could continue for one year. Third, amendments to contracts and to all related exchange rules would still require prior CFTC approval. The time frame for Commission review and approval would depend upon the nature of the rule being submitted; however, under the statute, Commission review could continue for 180 days (and even longer if requested by Commission staff).

Fourth, the Proposal makes clear that this would be a two-year pilot program. Accordingly, there would be no assurance that the pilot program would be continued at the end of that time frame. In addition, the Commission has not provided guidance on how it would evaluate the pilot program. In this regard, the CFTC has previously opposed amending the CEA to include a provision requiring the Commission and its staff to engage in cost-benefit analyses in its regulatory activities. The Commission has argued that such a provision is unnecessary because such analyses are already a routine part of its regulatory affairs. However, in the Federal Register release published for comment on this proposal, the Commission devotes most of its attention to a description of the benefits of Commission review and approval; there is no original assessment by the Commission of the costs of such review. This imbalance could be interpreted as calling into question the Commission's commitment to its proposed pilot program.

Taken together, these restrictions and limitations could create considerable uncertainty concerning whether a contract would be approved by the CFTC and whether the CFTC might dictate amendments in the terms of the contract that could affect the valuation of the contract. This level of uncertainty also may well affect the viability of a new contract.

In addition, the restriction that contract months could not extend beyond one year also could make a new contract considerably less attractive as a trading vehicle to many market participants. Because futures markets may be viewed as having a relationship with swaps markets that is complementary as well as competitive, it can be

important to the viability of a futures or option contract that the contract is perceived as an attractive trading vehicle by market participants in swaps markets who are seeking to hedge the risks from swaps transactions in futures markets. However, it is not uncommon for swap agreements to have a duration that spans several years. Swaps markets participants seeking to hedge the risks associated with such agreements would find this one-year cap on the listing of new contract months to be unnecessarily restrictive and burdensome.

On a more general level, a number of contracts at the Exchange have open interest in contract months more than one year beyond the current delivery month. In the Exchange's Light Sweet Crude Oil Futures Contract, for example, at any one time, the Exchange lists for trading contract months that can be as much as 84 months out from the present time, and it is not uncommon for open interest to be observed in a contract month several years out from the current delivery month. Similarly, the Exchange generally lists for trading 36 consecutive trading months in the Exchange's Henry Hudson Natural Gas Futures Contract; again, there is often significant open interest in back months well beyond the first twelve contract months listed for trading. Therefore, depending in part upon the duration of the CFTC's review process, this restriction could act as a significant disincentive to the trading of a new contract.

NYMEX conducts an intensive review process in developing a new contract, which includes consultations with virtually all segments of the affected industry for that contract, consultations with the financial community and numerous forums for open debate in which reasonable views can be expressed and considered. The contract development process allows all potential users to protect themselves in ways that diminish the need or the utility of detailed CFTC prior review. The process allows potential users to shape the terms and conditions and voice their concerns over any provisions that they feel do not match cash market practices or other commercial concerns over which they have expertise. Equally important, the process allows a full airing of the terms and conditions prior to trading.

All potential market participants are afforded the opportunity to educate themselves and make their own decisions regarding whether to trade or not to trade a new contract. In view of the powerful economic forces that drive exchanges to be thorough and vigilant in developing a new product, the Commission should be confident in allowing exchanges to list contracts for trading and implement rules without detailed prior review. In this regard, NYMEX finds it significant that CFTC staff issued a no-action letter to LIFFE even though British exchanges are not currently subject to a pre-approval process for their contracts and rules.

In NYMEX's experience, detailed CFTC review and approval of the specific terms and conditions of a contract has not been necessary, provides marginal, if any,

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value, and adds cost, uncertainty and delay to the roll-out of new contracts. The pilot program would retain the costs associated with making a contract market designation application to the Commission, would retain the uncertainty associated with Commission approval and further would retain the delay in receiving final Commission approval of the application.

In the Federal Register release, the CFTC advances two examples to support continuing to require Commission approval of proposed new contracts. First, the CFTC indicated that discounts for nonpar varieties and locations for a potato contract proposed in recent years did not conform to cash market practices and that major producer groups opposed the proposed contract's terms. There is no indication that the proposed design of this contract would have made it more susceptible to manipulation or otherwise would have affected market integrity. Instead, the issue was one of the viability of the contract based upon its design. This issue is one that should be decided by the marketplace.

The CFTC also noted that some exchanges have made positive use of the Commission's review and approval process in developing new products. In its second example, the Commission noted that one exchange accepted Commission staff's suggestions on an appropriate means of constructing an index with a large number of inactively traded stocks. In this regard, NYMEX notes that the Commission makes clear in the release that exchanges would be able to determine whether and when to make use of the new listing procedure. Thus, an exchange would retain the option to submit an application for contract market designation under the Commission's existing procedures. In light of this option, an existing exchange that is not interested in obtaining whatever benefits can be derived from Commission review and approval should be freed from such requirements because the exchange has made a determination, based upon its best business judgement, that CFTC review and approval would offer no real benefit either to the exchange or to its market users.

Rather than expending considerable Commission staff resources on a pilot program that is likely to be used sparingly by futures exchanges, if at all, the Exchange suggests that the Commission should focus upon providing U.S. futures exchanges with the maximum possible regulatory flexibility. Such flexibility should be no less than the regulatory flexibility that the Commission has already extended to several foreign futures exchanges who have been permitted to place computer terminals for their electronic trading systems here in the U.S.

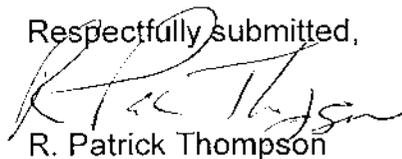
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NYMEX thanks the Commission for the opportunity to submit comments concerning the Proposal and would be pleased to furnish additional information in this

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regard. If you have any questions, please do not hesitate to contact the undersigned.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "R. Patrick Thompson". The signature is written in a cursive style with a large initial "R".

R. Patrick Thompson  
President

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