February 6, 2004

VIA FACSIMILE AND E-MAIL
James Carley, Director
Division of Clearing and Intermediary Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Proposed Amendment of Certain CFTC Orders

Dear Mr. Carley:

As previously discussed with CFTC staff, the New York Mercantile Exchange, Inc. ("NYMEX") is requesting that the Commodity Futures Trading Commission ("CFTC" or "Commission") order to NYMEX issued on May 30, 2002 ("May 30 Order") be supplemented and its order on February 4, 2003 ("Feb. 4 Order) be amended. Specifically, NYMEX requests that the May 30 Order be supplemented to allow the following option contracts to be listed only for clearing:

Light Sweet Crude Oil Average Price Option;
New York Harbor Heating Oil Average Price Option;
New York Harbor Unleaded Gasoline Average Price Option;
Natural Gas Look-Alike Option;
Light Sweet Crude Oil Look-Alike Option;
New York Harbor Heating Oil Look-Alike Option; and
New York Harbor Unleaded Gasoline Look-Alike Option.

With respect to the Feb. 4 Order, NYMEX requests that a technical amendment be made to that order to expand the permissible contracts so as to include contracts listed only for clearing at NYMEX and for which NYMEX's rules provide for exchanges of options for options in that contract.

In connection therewith, the Exchange also hereby agrees to establish and maintain a permanent customer protection mechanism represented by a commitment of not less than $10 million that shall be available at all times to reimburse promptly NYMEX retail customers whose funds are lost in whole or in part as a result of a default in any NYMEX contract by another customer of the same futures commission merchant where such default results in a default of the FCM clearing member to NYMEX's clearinghouse. As a note, the NYMEX Board of Directors recently unanimously approved a new Resolution; the new Resolution, which will become effective upon the issuance of the CFTC order requested by the Exchange, would establish a new permanent retail customer protection mechanism under terms that parallel the representation included in this paragraph.

For purposes of the representation and NYMEX commitment in the paragraph above, NYMEX represents that the term "retail customer" shall be defined under NYMEX rule to include any natural person who does not otherwise qualify as an "eligible contract participant" under the requirements of Section 1a(12) of the Commodity Exchange Act, except that such definition of retail customer shall not include any NYMEX floor trader or floor broker or any family member of any NYMEX floor trader or floor broker who maintains an account at the same FCM where such NYMEX floor trader or floor broker maintains an account.

Additional Representations

NYMEX currently subjects all transactions submitted via NYMEX ClearPort(sm) Clearing to a risk management filter. Consistent with this system design, the Exchange represents that transactions in all of the seven option contracts to be listed only for clearing thus would be subjected to a risk management filter.

Of the seven option contracts to be listed only for clearing, the three Average Price Option ("APO") contracts are currently listed for floor trading and would be switched to being listed only for clearing. The Exchange's policy and practice is to conduct a daily mark to market for any listed Exchange contract with open interest, regardless of whether the contract is listed for trading and clearing or listed for clearing only at the Exchange. Thus, the Exchange represents that NYMEX staff will conduct a daily mark to market for any of the seven option contracts to be listed only for clearing whenever any such contract has any open interest.

Additionally, NYMEX represents that it will make available open interest and settlement price information for these seven option contracts in the same manner as for contracts listed for trading on NYMEX. Furthermore, NYMEX staff, as is the case for the other products listed will determine the settlement prices for these option contracts in connection with prices for the related underlying floor-traded contracts.

With respect to position accountability levels, position limits and reportable position levels, under rule amendments to NYMEX Rules 9.26, 9.27 and 9.34 approved by the Exchange's Executive Committee earlier today, a position in one of these option contracts would be aggregated with positions in the related underlying floor-traded contract and thus would fall within the existing level or limit established for such floor-traded contract. Thus, a position in the new NYMEX Natural Gas Look-Alike Option contract would be aggregated with positions in NYMEX's floor-traded Natural Gas futures contract. For risk management purposes, the Exchange also would look to include positions in these new option contracts within the reportable position levels for the related underlying floor-traded contract.

Margining Procedures

As to margining for these option contracts, NYMEX currently uses software created by the Chicago Mercantile Exchange known as SPAN (Standard Portfolio Analysis) to assess margin requirements. SPAN's focus is on taking a portfolio approach to risk. This is important since it implicitly recognizes that when futures and options positions are put together into portfolios, the risk profile can change.

SPAN at NYMEX begins with the input parameters. Except as specified for certain products that are listed through the Exchange's NYMEX ClearPort(sm) services, in general, NYMEX's policy otherwise is to set margins to cover about 99% of the expected price movements over a 1-day period for its clearing members. Additional margin coverage is routinely added of 10% for Member Customers and 35% for Non-Member Customers. NYMEX margin policy further calls for spread credits within a commodity across months or spread credits between commodities that are related to each other.

SPAN margins begin with risk arrays. The list below represents 16 scenarios of what could happen to an individual option position as both the futures price ("futures scan range") and implied volatility ("volatility scan range") change. The scenarios include a hypothetical futures price move and a hypothetical move on option volatility. The margin then resolves to the worst case loss among the 16 scenarios.

The 16 scenarios are as follows:

- 1. Futures Unchanged Volatility Up
- 2. Futures Unchanged Volatility Down

- 3. Futures Up 1/3 Volatility Up
- 4. Futures Up 1/3 Volatility Down
- 5. Futures Down 1/3 Volatility Up
- 6. Futures Down 1/3 Volatility Down
- 7. Futures Up 2/3 Volatility Up
- 8. Futures Up 2/3 Volatility Down
- 9. Futures Down 2/3 Volatility Up
- 10. Futures Down 2/3 Volatility Down
- 11. Futures Up 3/3 Volatility Up
- 12. Futures Up 3/3 Volatility Down
- 13. Futures Down 3/3 Volatility Up
- 14. Futures Down 3/3 Volatility Down
- 15. Futures Up Extreme Move Volatility Unchanged
- 16. Futures Down Extreme Move Volatility Unchanged

For example, currently for the Exchange's Light Sweet Crude Oil ("Crude Oil") contracts, the futures scan range is approximately $2,500 and the Volatility Scan Range is 2.50%. The sixteen scenarios for a short 30 day at-the-money Crude Oil Option would resolve to

Scenario	**Loss (Credit)**
1	60
2	-105
3	619
4	456
5	-392
6	-544
7	1,279
8	1,130
9	-734
10	-863
11	2,027
12	1,899
13	-977
14	-1,075
15	+2,300
16	-439

The largest loss (scenario 15) is $2,300 which resolves to the margin for that short call. Of course for long option positions, full premium would be required.

Settlement Procedures

With respect to settlement procedures for these option contracts, the "look-alike" option contracts would be settled and margined in the same manner with the existing floor-traded options. The only differences would be that the look-alike options would be cash-settled and European-style exercise. The Exchange believes that these features actually makes such contracts easier to settle and margin than the

floor- traded counterpart. The Exchange intends to extract implied volatilities from its floor-traded options at the end of each trading day. These volatilities would be inputted into a European Option Pricing Model for each respective strike and expiration month to calculate the daily settlement prices for the new look-alike options. Given that the current Span Margin system is based upon a European Option Pricing Model, there would be no difference in how these options would be margined.

The APOs similarly are cash settled, European-style options. Settlements would be done by extracting implied volatilities from the floor traded counterparts by expiration month and strike price. These volatilities would be input into an Average Price Option Model (Curran, 1994), along with relevant futures settlement price to estimate fair value at the end of the day. If the option is in its delivery period, the average futures settlement price would be inputted. For example, if a July APO is trading on July 15 for Heating Oil and there are 20 trading days in July, the average would be a 50% weight of the settlement prices that had already elapsed since the beginning of the calendar month, plus a 50% weight on the current settlement price.

Should you have any questions concerning the above, please contact the undersigned at (212) 299-2207.

Very truly yours,

Brian Regan
Vice President and Counsel