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*We wouldn't  
trade them  
for anything.*

March 13, 1998

**VIA FACSIMILE AND ELECTRONIC MAIL**

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

RECEIVED  
COMM. FUTURES TRADING COMMISSION  
MAR 15 1998

Re: Revised Proposed Rulemaking Concerning Account Identification  
for Eligible Bunched Orders 63 FR 695 (January 7, 1998)

Dear Ms. Webb:

The New York Mercantile Exchange ("NYMEX" or "Exchange") appreciates the opportunity to comment, on its own behalf and on behalf of its wholly-owned subsidiary, the Commodity Exchange, Inc., on the Commodity Futures Trading Commission's ("CFTC" or "Commission") revised rulemaking involving proposed amendments to Commission Regulation §1.35 ("Revised Proposal"). This proposed rulemaking would allow eligible customer orders to be placed on a contract market without specific customer account identification either at the time of order placement or at the time of report of execution.<sup>1</sup>

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 Exchange supports the Commission's effort to facilitate enhanced access to futures markets for sophisticated customers with managed accounts while continuing to

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<sup>1</sup>The Commission published for comment its initial proposal to amend Regulation § 1.35 on May 3, 1993. 58 FR 26270 (May 3, 1993).

Ms. Jean A. Webb  
March 13, 1998  
Page 2

maintain appropriate safeguards against misallocation of trades. In addition, NYMEX notes that the Revised Proposal has been modified significantly from the initial proposal. A comparison of the two proposals suggests that the Commission has incorporated a number of suggestions in the revised proposal made by commenters on the initial proposal. The revisions set forth in the Revised Proposal generally involve expanding definitions for defined terms that were deemed to be unnecessarily restrictive or eliminating procedures that were identified as overly cumbersome.

1. Role of Exchange Rules

In general, proposed new Regulation § 1.35(a-1)(5) would provide that customer account identifiers need not be recorded at the time eligible orders are placed on a contract market or at the time of report of execution of the orders, provided that certain enumerated requirements were met and provided that the order was handled in accordance with contract market rules approved or permitted to go into effect by the Commission. Under proposed Regulation § 1.35(a-1)(5)(iv), the account manager and the futures commission merchant ("FCM") would be required to allocate fills from each eligible order to eligible participating customer accounts prior to the end of the day the order is executed "as specified by exchange rules for this purpose."

NYMEX supports these provisions. In particular, the Exchange commends the Commission for structuring its proposal so as to defer to each exchange to decide whether or not eligible order procedures should be implemented at that exchange. Also, NYMEX believes that it is very important that each exchange be provided with the flexibility to specify the procedures and requirements applicable to end-of-day allocations at that exchange. Thus, for example, a particular futures exchange that is implementing Commission-approved rules allowing eligible order procedures may determine, in order to minimize the impact of such a procedure on the Exchange's clearing processes, that it would be appropriate to require that allocation occur as soon as practicable after execution of the entire transaction.

2. Eligible Orders: Placement of Futures-Only Orders

As currently proposed, Regulation § 1.35(a-1)(5)(iii) essentially would provide that eligible orders include only those orders placed by an account manager, on behalf

Ms. Jean A. Webb  
March 13, 1998  
Page 3

of consenting eligible customers, as part of the account manager's management of a portfolio also containing instruments which are either exempt from regulation pursuant to the Commission's regulations or excluded under the Act from Commission regulation.

The scope of this proposed definition is unnecessarily restrictive and would exclude many appropriate uses of the post-trade allocation procedures. The Exchange believes strongly that eligible orders should be defined to include orders involving only futures and futures options ("futures-only orders") placed by a commodity trading adviser ("CTA"). In the release, the Commission stated that it had been advised that there could be instances where a CTA placing exchange traded futures-only orders on more than one futures exchange might need post-trade allocation in order to achieve equivalent treatment of customers' accounts. Therefore, the Commission requested comment regarding whether such relief was necessary and why predetermined allocation formulas or average pricing could not provide fair treatment.<sup>2</sup>

First, there are a number of trading strategies that may not be conducive to the filing of a predetermined allocation scheme. As a general matter, trading strategies involving orders placed at multiple futures exchanges, such as arbitrage trading or trading various volatility spreads, can be just as complex and as dynamic as strategies involving futures and securities or other exempted or excluded financial products.

Second, average pricing also would not be a viable alternative to post-trade allocation of eligible orders. It is the Exchange's understanding that only a handful of U.S. futures exchanges currently have such systems. At NYMEX, average pricing is available for COMEX Division products, pursuant to the procedures specified in COMEX Rule 4.90, but is not available for NYMEX Division products. Moreover, average pricing systems generally are not structured to handle partial fills and do not address orders executed on other exchanges. Average pricing systems also are subject to a number of operational constraints. For example, if a given order is filled during a trading session through 20 transactions, and one of the transactions results in an out-trade, under current methodologies, it can be very difficult and time-consuming to recalculate the average price for the remaining trades. Finally, CTAs have been reluctant to use average pricing systems because of the need to disclose the size of a

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<sup>2</sup>63 FR 695, 697 (January 7, 1998).

Ms. Jean A. Webb  
March 13, 1998  
Page 4

large order at the outset.

The Commission's Revised Proposal is grounded upon the fundamental requirement that all post-trade allocations be conducted in a fair and non-preferential manner. In view of this core requirement, the Exchange believes that it is especially appropriate to permit futures-only orders to be handled through the eligible order procedures. Because CTAs are Commission registrants, they are exclusively subject to Commission regulation. Thus, the Commission, acting for example through its oversight of the National Futures Association, can exercise a greater degree of control over the auditing of CTAs to ensure that CTA allocation schemes are indeed non-preferential than would be the case for non-Commission registrants.

### 3. Eligible Customers: Exclusion of Natural Persons

The Commission announced in the Revised Proposal that the definition for eligible customers contained in proposed Regulation § 1.35(a-1)(5)(ii) would be substantially similar to the definition of "eligible participant" found in Part 36 of the Commission's regulations, except that the definition for eligible orders would exclude sole proprietorships, floor brokers, floor traders, natural persons and self-directed employee benefit plans. The Exchange disagrees with this proposed definition on two grounds.

First, the Exchange believes that it would be appropriate for the Commission to revise the definition so as to include natural persons such as those natural persons meeting the asset tests contained in Parts 35 and 36. In this regard, in discussing the proposed definition in the release, the Commission observed that natural persons may be sufficiently sophisticated to participate in eligible order procedures. In the release, the Commission announced its belief that "preferential allocations would be more likely to occur if accounts owned by individuals were included in eligible orders."<sup>3</sup> The Exchange requests that the Commission reconsider its position on this issue and notes that natural persons meeting the asset tests provided in Parts 35 and 36 would have sufficient resources available to them to protect their own interests.

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<sup>3</sup>63 FR at 700.

Ms. Jean A. Webb  
March 13, 1998  
Page 5

The Exchange also disagrees with the proposed definition for eligible customers because it would create yet another version of sophisticated customer, none of which is the same.<sup>4</sup> The Commission should endeavor to enhance the clarity and consistency of its regulations, rather than making such rules needlessly complex and thus increasing the costs of regulatory compliance. Therefore, NYMEX urges the Commission to move in the direction of using a uniform definition of sophisticated customer, rather than creating yet another category of customer.

#### 4. Eligible Customers: Customer Consent

Under proposed Regulation § 1.35(a-1)(5)(iii), an entity listed in that subsection would not constitute an eligible customer unless it had provided prior written consent to the account manager that its orders could be handled through the eligible order procedure. The Exchange notes that eligible account managers may include, in addition to commodity trading advisers, investment advisers and banks, insurance companies and other financial institutions. The Exchange recommends that the Commission defer regulation of the relationship between the account manager and the account manager's customer to the primary regulator of the account manager, rather than impose regulatory requirements on account managers that may not be regulated by the Commission.

However, in the event that the Commission concludes that it will impose some obligation on the account manager, a requirement that includes prior written customer consent is unnecessary. The Exchange notes that the Commission has promulgated final rules amending Commission Regulation § 1.55 and related Commission regulations, which will become effective April 21, 1998. When implemented, the rule

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<sup>4</sup>In addition to the proposed definition for eligible customer, there are at least three other definitions of sophisticated customers contained in current Commission regulations: qualified eligible participant (Commission Regulation § 4.7); eligible swap participant (Part 36); and eligible participant (Part 36). In addition, as discussed below, an additional category of sophisticated customer is contained in amendments to Regulation § 1.35 that will become effective on April 21, 1998. For a discussion of these categories, see Richard A. Miller, The Hierarchy of Investors and Counterparties Under U.S. Law, 17 Futures and Derivatives Law Report, no. 9, p. 9 (December 1997).

Ms. Jean A. Webb  
March 13, 1998  
Page 6

amendments will eliminate the requirement, as applied to certain sophisticated customers, that FCMs and introducing brokers provide such customers with Commission-mandated risk disclosure statements and obtain written acknowledgments of receipt of the risk disclosure statement before opening a commodity futures and options account for these customers. In other words, the Commission, in a recent rulemaking, recognized a class of sophisticated investors who did not need the protection presumably provided by requiring their prior written consent.

In this regard, the scope of the eligible customers proposed for the current rulemaking and the scope of customers eligible for treatment under the recently approved rule amendments to Regulation § 1.55(f) are both based in large part upon the definition of eligible participant in Part 36.<sup>5</sup> In view of the degree of overlap between the definition of customer in Regulation § 1.55(f) and the proposed definition of eligible customers in Regulation § 1.35(a-1)(5)(i), the rationale underlying elimination of the prior, written consent requirement for certain sophisticated customers in Regulation § 1.35(f) also should apply to Regulation § 1.35(a-1)(5)(i). Therefore, in the event that the Commission determines to impose some obligation on the account manager, NYMEX recommends that the Commission provide only that the account manager provide appropriate disclosure to potential eligible customers, rather than disclosure and written consent.

#### 5. Certification to a Futures Commission Merchant

Proposed Regulation § 1.35(a-1)(5)(iv) would require an account manager to certify certain representations to an FCM before placing the initial eligible order. Such a certification would need to be given to each FCM "executing and/or allocating any part

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<sup>5</sup>In the Federal Register release for the Regulation § 1.55(f) rulemaking, the Commission stated that the categories of sophisticated customers specified in new Regulation § 1.55(f) were based substantially upon the categories of eligible participants in Part 36 and of eligible swap participants in Part 35 of the Commission's regulations. 63 FR 8566, 8567 (February 20, 1998).

Ms. Jean A. Webb  
March 13, 1998  
Page 7

of the order.”<sup>6</sup> The Exchange believes that it should be sufficient to provide such a certification to the clearing FCM allocating the trades to the ultimate customers. In addition, the Exchange believes that the “and/or” formulation could create confusion as to the FCM(s) to whom the account manager must provide the certification. Also, while the Commission noted that such certification need not be made on an order-by-order basis, the Exchange suggests that it may be useful to clarify that the certification would remain in effect unless revoked.

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NYMEX thanks the Commission for the opportunity to submit comments concerning the proposed rulemaking 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,

  
R. Patrick Thompson  
President

cc: Chairperson Brooksley Born  
Commissioner Barbara P. Holum  
Commissioner David D. Spears  
Commissioner John E. Tull, Jr.

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<sup>6</sup>In this regard, the Commission noted that where the account manager placed an order directly with a floor broker rather than an executing FCM, the certification would need to be given to each FCM allocating any part of an eligible order and not to the floor broker. 63 FR at 701, n.60.