

U.S. COMMODITY FUTURES TRADING COMMISSION

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January 7, 1999

Mr. R. Patrick Thompson
President
New York Mercantile Exchange
One North End Avenue
World Financial Center
New York, New York 10282-1101

Re: Proposed New Rule 6.21A – Exchange of Futures Contracts for, or in connection with, Swap Agreements

Dear Mr. Thompson:

By letters dated February 22, 1997, through November 2, 1998, the New York Mercantile Exchange (“NYMEX” or “Exchange”) submitted a proposal to adopt new Rule 6.21A for approval by the Commodity Futures Trading Commission (“Commission”) pursuant to Section 5a(a)(12)(A) of the Commodity Exchange Act (“Act”) and Commission Regulations 1.38 and 1.41(b). NYMEX Rule 6.21A would establish a three-year pilot program for the noncompetitive exchange of futures contracts for, or in connection with, swap agreements (“EFS transactions”).

The Commission understands that, as a condition for participation in the Exchange’s pilot program for EFS transactions, the Exchange will require certain market participants to comply with the Commission’s EFP-related reporting and recordkeeping regulations as if these regulations applied to EFS transactions. Specifically, the Exchange will require:

- (1) Each Exchange member, futures commission merchant (“FCM”), and introducing broker (“IB”) to comply with the requirements of Commission Regulation 1.35(a) as if this regulation applied to EFS transactions and will further require each Exchange member, FCM, and IB to provide the required records to the Exchange for inspection upon request;
- (2) Each customer to comply with the requirements of Commission Regulation 1.35(a-2)(2) as if this regulation applied to EFS transactions and will further require each customer to provide the required records to the Exchange for inspection upon request;

- (3) Each Exchange clearing member, FCM, and foreign broker to comply with the requirements of Commission Regulations 17.00(a)(1) and (2) as if these regulations applied to EFS transactions and will further require each Exchange clearing member, FCM, and foreign broker to file the required records with the Exchange;
- (4) Each trader who holds or controls a reportable futures position to comply with the requirements of Commission Regulation 18.05 as if this regulation applied to EFS transactions and will further require each trader to provide the required records to the Exchange for inspection upon request; and
- (5) Upon the request of the Commission, each FCM, IB, foreign broker, and trader to comply with the requirements of Commission Regulations 21.03(e)(1)(iii) and (e)(2)(iv) and will further require each FCM, IB, foreign broker, and trader to file the required records at the place and within the time frame specified by the Exchange.

The Exchange has agreed to provide the Commission with any information and/or documentation regarding EFS transactions that was obtained from Exchange members, FCMs, IBs, foreign brokers, or customers upon the request of the Commission, provided that the Exchange may petition for confidential treatment of such information and/or documentation as appropriate.

The Commission notes that the Exchange has agreed to comply with the requirements of Commission Regulations 16.00(a) and 16.01(a) as if these regulations applied to EFS transactions. The Exchange has also agreed to submit reports on a quarterly basis which include the following information:

- (1) The total number of EFS transactions executed during the reporting period for each commodity;
- (2) The total number of Exchange contracts exchanged in connection with EFS transactions during the reporting period for each commodity;
- (3) The percentage of total Exchange contracts traded during the reporting period which are exchanged in connection with EFS transactions for each commodity; and
- (4) Pricing information for the swap leg of two EFS transactions for each commodity for each month of the reporting period.

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In addition, the Exchange has agreed to submit its entire EFS database file, which includes certain transaction information for each EFS transaction, to the Commission on a monthly basis. The Exchange shall submit the quarterly reports and EFS database file, described above, to the Commission at its headquarters office in care of: David P. Van Wagner, Acting Associate Director and Rebecca L. Creed, Attorney, Contract Markets Section, Division of Trading and Markets.

The Commission understands that, although EFS transactions will not be identified separately from EFP transactions in the Exchange's clearing records due to certain computer limitations, the Exchange will distinguish EFS transactions by reference to other trading documents. The Commission notes that the Exchange has committed to solving these computer difficulties during calendar year 1999 so that EFS transactions can be uniquely identified throughout the clearing process.

The Commission also reminds the Exchange that compliance with the standards set forth in Rule 6.21A serves only to permit the noncompetitive execution of an EFS transaction on an ex-pit basis. Such compliance does not insulate the EFS transaction from other requirements under the Act, the Commission's regulations, or other applicable law. Specifically, each EFS transaction must comply with the requirements of Part 35 of the Commission's regulations and is subject to the antifraud and antimanipulation provisions of the Act. See Sections 4b, 4o, 6(c), and 9(a)(2) of the Act. The Commission believes that the Exchange should make this point explicit to its members when educating them as to the implementation of the pilot program for EFS transactions.

The Commission notes that the Exchange's pilot program for EFS transactions will terminate three years from the effective date of NYMEX Rule 6.21A. The Exchange may petition the Commission, pursuant to the rule review procedures set forth in Section 5a(a)(12)(A) of the Act and Commission Regulation 1.41, either to extend the term of the pilot program or to approve it on a permanent basis. The validity of a swap agreement underlying a bona fide EFS transaction, which otherwise complies with the requirements of Part 35 of the Commission's regulations and which extends beyond the duration of the effective dates of the pilot program for EFS transactions, is unaffected by the termination of such program.

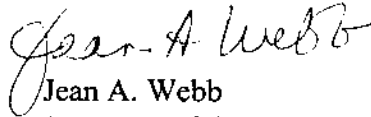
The Commission reserves the authority to impose additional regulatory requirements on EFS transactions during the duration of the pilot program in connection with any changes in the regulatory structure governing EFP transactions that the Commission undertakes in accordance with the public rulemaking procedures set forth in Part 13 of the Commission's regulations.

Any contract market which is interested in allowing EFS transactions in their designated markets may submit a proposal to the Commission for its consideration, pursuant to Section 5a(a)(12)(A) of the Act and Commission Regulation 1.41.

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Please be advised that on this date, the Commission approved the above-referenced rule proposal pursuant to Section 5a(a)(12)(a) of the Act and Commission Regulations 1.38 and 1.41(b).

Sincerely,


Jean A. Webb
Secretary of the Commission

**Remarks of Commissioner Barbara Pedersen Holum
Concurring in Part and Dissenting in Part
Proposal of the New York Mercantile Exchange to Permit
the Exchange of Futures for or in Connection with Swap Agreements**

The New York Mercantile Exchange ("Nymex") submitted its proposal to permit the exchange of futures for swap agreements ("EFS") to the Commission on February 22, 1997. Now, after a review period of nearly two years, staff is recommending that the Commission (i) restrict approval for a pilot period of three years and (ii) require special cumulative reporting of all EFS transactions during the pilot period. I agree with and join in the action the Commission is now taking to permit EFS transactions. However, for the reasons outlined below, I dissent from the imposition of the pilot program and special reporting requirements.

Adoption of the EFS rule on a pilot basis will discourage participation and detract from the underlying economic utility of the EFS proposal. The EFS proposal is simply an exchange rule that parallels existing "exchange for physical" provisions and serves the exact same economic function. For that reason, imposition of a pilot program is unwarranted.

Also, imposing special comprehensive reporting appears ill-advised for the EFS proposal, especially since existing Nymex and CFTC rules ensure maintenance and availability of applicable trade documents on an as-needed basis. It therefore seems clear that requiring routine filing of trade documents with the CFTC is unnecessarily duplicative and burdensome.

In sum, adopting the proposal on a pilot basis and imposing duplicative reporting requirements will impede the competitive ability of Nymex without any offsetting regulatory purpose. Both regulatory provisions impose economic costs without any compensating regulatory benefits. For this reason, I believe these two regulatory conditions should be eliminated, and the EFS proposal given an unrestricted approval. Also, in my view, the delay in approving this Nymex proposal was unwarranted. Efforts by Commission staff to "fine-tune" oversight mechanisms, as has apparently occurred here, do not justify the substantial delay in acting on this exchange initiative.


Commissioner Barbara Pedersen Holum

1-6-99
Date