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August 26, 1998

*We wouldn't
trade them
for anything.*

COMMENT

VIA FACSIMILE, FEDERAL EXPRESS AND ELECTRONIC MAIL

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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COMMODITY FUTURES
TRADING COMMISSION
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Re: Proposed Amendments to Commission Regulation § 1.31 63 FR 3068 (June 5, 1998)

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") proposed amendments to Commission Regulation § 1.31, which would revise certain recordkeeping requirements.

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.

At present, Regulation § 1.31 provides that certain records may be stored initially using either microform, microfiche or optical disk storage methods. Other records generated initially on paper may be stored on microfilm or microfiche for the final three years of a required five-year period. Finally, trading cards and written customer order tickets must be retained in hard copy for a full five years.

The Commission now proposes to shift the focus of Regulation § 1.31 from the current specification of a particular class of optical disk or micrographic media to a more generic, performance-based approach to the definition of permissible technology. As part of this shift, the Commission would add a new defined term, "micrographic media,"

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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.

which would be defined as microfilm, microfiche "or any similar medium." In addition, the Commission also would add "electronic storage media" as another new defined term.¹ For affected persons who opt to use micrographic or electronic media to store required records, the Commission's proposal ("Proposal") includes a number of conditions for such storage; some conditions would be applicable both to use of micrographic media and use of electronic storage media, while certain additional conditions would apply only to use of electronic storage media.

In the Federal Register release, the Commission referred to its "traditional focus on minimizing unnecessary regulatory costs." This focus takes on increasing importance because of the competitive environment confronting persons affected by Regulation § 1.31's requirements. Specifically, the pace of change in technology development is unrelenting. Affected persons also face intensifying competition on a global scale, including from competitors who participate in less regulated overseas markets or in largely unregulated over-the-counter markets. In order to remain competitive, affected persons face the daunting task of constantly reducing their costs. Thus, to meet this intense competition, many affected persons by necessity will move along a "migration path" over the next several years to implement new and more efficient technologies.

In view of these marketplace realities, NYMEX offers three organizing principles as supplements to the principle of minimizing unnecessary regulatory costs. The Exchange respectfully suggests that the Commission use these principles to reshape Regulation § 1.31. First, the Commission should provide affected persons with the greatest possible flexibility to adopt the record storage methods that best meet their business needs. Second, in order for the Commission to provide affected persons with appropriate guidance over time, NYMEX concurs generally with the National Futures Association's ("NFA") informal proposal, which was submitted to Commission staff by

¹Under the Proposal, electronic storage media would mean any digital storage medium or system that :

"(A) preserves the records exclusively in a non-rewritable, non-erasable format; (B) verifies automatically the quality and accuracy of the storage media recording process; (C) serializes the original and, if applicable, duplicate units of storage media and creates a time-date record for the required period of retention for the information placed on such electronic storage media; and (D) permits the immediate downloading of indexes and records preserved on the electronic storage media onto paper, microfilm, microfiche or other medium acceptable under this paragraph upon the request of representatives of the Commission or the Department of Justice."

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letter dated December 24, 1997,² that the Commission should adopt uniform standards of accessibility and security for all required records that eliminate distinctions between records maintained in hard copy and those maintained in electronic media.³ Finally, a good number of affected persons are also registered with the Securities and Exchange Commission ("SEC"), e.g., futures commission merchants registered as broker-dealers. Accordingly, consistent with the above and mindful of this fact, the Exchange suggests that, at a minimum, the uniform standards to be adopted by the Commission should be no more stringent than those adopted by the SEC for storage of records, including the rules adopted by the SEC in early 1997 permitting use of electronic media to store required records.⁴

Before turning to the specific aspects of the Proposal, the Exchange first would like to acknowledge that the Commission deserves credit for trying to move in the direction of a more general, performance-based standard for permissible technology. On the other hand, as discussed below, the Exchange believes that a number of the conditions that the Commission seeks to impose upon the use of micrographic and/or electronic media are unnecessary, would substantially increase the regulatory cost of using such systems, and thus would seriously diminish the potential attractiveness of using non-paper methods for storing required records.

In this regard, it is important for the Commission to recognize that complying with the current requirements of Regulation § 1.31 imposes a substantial cost upon affected persons. For example, the Exchange has contracted with a warehouse facility to store many of its required records. Under this agreement, each month NYMEX is charged a fee for each cubic foot of stored materials. In addition, NYMEX is charged a fee of \$14.65 whenever a box is retrieved from storage and delivered to the Exchange, such as in response to a request for records from Commission staff, and a fee in the same amount to return the box to storage. Consequently, in complying with Regulation § 1.31, the Exchange expends more than \$100,000 dollars annually just for warehousing fees.

²Letter to I. Michael Greenberger, Director, Division of Trading and Markets, CFTC, from Daniel Roth, General Counsel, NFA, dated December 24, 1997.

³The NFA also suggested that there should be a reliability standard applicable to all electronic media. Other organizations commenting upon the Proposal have argued that there should be a uniform standard on reliability that should apply to all required records.

⁴62 FR 6469 (February 12, 1997), codified at 17 C.F.R. § 240.17a-4(f) (effective April 14, 1997).

Conditions on Use of Either Micrographic or Electronic Storage Media

The Commission would continue to require that affected persons must index all stored information and keep available facilities for the production of easily-readable images of the stored records and easily-readable hard-copy images. The Exchange does not object to these requirements, although the Exchange's views on the appropriate response time for responding to document requests is discussed below. In addition, the CFTC would require such persons to store a duplicate of each record, in any of the media acceptable under the regulation, as well as a duplicate of each index, at a location separate from the original. In response, the Exchange believes that the most appropriate course for the Commission to take is to set forth a general standard regarding the security of records that applies to all required records.

The Commission further would require that affected persons must waive any privilege, claim of confidentiality or other objection to disclosure of any information that is not required by the Commission and that is stored on the same individual medium, e.g., the same disk or sheet of microfiche. The SEC's record retention rules do not require such a waiver. It is reasonable to foresee that in light of, for example, the large capacity of certain electronic storage media, on occasion there will be inadvertent waivers, by a recordkeeper subject to the Regulation § 1.31 requirements, of confidential or privileged material.

The Futures Industry Association ("FIA") noted in its comment letter on the Proposal that the American Bar Association has issued an ethics opinion containing ethical guidelines to be followed by an attorney who receives material that on its face appears to be privileged or confidential and receives the material under circumstances where it is clear that the material was not intended for the recipient.⁵ Some of the Commission staff members who request records from affected persons are attorneys, but records also have been requested by investigators. The FIA suggests that the Commission should incorporate the ethical guidelines, described in footnote #5 of this comment letter, for all Commission staff members. The Exchange concurs with the FIA's position on this issue and believes that the Commission should amend its rules to provide relief for such inadvertent waiver.

Additional Conditions on the Use of Electronic Storage Media

Response Time for Document Requests

In the release, the Commission noted that Regulation § 1.31(a) generally

⁵In such circumstances, attorneys should: (a) refrain from examining the material; (b) notify the sender of the receipt of the material; and (c) abide by the sender's instructions on the disposition of the material. ABA Op. No. 92-368 (November 10, 1992).

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requires that all copies or originals shall be provided "promptly."⁶ However, Subsections (b), (c) and (d) of that regulation, which govern the use of reproductions on microfilm, microfiche and optical disk as substitutes for hard-copy records, specifically provide that such reproductions must be produced "immediately" upon request by Commission staff or a representative from the Department of Justice.

In the NFA's December 24, 1997 letter, the NFA suggested that the Commission eliminate this distinction between the standard used for records maintained in hard copy and the standard used for records maintained in electronic media. The NFA proposed that the Commission instead adopt a uniform standard of "readily accessible" and further suggested that this standard might be defined to require retrieval of records by the next business day following a request. In discussing the current distinction in the Federal Register release, the Commission indicated that this distinction recognized that the "reduced space and storage requirements for electronic and micrographic records, as compared with hard copy records, enable recordkeepers to keep such required records on their premises, rather than in a separate storage facility. . . ."

NYMEX notes that while some electronic records may be stored by recordkeepers on their premises, the proximity of such records does not always guarantee that these records are immediately available. For example, if Commission staff requested that an exchange provide trade data concerning activity in a particular pit for a trade date six months or a year prior to the date of the request, the exchange may need to schedule time to take its major computer system used for this purpose off-line so that a tape of these trade data, which also would include data for many trade dates other than the date in question, could be loaded onto the system and rerun. A replay of this tape may take several hours to run. Because of the many critical tasks that such computers now support, it may not be feasible to interrupt the tasks that are being performed by such a computer at the time the data request is received and to provide this information immediately. Instead, the exchange would need to schedule time on a subsequent day, most likely in the early hours of the morning, when this computer system was not being actively used for other support functions.

Therefore, as noted previously, NYMEX agrees with the NFA that the Commission should adopt a uniform standard, although the Exchange believes that it would be inappropriate to require, following a document request, production of all requested records by the next business day under all circumstances. NYMEX suggests instead that the Commission utilize a standard requiring "prompt" production of records, which would require recordkeepers to provide records upon request as "expeditiously as reasonably can be expected" in light of the circumstances. Such a standard thus

⁶With the regard to this "promptly" standard, the Commission has indicated that a recordkeeper is obligated by this requirement to furnish a copy of the original of a book or record "as expeditiously as reasonably can be expected." 46 FR 21 (January 2, 1981).

would allow consideration, among other things, of the nature and volume of the records being requested.

The terms "immediate" and "immediately" are used numerous times in the Proposal when referring to proposed conditions applicable to electronic storage media.⁷ The Proposal does not include definitions for these terms. At least with regard to NYMEX, Commission staff generally have acted reasonably in requesting records from the Exchange, and have taken into account the size and nature of the request, the number of other requests made recently by Commission staff in other offices or divisions, the Exchange staff available to process the request, and other relevant circumstances. However, the Exchange is concerned that the Proposal leaves open the possibility that these undefined terms could be interpreted literally in the future to provide little or no flexibility to affected persons. Therefore, NYMEX strongly urges the Commission to adopt a uniform "prompt" or "promptly" standard that would apply to all required records.

Format for Records and Copies of Records

In addition to proposing that affected persons who maintain records on electronic storage media must provide copies of such records immediately upon request, the CFTC further would require that such copies must be produced on Commission compatible machine-readable media. The Commission also would require that such copies "must use a format and coding structure (e.g. ASCII) specified in the request." It is not clear from the Proposal whether the Commission intends to specify format and coding in advance of the dates of specific requests for information.

As noted in the Release, ASCII, which is the acronym for the American Standard Code for Information Interchange, is a scheme for arranging bits (one or zero) in groupings of eight-bit bytes, such that the group of eight bits represents one of 256 possible characters. In other words, the Commission recognized that ASCII is a character-based system. ASCII has only a very rudimentary picture capacity. Thus, ASCII most likely would not be used to represent document scans. In this regard, it is the Exchange's understanding that formats that could be used for the scanning of documents are not effectively converted into the ASCII format. Therefore, if affected persons were to believe that Commission staff might insist that copies be produced in the ASCII format, this would be serious disincentive to the use of technologies involving

⁷Thus, the proposed rule amendments would require "immediate downloading" of indexes and records (Regulation § 1.31(b)(1)(ii)(D)); "immediate ascertain[ment]" of the location of a particular record (Regulation § 1.31(b)(2)v(A)); "immediate" provision of copies of records on approved machine-readable media (Regulation § 1.31(b)(3)(i)); and "immediate" examination of indexes, written operational procedures and other information necessary to allow Commission staff to access records and indexes (Regulation § 1.31(b)(2)(v)(B), 1.31(b)(3)(ii)(A), 1.31(b)(3)(ii)(C) and 1.31(b)(3)(iii)(A)).

the scanning of documents.

Other Conditions

The Proposal also would require that a recordkeeper using electronic storage media must develop an "audit system" consisting of written procedures and controls designed to provide accountability over the initial storage of data and any subsequent change to the data.⁸ Furthermore, the Commission also proposes that affected persons must either maintain on-site or in escrow an extensive amount of information that would allow Commission staff on their own to access and understand electronically stored data maintained by such persons.⁹

Finally, the Proposal would require that every recordkeeper that maintains records solely in electronic form must enter into an arrangement with a third party technical consultant ("Technical Consultant") who would submit a set of undertakings to the Commission. The Technical Consultant, as described in the Proposal, would be a party that has the technical and financial capability to perform the undertakings required under the Proposal. In general, the Technical Consultant would need to represent to the CFTC that it would have access to the recordkeeper's electronic storage media and that it would take reasonable steps to provide the Commission or the Department of Justice with access to the information stored on the recordkeeper's electronic storage media.

With regard to the proposed requirement for an audit system, the Exchange questions the necessity of this provision. It should be noted that the Proposal would limit acceptable electronic storage media to media that, among other things, create records that are both non-rewritable and non-erasable. The need for such an audit system for electronic storage media would appear to be even less than the need for such a system for records maintained in hard copy, and the Commission is not proposing a similar requirement for hard-copy records. Thus, the Exchange believes that the Commission should reexamine whether this condition would serve a regulatory objective and whether the assumed benefits would outweigh the costs to affected persons of this condition.

⁸Thus, for example, the Proposal indicates that an audit system would need to detect errors in the electronic recording of data, capture the identities of individuals inputting records and making changes and identify both new documents created and documents changed.

⁹The Proposal indicates that, among other things, the necessary information would need to include the physical and logical format of the electronic storage media, the file format of all different information types maintained on the electronic storage media, and any source code, related documentation, and other information necessary to access the records and indexes maintained on the electronic storage media.

With regard to the condition to maintain extensive information, including source codes, to allow Commission staff to access records stored on electronic storage media without any assistance from the recordkeeper, the Exchange notes initially that many firms today, including NYMEX, license software, such as Norton Backup, Novell Storage Management System or Cheyenne ARCserve, for purposes of backing up critical records. Such licensing agreements typically do not allow the licensee to obtain the underlying source code of that software. Thus, in such instances, a recordkeeper would have no means of providing the Commission with this source code.

On a more general level, there is a relatively straight forward solution that would address both the difficulty noted above with regard to CFTC staff requesting copies in certain formats and the Commission's interest in having sufficient information to permit CFTC staff to access electronic records of a recordkeeper without assistance. As it is likely that many recordkeepers may seek to use some type of scanning technology to maintain records on electronic storage media, consider the following example of a typical software structure for using such technology. First, there would be the "operating system layer," which consists of the operating system software for the particular computer being used (e.g., a UNIX operating system for Digital Equipment Corp. ("DEC") hardware or a Windows 98 operating system for all types of personal computers). Second, there is the "application layer," which is the application that would read files from the computer and write the files to the disc or CD-ROM. Finally, there is the "file layer," which allows a user to read the file itself.¹⁰ At each level, there are a number of software choices available for users and these competing alternatives generally are rather moderate in cost. In addition, it is the Exchange's belief that, at each of these layers, there is a relatively small cluster of software alternatives that are used by the vast majority of market-users.

Therefore, the Exchange respectfully suggests that the Commission identify the top software choices at each layer that will be maintained by CFTC staff and that will be accepted as complying with the requirements of Regulation § 1.31. As these lists will change over time, it may be appropriate for the Commission to use general language in referring within Regulation § 1.31 to what would be acceptable to the CFTC, and then issuing occasional announcements in the Federal Register that could also be posted on the CFTC's website. Any recordkeeper could use any software on the lists and still be in compliance with Regulation § 1.31.

Finally, the Exchange strongly objects to the Proposal's mandating a third-party Technical Consultant for any recordkeeper seeking to store data solely on electronic storage media. In the release, the Commission sought comment on the costs of

¹⁰In addition, assuming sufficient demand, there are a number of filters that allow an operating system to convert from one format to another. Thus, for example, there are filters that convert from the WordPerfect format to the Word format.

obtaining the services of a qualified third party. In the case of the Exchange, this cost would be enormous. At present, due in part to the merger in 1994 with COMEX, NYMEX uses four major computer systems for different purposes: DEC Alpha, IBM, Tandem and Stratus. In order for a third party to undertake the duties that the CFTC would impose upon third-party Technical Consultants, a third party serving NYMEX would need to own or lease time on each of these systems. The hardware cost alone would be millions of dollars.

Moreover, because of the requirement that the Technical Consultant respond in fairly short order to requests for records from Commission staff or from the Department of Justice, it would appear that these computer systems would need to be available to process such requests on short notice and therefore could not be used for other high priority purposes. Consequently, a Technical Consultant would pass along to NYMEX much of the depreciation cost of these computer systems and also the opportunity cost associated with these systems remaining idle.

In addition, a Technical Consultant would need to retain adequate technical support staff to operate these systems and to provide programming as necessary to keep all necessary support programs in operation. At current market rates, the going rate for a computer consultant is approximately \$100,000 dollars a year. Consistent with current practices for computer consultants, the Exchange believes that a Technical Consultant would need to obtain a separate consultant to specialize in each of the computer systems used by the Exchange. Thus, the Exchange estimates that, at a minimum, a Technical Consultant retained by NYMEX would need to retain at least four consultants to understand these four systems and another four consultants to understand the applications that are run on these four systems. Also, a Technical Consultant likely would need to retain, at roughly the same going rate, a manager to oversee the activities of these consultants. Therefore, at a minimum, the staff costs and hardware expenses noted above that a Technical Consultant would incur to provide this service to NYMEX may be conservatively estimated as costing nearly a million dollars annually. In addition, the Exchange estimates that it would take at least a year for a Technical Consultant's staff to become sufficiently familiar with the computer systems used by NYMEX and with the applications used on these systems.

The Exchange argues strenuously that it is simply not in the public interest to require a recordkeeper at great expense to hire outside Technical Consultants to duplicate a core subset of that recordkeeper's internal information technology expertise.¹¹ In this regard, requiring recordkeepers to retain a Technical Consultant would appear to be inconsistent with the Commission's "traditional focus on minimizing

¹¹Even if a recordkeeper currently uses only one major computer system, the Exchange's analysis suggests that the cost to that recordkeeper of retaining a Technical Consultant as required by the Proposal would involve an annual expense of several hundred thousand dollars.

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unnecessary regulatory costs." The cost of complying with this condition would be enormous and unnecessary. Indeed, this huge compliance cost would mean that projects that could benefit market users, such as modernization of an electronic trading system or the development of new products to meet the changing needs of those market users, might need to be delayed or cancelled. The more likely result would be that, if the Commission determines to retain this condition for storing data solely on electronic storage media, the immense cost that would be faced by NYMEX would effectively prohibit the Exchange from shifting to new technology that may offer a more reliable and efficient means of storing records than what is currently permitted by CFTC regulation.

The Exchange also questions the appropriateness of requiring recordkeepers to share access to confidential information with an outside party. In addition, requiring a registrant to share data and other information with a third party also raises the prospect that files may be corrupted in the process. Therefore, the Exchange believes that the Commission's concerns are most appropriately addressed through a uniform standard on security of stored records that would apply to all required records and that could be tailored to address specific situations when the Commission's ability to obtain records from a particular recordkeeper had become uncertain.

In conclusion, the Exchange commends the Commission for trying to move in the direction of a more general, performance-based standard for permissible technology. A number of the conditions that the Commission seeks to impose upon the use of micrographic and/or electronic media are unnecessary, would substantially increase the regulatory cost of using such systems, and thus would seriously diminish the potential attractiveness of using non-paper methods for storing required records. Therefore, the Exchange respectfully suggests that the Commission instead adopt general standards regarding reliability, accessibility and security for all required records that would provide recordkeepers with flexibility to select the storage methods that best suit their business needs.

* * * *

NYMEX thanks the Commission for the opportunity to submit comments concerning the proposed rule amendments and would be pleased to furnish additional

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

Respectfully submitted,

A handwritten signature in black ink that reads "R. Patrick Thompson" followed by a stylized flourish or initials.

R. Patrick Thompson
President

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