



COMMENT

RECEIVED
C.F.T.C. JUN 12 10 31 17

'02 JUN 16 AM 7:23 THE SECRETARIAT

Ms Jean A Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington
USA

RECEIVED C.F.T.C.
RECORDS SECTION

International House,
1 St. Katharine's Way,
London E1W 1UY, England.
Switchboard: 020 7481 0643
Facsimile: 020 7481 8185
www.ipe.uk.com

12 April 2002

Sent by facsimile, email and by post

02-3
①

Dear Ms Webb

Re: NYMEX EFF proposal for the Brent Crude Oil futures contract

On behalf of the International Petroleum Exchange (IPE), I would like to thank the Commission for submitting the above proposal for public comment.

It is clear from the proposals submitted by NYMEX that this procedure is directed at attracting open interest from the IPE and we are therefore grateful for this opportunity to submit comments to the Commission. We would be happy to provide the CFTC with further information should that be required and to meet with the Commission to discuss this further.

At the outset, we should make it clear that the IPE is not seeking to raise concerns on the EFF procedure on competitive grounds. Competition is good for market development and innovation which benefits market participants and exchanges alike. We do, however, have a number of fundamental concerns regarding the potential operation of this EFF procedure and we fear that the EFF facility, as currently constructed, may have a detrimental impact on the price discovery process for the IPE's Brent crude futures contract. As the Commission is aware, the IPE's Brent futures contract is an internationally accepted benchmark for crude oil and is part of the Brent trading complex which is used to price over 60% of the world's internationally traded oil. During March 2002, IPE Brent traded 1.87 million lots, equivalent to 1.8 billion bbl of crude. Particularly with current world developments, increasing attention is being devoted to the price of crude oil. Consequently, we would respectfully ask the Commission to carefully weigh the consequences of this rule.

We understand that US regulations require that all futures transactions be executed openly and competitively. In addition, any discussions off the floor of a futures exchange with a counterparty that could be construed to be an express or an implied agreement to execute an exchange futures trade may be a prohibited, prearranged trade. Transactions may, however, be executed non-competitively in accordance with written rules of a contract market which have been submitted to and approved by the CFTC.

NYMEX in its submission to the Commission has acknowledged that its EFF rule provides for non-competitive executions. However, the novel public policy element of this procedure is that, for the first time as far as we are aware in global futures markets, this proposed rule could affect not just non-competitive executions on the NYMEX but also non-competitive executions on another exchange.

While IPE takes no position on non-competitive trading on the NYMEX, it is concerned at the potential that the CFTC can or should adopt a rule that could promote non-competitive trading at another exchange

without that exchange's consent. In particular, NYMEX's EFF proposal, by its very nature, could encourage pre-execution discussions between parties to the trade on the other exchange in violation of that other exchange's prohibitions on pre-arranged trading. This is due to the fact that the same two parties will necessarily be effecting a negotiated transaction on NYMEX, which will lead them to negotiate the corresponding liquidating transaction on IPE in order to ensure that they can co-ordinate price and quantity. As such, the EFF proposal creates a clear incentive to engage in improper practices at the other exchange. As the CFTC is aware, an exchange makes a decision to permit non-competitive trading (for example, block trades) after carefully considering the integrity of its marketplace and, in particular, the integrity of its price discovery. Allowing the NYMEX to undermine this proprietary decision-making process could, in our view, create incentives for improper practices and undermine price discovery. We understand that the NYMEX proposal requires that the liquidating transaction be executed in accordance with the procedures of the IPE. However, neither, NYMEX nor, for that matter, the CFTC has a means of detecting violations of, or enforcing, this requirement and it is disingenuous and unrealistic to expect that parties executing an EFF on NYMEX will always comply with IPE rules on the related liquidating transaction.

NYMEX has analysed the EFF rule as being analogous to block trading proposals at other exchanges. However, block trades do not involve related futures transactions on another exchange, and this analogy is therefore difficult to sustain. Moreover, the Commission should be aware that the IPE does not currently have a non-competitive block trading facility though we will shortly issue proposals to our membership to introduce such a facility. Several features of this new facility are, we believe, material considerations for the Commission's analysis of NYMEX's EFF rule.

Firstly, we have been careful to ensure in the IPE's proposed new facility that block trades will only be permitted up to one hour before the daily settlement period of the contract (currently at 7.30pm UK time). Furthermore, block trades will only be capable of being executed up to three days prior to expiry of the relevant contract month. Both measures are designed to ensure that the price discovery processes during these sensitive periods are not dislocated. As a consequence, there are significant limits in terms of the ability of IPE members to engage in pre-execution discussions. Given our analysis above on the impact of NYMEX's EFF rule, we are concerned at the potential for confusion with one exchange encouraging pre-execution discussions and the other exchange limiting the potential for such discussions. This would seem to present regulatory issues that are undesirable. Absent these objections, if the CFTC was to approve this rule, we believe that NYMEX should put sufficient parameters around this facility to reflect trading rules on the IPE (given that NYMEX has so closely associated this EFF rule with the IPE Brent crude futures contract). We also consider that NYMEX should ensure that its members and customers are aware of the rules of the other exchange. We presume that the CFTC would also wish that end-users are aware that their IPE contract has been swapped for a NYMEX contract and that changes in the regulatory and legal protections surrounding this "swap" have been properly and adequately disclosed to end-users.

Secondly, NYMEX proposes that its EFF minimum transaction size be 50 contracts. We understand that the CFTC has established the precedent that the size requirement for block trades looks to the most liquid market trading the underlying futures contract. We are not clear that this consideration is relevant in this particular context – as the EFF facility is not, as we explained above, directly analogous to block trading facilities. However, we do believe that the minimum size requirement for the EFF facility (as it refers to non-competitive trading facilities at another exchange) does have to take as its point of reference the construction of any such non-competitive trading facilities at that other exchange. In addition, where a specific contract is targeted (such as Brent) the limits that apply to that contract on the other exchange should be applicable to NYMEX's contract. Given the linkage between this EFF facility and the IPE's Brent contract, our view therefore is that the minimum size requirement for EFFs should follow the limit of block trade transactions that are approved by the IPE. The IPE's proposed block trading level will be at 1,000 lots which equates to two physical cargoes of crude oil. In the view of the IPE, this is a sufficiently large transaction that warrants treatment as a block trade.

We also note that NYMEX proposes that EFF transactions need not be reported to the NYMEX clearing member for up to two hours after trade confirmation on the other market. We also note that this transaction will not be reported generally to the market. This appears to us to be inconsistent with the emphasis on competitiveness and price discovery – we would have thought that it was in the interests of market transparency for market participants to know as soon as possible that an EFF trade has been conducted. In relation to the IPE's block trading proposal, we have been required by our regulator to

impose a five-minute registration of block trades. It would appear to us inequitable if there were differing procedures between the two markets. This could also have a significant impact on the price discovery process at the IPE, if substantial open interest disappeared from the IPE and was not registered on the NYMEX within a realistic timeframe. Again, if this facility was approved, there could be an inconsistency between the approaches taken by the FSA and CFTC in relation to market transparency that is also undesirable.

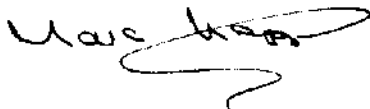
Furthermore, it is unclear to us as to the price at which the EFF would be registered on the NYMEX. Would this bear any reference to the original execution price on the IPE, the price at which the transaction was liquidated on the IPE or the current market price when the trade is actually executed or registered at NYMEX? This as well could have a significant price formation impact – given the two-hour delay in registration – if the price at which the EFF is registered is at significant variance from current market values. Again, in the IPE's block trading proposal, we are requiring that the price be "fair and reasonable" basis current market values – we believe that the same principle applies to block trading proposals established at other US exchanges (such as the CME). Without further information on this, it is difficult to respond to your questions concerning the impact of the price discovery process at the IPE.

To the extent that the NYMEX proposal permits the establishment of positions on the NYMEX by EFF, it must also permit a liquidation of those positions by EFF. The NYMEX Proposed Rule 6.21D is unclear on this point. It speaks of effecting an underlying transaction on another exchange and a "subsequent" EFF of that transaction onto the NYMEX. Certainly, any proposal of this type, in order to be meaningful, must permit the EFF to go in both directions. Therefore, two parties should be able to enter into an underlying transaction on the NYMEX and then EFF that transaction onto another exchange. Of course, the second part of that transaction (the EFF onto the other exchange) can only occur if the other exchange permits such an EFF transaction. There is no justification for and the CFTC should not permit a one-way EFF. To do so would make a mockery of NYMEX's proposed rationale for its EFF rule of increasing competition among markets. This as well underscores the need to involve the IPE in this process and to develop a co-ordinated EFF proposal.

In summary, we believe that this proposal presents a number of significant issues which warrant further and more detailed consideration. Not least of these are the undesirable regulatory and legal consequences that could ensue if this facility was used to facilitate the breaking of IPE's rules or the FSA's market abuse regime in order to establish a position on NYMEX. We are far from clear that this rule in itself would promote competition between the exchanges.

We have copied this letter to the FSA as we believe that this raises matters that are relevant to both regulatory bodies.

Yours sincerely,



Marc Leppard
Director of Regulation

cc. Gay Huey Evans, Director, Markets & Exchanges Division, Financial Services Authority