99-29
(4)

New York
Mercantile Exchange
NYMEX/COMEX. Two divisions, one marketplace

RECEIVED
C.F.T.C.

1999 OCT 13 P 2:

RECEIVED

1999 OCT 13 A 11:

RECORDS SECTION

COMMENT

October 12, 1999

VIA FACSIMILE AND FEDERAL EXPRESS

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

Re: Petition of the Chicago Board of Trade, the Chicago Mercantile Exchange and the New York Mercantile Exchange for Exemption Pursuant to Section 4(c) of the Commodity Exchange Act 64 FR 46536 (August 25, 1999)

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 petition for exemption ("Petition") to the Commodity Futures Trading Commission's ("CFTC" or the "Commission"), submitted jointly by letter dated June 25, 1999, by the Chicago Board of Trade, the Chicago Mercantile Exchange and the New York Mercantile Exchange (collectively the "Exchanges"). The Petition requested an exemption, pursuant to Section 4(c) of the Commodity Exchange Act ("Act"), for all boards of trade that have been designated by the Commission as contract markets, from certain statutory requirements concerning the contract market designation process for new contract submissions and concerning the contract market rule review process.

The Exchanges' Petition was filed in response to a Commission Order dated June 2, 1999. The Order directed CFTC staff:

> "to begin immediately processing no-action requests from foreign boards of trade seeking to place trading terminals in the United States, and to issue responses where appropriate, pursuant to the general guidelines included in the Eurex (DTB) no-action process, or other guidelines established by the Commission, to be reviewed and applied as appropriate on a case-by-case basis."

Subsequently, the Division of Trading and Markets ("T&M") granted no-action requests for the London International Financial Futures Exchange, DTB, the Sydney Futures Exchange Limited, the New Zealand Futures and Options Exchange Limited, and the

One North End Avenue
World Financial Center
New York, NY 10282-1101
(212) 299-2000

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.

ParisBourse [SBF] SA.

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.

I. Summary

The recent activity by Commission staff to provide no-action relief to numerous foreign futures exchanges has placed the Exchanges at a severe competitive disadvantage. As detailed in the Petition, the Exchanges urgently need the regulatory relief for which they petition in order to compete on a fair and equal basis with the foreign boards of trade that have been granted and with foreign boards of trade that soon will be allowed to offer electronic access to their markets to persons in the U.S. In particular, the Exchanges seek relief in the following three areas:

1. Exchanges should be able to list new futures and options contracts without pre-approval by the Commission;

2. Exchanges generally should be able to adopt new rules and rule changes after submitting them to the Commission ten days prior to their taking effect; and

3. Exchanges should be allowed to implement trading rules and procedures comparable to those of a competing foreign board of trade, provided that the rules and procedures are limited to only the contracts that are in direct competition to those of the foreign board of trade.

II. General Principles

In Section III. below, we answer each of the 11 sets of questions contained in the Commission's Federal Register release ("Release"). However, before turning to those responses, we believe that it would be useful to the Commission to consider first the following general principles.

First, in terms of sound economic policy, U.S. customers and other users of futures markets benefit when there is a level regulatory playing field because they can provide clear signals regarding those products and providers that best meet their

needs. On the other hand, market efficiency may be distorted when customers make choices among similar products on the basis of differences in regulatory treatment among providers rather upon the basis of intrinsic distinctions in those products. The marketplace should be allowed to operate and thus provide market users with the ability to signal clearly their preferences. Handicapping domestic exchanges by placing regulatory burdens upon them not imposed upon foreign exchanges is unfair both to market users and markets. In the long run, differences in the CFTC's regulatory treatment of domestic and foreign exchanges could affect the viability of domestic exchanges, leaving fewer choices for market users.

Second, with regard to the Act, a Commission approach of regulating similar activities in a similar manner is consistent with the legislative intent underlying Section 4(c). This statutory provision was added to the Act as part of the Futures Trading Practices Act of 1992. With regard to the grant of exemptive authority under Section 4(c), the Conferees clearly stated that: "[t]he Conferees intend that the Commission, in considering fair competition, will implement this provision in a fair and even-handed manner to products and systems sponsored by exchanges and non-exchanges alike."[1] In other words, Congress has given the CFTC explicit guidance that it should implement Section 4(c) in a fair and even-handed manner not only as to exchanges vis-a-vis non-exchanges, but also that the Commission should be fair among exchanges as well.

Third, the CFTC has repeatedly announced in recent years a Commission policy of "fair competition" through "even-handed regulation." Accordingly, in terms of the Commission acting in a manner consistent with its own established regulatory policy, it should be consistent in its regulatory treatment of foreign and domestic futures exchanges. In this regard, the no-action relief letters issued by Commission staff have been based on determinations by staff that such relief would not be "not contrary to the public interest."

In reaching these conclusions for the various foreign exchanges that have been granted such relief to date, CFTC staff, in its comparability analyses, seemingly also have determined that certain practices and procedures permissible at foreign boards of trades offering electronic access in the U.S. to their markets are consistent with CFTC statutory duties to protect customers and market integrity. In addition, several foreign exchanges are not required to obtain formal prior approval of new contracts and rules under the regulatory regime of their home regulator or from the CFTC. If such practices and the absence of prior approval of contracts and rules are acceptable for products offered by foreign exchanges to U.S. customers, there does not appear to be a principled basis to support not allowing domestic exchanges the flexibility to consider

---

[1]House Conference Report No. 102-978 to H.R. 707, p.78.

permitting such practices in connection with directly competing products that are also offered to U.S. customers.

Fourth, a Commission approach of regulating similar activities in a similar manner would be consistent not only with the Administrative Procedures Act but also with the protection of the due process clause of the Fifth Amendment to the U.S. Constitution. There is a long line of precedent that has established that an agency action is arbitrary when the agency offered insufficient reasons for treating similar situations differently. Transactive Corp. v. U.S., 91 F. 3d 232, 237 (D.C. Cir. 1996). See, e.g., Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mutual Auto. Ins. Co., 463 U.S. 29, 57, 103 S. Ct. 2856, 2874, 77 L. Ed. 2d 443 (citing Greater Boston Television Corp. v. FCC, 444 F.2d 841, 852 (D.C. Cir. 1970), cert. denied, 403 U.S. 923, 91 S. Ct. 2229, 2233, 29 L. Ed.2d 701 (1971)); Airmark Corp. v. FAA, 758 F.2d 685, 691-692 (D.C. Cir. 1985); Local 777, Democratic Union Organizing Committee v. NLRB, 603 F.2d 862, 872 (D.C. Cir. 1978).

Thus, for example, the D.C. Circuit has ruled that once an agency has agreed to allow exceptions to a rule, it must provide a rational explanation if it later refuses to allow exceptions in cases that appear similar. Green Country Mobilephone v. FCC, 765 F.2d. 235, 237 (D.C. Cir. 1985), citing NLRB v. Washington Star Co., 732 F.2d 974, 977 (D. C. Cir. 1984). Here, of course, the Commission has explicit statutory authority under Section 4(c) to grant exemptive relief and has already granted relief pursuant to that authority; thus, the issue would be whether the Commission exercises that exemptive authority for other exchanges, including domestic exchanges, in a consistent manner.

Fifth, a Commission approach of regulating similar activities in a similar manner also would be consistent with its statutory obligations under Section 15 of the Act. Section 15 provides in pertinent part that the CFTC must consider the public interest to be protected by the anti-trust laws and endeavor to take the least anti-competitive means of achieving the objectives, policies and purposes of the Act. This statutory duty applies to the adoption of exemptions under Section 4(c). Exempting foreign exchanges from various CFTC regulatory burdens while continuing to impose such burdens upon domestic exchanges creates a lopsided regulatory environment that is inherently anti-competitive.

III. Response to Questions in the Release

(1) Do the limitations on the degree of access that foreign exchanges will have to the U.S. markets pursuant to no-action positions alter the need for any of the exemptive relief sought by the Exchanges in their petition?

No. In the Release, the Commission notes that T&M, in granting no-action relief for LIFFE, required LIFFE to adhere to periodic reporting requirements apprising

the Commission of the level of its business activity in the U.S. In addition, the Commission notes that if LIFFE wishes to make new contracts or products available in the U.S. through its electronic trading system, it must request and obtain supplementary no-action relief from T&M. With regard to the level of business activity, the Commission suggests in the Release that, at some level of U.S. business activity, a foreign exchange could be required to seek designation as a contract market.

However, this possibility does not alter the need for any of the exemptive relief sought by the Exchanges in the Petition. Currently, several foreign exchanges operating under no-action relief enjoy certain regulatory advantages over domestic exchanges, including freedom from CFTC prior review and approval of new contracts and new rules. It is unclear to NYMEX how a potential future level of business activity addresses this current inequality. One possible inference is that the Commission is suggesting that it would address this existing inequity only after a foreign exchange has managed to siphon off most of the liquidity from a competing U.S. market. We hope that this is not the Commission's final view on this topic. At that point, CFTC regulatory efforts to redress the regulatory disparity likely would be of little practical value to the disadvantaged domestic exchange.

Similarly, it is true that T&M's no-action letters specify the foreign exchanges' contracts for which no-action relief is applicable, and foreign exchanges must request and obtain supplementary no-action relief from T&M before making new contracts or products available in the U.S. through their electronic trading systems. The Exchange recognizes that considering no-action relief on a contract-by-contract basis allows Commission staff to assess in each instance whether a particular contract may require the foreign entity to obtain designation as a contract market for that contract. However, the mere issuance of a supplemental letter adding a new contract to the specified list can in no way be viewed as comparable to the cost, burden and delay associated with a domestic futures exchange's effort to obtain contract market designation from the CFTC for a new contract.

In the Commission's June 2, 1999 Order, the CFTC determined to "commit to simultaneously initiate processes to address the comparative regulatory levels between U.S. and foreign electronic trading systems so as not to provide one with a competitive advantage." These competitive disadvantages were created by the staff no-action letters, and the limitations on the degree of access that foreign exchanges will have to the U.S. markets pursuant to no-action positions do not alter the need for any of the exemptive relief sought by the Exchanges.

> **(2) The Commission recently proposed a two-year pilot program to permit the immediate listing of certain new contracts for trading for a specified period of time prior to obtaining Commission approval. Please discuss whether the Commission's proposed rulemaking addresses the**

Exchange's stated need for relief in this area.

No, the Commission's proposed rulemaking does not fully address the Exchange's stated need for relief in this area. NYMEX believes that this proposed rulemaking may be suggestive of a greater willingness on the part of the CFTC to work with the industry to address a badly outmoded regulatory regime. When viewed in this light, the proposed rule-making may be seen as a good first step.[2] However, the basic premise underlying this rulemaking is that Commission approval of all contract market designation applications is still necessary.

Comparing the proposed rulemaking with the Petition is helpful in highlighting a number of restrictions, conditions and limitations in the proposed rulemaking that would severely undercut the attractiveness of using the new pilot program. First, under this pilot program, exchanges would still need to apply for Commission approval within 45 days of the launch, and Commission approval would still be necessary to continue trading the contract. Under Section 6(a) of the Act, the Commission may take up to one year to approve or deny an application for contract market designation. Thus, uncertainty regarding whether or not a pending application for designation would be approved or denied, or perhaps modified from the original filing under terms dictated to an exchange by the CFTC, could continue for a whole year. Moreover, during the period that Commission approval was pending, a board of trade would have a continuing duty to notify the public in all public references to the contract or its trading months that the contract was trading pending Commission designation.

Second, under the pilot program, until an exchange had received contract market designation from the CFTC, it could not list for trading any contract months for futures or option contracts pending approval under the pilot procedure where either the delivery month or the option expiration, as applicable, would be beyond one year. As noted above, under the statute the CFTC's approval process could continue for one year. In addition, the restriction that contract months could not extend beyond one year also could make a new contract considerably less attractive as a trading vehicle to many market participants. Because futures markets may be viewed as having a relationship with swaps markets that is complementary as well as competitive, it can be important to the viability of a futures or option contract that the contract is perceived as an attractive trading vehicle by market participants in swaps markets who are seeking

---

[2] In addition, the proposed rulemaking would provide that predesignation listing be available only when an exchange already is a designated contract market for at least one nondormant contract. The CFTC justified this provision by noting that the initial designation of a board of trade as a contract market often entails a more lengthy review which includes analysis of its trading and clearance systems and its self-regulatory programs. NYMEX agrees with the Commission on this point.

to hedge the risks from swaps transactions in futures markets.

However, it is not uncommon for swap agreements to have a duration that spans several years. Swaps markets participants seeking to hedge the risks associated with such agreements would find this one-year cap on the listing of new contract months to be unnecessarily restrictive and burdensome. On a more general level, a number of contracts at the Exchange have open interest in contract months more than one year beyond the current delivery month.[3] Therefore, depending in part upon the duration of the CFTC's review process, this restriction could act as a significant disincentive to the trading of a new contract.

Third, amendments to contracts and to all related exchange rules also would still require prior CFTC approval. The time frame for Commission review and approval would depend upon the nature of the rule being submitted; however, under the statute, Commission review could continue for 180 days (and even longer if requested by Commission staff).

Fourth, the Proposal makes clear that this would be a two-year pilot program. Accordingly, there would be no assurance that the pilot program would be continued at the end of that time frame. In addition, the Commission has not provided guidance on how it would evaluate the pilot program. Taken together, these restrictions and limitations could create considerable uncertainty concerning whether a contract would be approved by the CFTC and whether the CFTC might dictate amendments in the terms of the contract that could affect the valuation of the contract. This level of uncertainty also may well affect the viability of a new contract.

Rather than expending considerable Commission staff resources on a pilot program that is likely to be used sparingly by futures exchanges, if at all, the Exchange suggests that the Commission should focus upon providing U.S. futures exchanges with the maximum possible regulatory flexibility. Such flexibility should be no less than the regulatory flexibility that the Commission has already extended to several foreign futures exchanges who have been permitted to provide electronic access to their electronic trading systems to persons here in the U.S.

---

[3]In the Exchange's Light Sweet Crude Oil Futures Contract, for example, at any one time, the Exchange lists for trading contract months that can be as much as 84 months out from the present time, and it is not uncommon for open interest to be observed in a contract month several years out from the current delivery month. Similarly, the Exchange generally lists for trading 36 consecutive trading months in the Exchange's Henry Hudson Natural Gas Futures Contract; again, there is often significant open interest in back months well beyond the first twelve contract months listed for trading.

(3) In their petition, the Exchanges specifically request that all boards of trade designated by the Commission as contract markets be exempt from complying with the contract market rule review process set forth in Section 5a(a)(12) of the Act. Alternatively, the Exchanges propose that contract markets be required to provide notice of new rules or rule amendments to the Commission ten days in advance of the effective date and that the review of such proposals not be stayed or delayed unless the Commission determined that the rule was ``likely to cause fraud, render trading readily susceptible to manipulation, or threaten the financial integrity of the market." (a) Is this standard sufficient for the Commission to carry out its statutory obligations? (b) In additional to fraud, manipulation, and financial integrity issues, are there any other issues which the Commission should address when determining whether to stay or delay the immediate implementation of proposed contract market rules or rule amendments?

(a) Under the Act, the core statutory purposes for the Commission are to protect customers and market integrity. These purposes are directly addressed by the standards in the Petition. In using these standards, the Commission thus could carry out its statutory obligations. In addition, by focusing its regulatory efforts upon its core mission, the Commission could streamline its activities and operate as a true oversight agency.

(b) The concerns that NYMEX has with other issues that might be tacked onto the core statutory purposes of the CFTC is that these other peripheral issues have been and could continue to be used as an opportunity for Commission staff to substitute their business judgment for that of the members of the boards of directors, acting in their fiduciary capacity, at the regulated exchanges. This substitution of judgment is both inappropriate and unnecessary. Over time, NYMEX has developed a reputation in the financial community as a world class futures exchange, particularly with respect to energy and precious metals products. NYMEX has a powerful incentive to protect and enhance that hard-earned reputation by offering products and a trading environment that are reliable and that are sought by the marketplace. By comparison, if we were to put forward a poorly designed product, the marketplace would quickly reject that product and our reputation and our business good will, the franchise of the NYMEX name, would all suffer.

(4) Please discuss the impact of any legal uncertainty on contract markets and market users if the Commission were to undertake disapproval of contract market rules after their implementation.

It may be useful to respond to this question by first clarifying the scope of the exemptive relief sought by the Exchanges. Specifically, in the Petition, the Exchanges requested that, among other things, boards of trade that have been designated as

contract markets:

> "Shall be exempted, to the extent of the Commission's power under Section 4(c)(1), from the rule approval provisions of section 5a(a)(12) of the Act and related regulations, except the provisions relating to emergency rules, if the contract market provides notice of new rules or rule changes to the Commission 10 days in advance of the effective date. Rules submitted pursuant to this exemption shall not be stayed or delayed unless the Commission finds that the rule is likely to cause fraud, render trading readily susceptible to manipulation or threaten the financial integrity of the market. The Commission's power to alter or supplement any rule change implemented pursuant to this exemption shall not be diminished."

In other words, for rules submitted pursuant to the exemption, the Commission could institute disapproval proceedings for those rules that it stayed during the 10-day advance period and could disapprove such rules thereafter upon a finding that the rule is likely to cause fraud, render trading readily susceptible to manipulation or threaten the financial integrity of the market. However, in the event that the Commission did not act to stay or delay a rule during the 10-day period, then the Commission subsequently could alter or supplement the rule as necessary pursuant to its authority under Section 8a(7) of the Act, but it could not institute disapproval proceedings at that point.

This approach was intended to ensure that the Commission could make necessary changes but would limit the impact of such changes on markets and market participants by tailoring the changes so as to make only those changes that are deemed to be truly necessary. The Act has long provided the Commission with authority to supplement rules under Section 8a(7), and the CFTC has chosen to exercise this authority sparingly over the years. The Commission should continue to follow this approach for exempted rules.

> **(5)(a) Under the proposal, it might be possible for a single U.S. contract to be subject to rules drawn from a number of different competing foreign exchanges. It also might be possible for different contracts trading side-by-side at a particular U.S. contract market to be subject to different sets of rules based upon the rules of competing foreign exchanges. Please discuss the implications of these possibilities, including their impact, if any, upon the ability of the Commission, the contract markets, or Commission registrants to discharge their regulatory responsibilities.**

There is an obvious benefit to maintaining a substantial degree of uniformity respecting the rules applicable to various contracts at an exchange. Such uniformity facilitates the administration by an exchange of its rules as well as compliance with such rules by Commission registrants and other market participants. However,

differences in markets can necessitate differences in the rules governing the individual contracts for those markets.

Hence, it has long been the case at NYMEX that different contracts trading side-by-side can be subject to different sets of rules. For example, several months ago, the Exchange launched a new Aluminum Futures contract; at the same time, the Exchange authorized the implementation of a specialist market ("SMM") facility for that contract. The trading priorities that apply to a SMM differ from the trading priorities applicable to every other floor member in that ring. To date, the Aluminum Futures contract is the only contract at the Exchange with a SMM facility. In addition, matched orders are permissible on the COMEX Division of the Exchange for copper, but not for other contracts. The rules of the COMEX Division allow for an average price mechanism, but the rules of the NYMEX Division currently do not. Some NYMEX contracts are traded throughout the entire NYMEX ACCESS® electronic trading session, while the trading period for other contracts on NYMEX ACCESS® is much more limited.

Two conclusions can be drawn from the Exchange's experience. First, Commission registrants and other market participants have demonstrated the capacity to identify and take into account on an ongoing basis different rules for different products. Second, while the Commission's grant of the exemptive relief sought in the Petition would provide the Exchange with the flexibility to respond quickly and decisively to competitive challenges, the NYMEX Board of Directors would exercise its best judgment regarding whether a particular practice permitted at a foreign exchange would be implemented at the Exchange. This analysis would consider a number of factors, including the possible impact of implementing such a change upon NYMEX products that do not compete directly with the products of the foreign exchange and thus would not be eligible for such a change.

(b) The Exchanges preface their specific requests for exemptive relief with the general request that the ``Commission exercise its authority under Section 4(c) of the Act and grant certain exemptions from provisions of the Act except for . . . the provisions that prohibit manipulation." If the Commission were to grant the exemptive relief requested, could the Commission and the contract markets ensure that such comparable trading rules and procedures were not inconsistent with the Act's prohibitions against fraud and manipulation?

The grant by T&M of no-action relief to several foreign exchanges is grounded upon T&M's finding that such a grant "would not be contrary to the public interest." It is the Exchange's understanding that T&M, in its comparability analysis, includes an assessment of the extent to which the foreign regulatory scheme provides acceptable protection against fraud and manipulation. Once Commission staff have made this

finding, the same analysis should apply to the same rules and procedures permissible under the foreign regulatory scheme being allowed for domestic exchanges with competing products.

(c) Implicit in the Exchanges' petition is the notion that rules established for electronic trading on foreign exchanges could be applied to open outcry markets. Are there any public interest issues raised by applying rules designed for electronic trading systems to open outcry markets?

In the Petition, the Exchanges sought exemptive relief to implement trading rules and procedures "comparable" to those of the competing foreign exchange, and such relief would be limited by the proviso that such rules and procedures would apply only to contracts that are in direct competition from a contracts listed by the foreign exchange. NYMEX believes that these restrictions place appropriate limits on the scope of the relief sought.

(6) Please discuss whether the lack of a public comment process would have any impact on the ability of the Commission to discharge its regulatory responsibilities in these areas.

NYMEX conducts an intensive review process in developing a new contract, which includes consultations with virtually all segments of the affected industry for that contract, consultations with the financial community and numerous forums for open debate in which reasonable views can be expressed and considered. The contract development process allows all potential users to protect themselves in ways that diminish the need or the utility of detailed CFTC prior review and of public comment. The process allows potential users to shape the terms and conditions and voice their concerns over any provisions that they feel do not match cash market practices or other commercial concerns over which they have expertise. Equally important, the process allows a full airing of the terms and conditions prior to trading.

All potential market participants are afforded the opportunity to educate themselves and make their own decisions regarding whether to trade or not to trade a new contract. In view of the powerful economic forces that drive exchanges to be thorough and vigilant in developing a new product, the Commission should be confident in allowing exchanges to list contracts for trading and to implement rules without detailed prior review and public comment.

The Exchange also undertakes an extensive process of internal review of proposed rules. As a result of this process, proposed rules and rule amendments typically are reviewed by several Exchange committees and the Exchange's Board of Directors. In particular, if a rule proposal would affect the terms and conditions of an Exchange contract, such a proposal generally is reviewed by a NYMEX product

advisory committee, composed of a diverse mix of experienced and knowledgeable market participants in that product market. In NYMEX's experience, detailed CFTC review and approval and public comment on proposed contracts and rules has not been necessary, provides marginal, if any, value, and adds cost, uncertainty and delay to the roll-out of new contracts.

(7) What are the differences between foreign exchange rules related to order flow and liquidity programs and the U.S. contract market rules that the Commission has approved in these areas?

The key principle that must be emphasized is that where Commission staff have provided no-action relief to a foreign exchange that utilizes a program for payment for order flow and/or liquidity, domestic exchanges with directly competing products should have the flexibility to make a business decision regarding whether or not to respond in kind without being subjected to unnecessary regulatory obstacles.

(8) In June 1999, the Commission issued an Advisory on Alternative Execution, or Block Trading, Procedures for the Futures Industry, in which it announced its intention to consider contract market proposals to adopt similar alternative execution methodologies. Please discuss whether there are any modifications that could be made to the Commission's Advisory that would further address the Exchanges' concerns in this regard. Please also discuss the extent to which such changes would be consistent with the Commission's responsibilities for ensuring the integrity and economic utility of futures markets and protecting market participants against manipulation, abusive trade practices, and fraud.

This Advisory was issued as a follow-up to a Concept Release published for comment in January 1998, in which the Commission sought comment on a wide range of issues concerning alternative execution procedures. In the Advisory, the CFTC indicated that, following careful review of the comments received on the Concept Release, it had determined to evaluate contract market proposals to adopt alternative execution, or block trading proposals, on a case-by-case basis, rather than pursuant to a new rule directed specifically at such proposals. However, the Advisory by its terms does not change the current procedures for Commission review of exchange rule submissions and thus does not directly address the underlying need for regulatory relief.

(9) In their petition, the Exchanges states that U.S. contract markets are not permitted to delay the reporting of transaction information in order to accommodate market participants who desire to withhold relevant information about their transactions until they have been able to act in another market or execute additional transactions. The Exchanges believe

that the ability of foreign exchanges to delay the reporting of certain types of transactions, such as block trades, to the general marketplace will enable them to capture market share from U.S. contract markets. Please discuss whether there are any modifications that could be made to the Commission's Block Trading Advisory that would further address the Exchanges' concerns in this regard. Please also discuss the extent to which such change would be consistent with the Commission's responsibilities as described in question 8 above.

At present, U.S. contract markets are not allowed to delay the reporting of transaction information, while this practice can be found at various foreign futures exchanges, which thus provide participants in those markets with the ability to complete transactions in other markets before information about their futures transactions is disseminated. Again, domestic exchanges with directly competing products should have the flexibility to make a business decision regarding whether or not to respond in kind. There is no indication in the Advisory that the Commission has revised its views against any delay of reporting transaction information for domestic exchanges.

(10) In their petition, the Exchanges state that the Commission, in its review of U.S. contract markets' electronic trading systems, requires account identification information to be entered into trading terminals prior to the execution of customer orders. The Exchanges believe that U.S. contract markets may lose market share to competing foreign exchanges that are not subject to such a requirement. The Commission has allowed bunched orders for certain eligible customers to be placed on a contract market without specific customer account identification, either at the time of order placement or at the time of reporting order execution. Please discuss whether there are modifications that could be made to the approach taken by the Commission in this regard that would be responsive to the Exchanges' concerns. Please also discuss the extent to which such changes would be consistent with the Commission's responsibilities as described in question 8 above.

The Commission's exemption, for certain bunched orders, from the general requirements that account identification be recorded at the time of order placement and at the time of reporting order execution, is restricted to orders for certain eligible customers placed by eligible account managers. The general requirements remain applicable for all other orders. By comparison, several foreign exchanges that have been granted no-action relief by Commission staff do not have this requirement. Thus, there is still a significant regulatory disparity. The Exchanges should be given the flexibility to decide whether to match the foreign exchanges on this issue.

(11) Should the Commission's review of electronic trading systems be based on

standards other than or different from those contained in the IOSCO principles?

NYMEX supports the IOSCO Principles and does not object to the application of these principles to the Commission's initial review of an electronic trading system proposed by an exchange. However, once the Commission has conducted a full review of a new system, domestic exchanges should not be subject to de novo reviews whenever they make enhancements to their systems if the Commission is not willing to undertake any factual review of the electronic trading system of a foreign exchange seeking no-action relief.

IV. Response to FIA Comment Letter

As of the date of this comment letter, which is the final day of the comment period on the Petition, it appears that the FIA is the only organization other than a petitioning exchange to have submitted a comment letter prior to today. Briefly, the FIA supported the Exchanges on removing preapproval for new contract terms and conditions, but declined at this time to support the Exchanges on the other two prongs of the Petition.

We appreciate the FIA's support on the first component of our Petition. However, we also believe that certain comments in the FIA's comment letter on the other two components need to be addressed.

First, with regard to limiting Commission preapproval of exchange rules, the FIA attempted in its comment letter to draw a link between FCM representation on exchange governing boards and Commission review of exchange rules. But, the FIA did not provide adequate support for its proposed linkage.

The FIA began by acknowledging that U.S. exchanges are in compliance with the Act and Commission regulations, which provide for "meaningful representation" on exchange governing boards of a diversity of interests, including futures commission merchants. In this regard, at NYMEX, there are many FCMs that are Member Firms and thus share in the ownership and control of the Exchange. In particular, FCMs, through their conferring members, are represented on NYMEX's Board of Directors ("Board"), on the Executive Committee of the Board and on many Exchange committees. In addition, the Exchange has established a specific committee, the FCM Advisory Committee, to address FCM concerns, and NYMEX's Chairman and other NYMEX senior staff regularly appear before this committee to listen to the views of FCM representatives and to consult with them on Exchange developments and projects.

Nonetheless, the FIA stated that it could not support a proposal to limit Commission preapproval of exchange rules until exchange governance structures

assured "appropriate representation of all market participants." Judging from the examples provided in the FIA's letter, it appears that the FIA, in arguing for this type of quid pro quo, is speaking on behalf of certain FIA members, principally the large FCMs. These firms apparently believe that they could better protect their own economic interests by having even greater influence in the business decisions made by domestic exchanges, who are also FIA members.

However, beyond contending, in effect, that greater FCM representation on exchange governing boards would benefit the self-interest of FCMs, the FIA fails to show why greater assertion of such economic self-interest by FCMs would further any of the statutory purposes of the Act. Absent such evidence, the FIA's own letter provides inadequate support for the suggestion that, as a matter of CFTC regulatory policy, the Commission should adopt the FIA's linkage, which is implicitly proposed in the FIA's letter, and defer limiting Commission preapproval of exchange rules until FCMs have additional seats on exchange governing boards.

Second, with respect to trading rules and procedures that are permissible for a foreign exchange that has been allowed to place computer terminals in the U.S., we believe, with all due respect, that the FIA has misstated the issue. The FIA opines that the Commission should not "defer to the judgment of other jurisdictions simply for the purpose of achieving regulatory parity." This is not the case. Under current procedures, Commission staff will not issue a no-action letter to a foreign exchange until they have reviewed in some detail both the foreign exchange and the regulatory regime of its host country. In particular, CFTC staff will only issue a no-action letter when they have made a determination that such no-action relief "would not be contrary to the public interest." Based upon the information reviewed by Commission staff, in making this finding, Commission staff also have tacitly determined that a foreign regulatory regime offers acceptable protections for U.S. customers and for market integrity.

Of course, the Commission is not bound by staff's determination that a particular foreign regulatory scheme provides acceptable protections for U.S. customers and for the integrity of markets here. If the Commission were to disagree with its staff, it would be free to substitute its own judgment. In this regard, it is worth noting that the FIA, in its comment letter, neither challenges any of the no-action letters issued to date to foreign exchanges nor calls for Commission reconsideration of any of these letters.

In sum, in the Petition, the Exchanges are seeking flexibility from the CFTC for a specific factual context. First, as noted, pursuant to the no-action procedures that have been utilized to date, no-action relief is provided to the affected foreign exchanges only after Commission staff (or potentially the Commission), in issuing such no-action relief to a foreign exchange, determined that such relief "would not be contrary to the public interest" and thereby also determined that the applicable foreign regulatory scheme

provided acceptable protections for U.S. customers and for market integrity, including with respect to trading rules and procedures not currently permissible for domestic exchanges. Second, in the wake of such grants of no-action relief, the Exchanges are seeking flexibility to consider implementing the same trading rules and procedures only for those products that they offer that compete directly with a foreign exchange's products as specified in the applicable no-action letter.

The FIA chose not to address the issue of consistency in CFTC regulatory treatment in its comment letter. However, the fact remains that, in this specific context, there is no public policy rationale that can justifiably support treating domestic futures exchanges in an manner inconsistent with the regulatory treatment that has already been accorded to foreign exchanges and that has resulted in the present disproportionate and anti-competitive regulatory burden on U.S. futures exchanges.

V. Conclusion

The recent activity by Commission staff to provide no-action relief to numerous foreign futures exchanges has placed the Exchanges at a severe competitive disadvantage. As detailed in the Petition, the Exchanges urgently need the regulatory relief for which they petition in order to compete on a fair and equal basis with the foreign boards of trade that have been granted or that soon will be allowed to offer electronic access to their markets to persons in the U.S. In particular, the Exchanges seek relief in the following three areas:

1. Exchanges should be able to list new futures and options contracts without pre-approval by the Commission;

2. Exchanges generally should be able to adopt new rules and rule changes after submitting them to the Commission ten days prior to their taking effect; and

3. Exchanges should be allowed to implement trading rules and procedures comparable to those of a competing foreign board of trade, provided that the rules and procedures are limited to only the contracts that are in direct competition to those of the foreign board of trade.

* * * *

NYMEX thanks the Commission for the opportunity to submit comments concerning the Petition 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,

Pat Thompson / by [signature]

R. Patrick Thompson
President

cc: Chairman William J. Rainer
Commissioner Thomas J. Erickson
Commissioner Barbara P. Holum
Commissioner James E. Newsome
Commissioner David D. Spears