



New York  
Mercantile Exchange

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COMMENT

April 16, 2002

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FEDERAL RESERVE BANK  
SECRETARIAT

**VIA FACSIMILE AND EXPRESS MAIL**

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

**Re: Request of the New York Mercantile Exchange, Inc. for Approval of Proposed NYMEX Rule 6.21D for Exchange of Futures for Futures 67 Fed. Reg. 11286 (March 13, 2002)**

Dear Ms. Webb:

Previously, by letter dated April 12, 2002, the New York Mercantile Exchange, Inc. ("NYMEX" or the "Exchange") submitted comments on the above-referenced Federal Register release. The Exchange has determined to submit a few additional comments, on its own behalf and on behalf of its wholly-owned subsidiary, Commodity Exchange, Inc. ("COMEX"), to the Commodity Futures Trading Commission ("CFTC" or "Commission") on our request for Commission approval of proposed NYMEX Rule 6.21D. The proposed new rule would permit the exchange of futures for futures ("EFF") transactions in the Exchange's NYMEX Brent Crude Oil ("Brent") futures contract.

This letter is intended to provide follow-up responses to a comment letter submitted by the International Petroleum Exchange ("IPE"). Regrettably, the IPE appears to be laboring under a number of misapprehensions, and the Exchange hopes this response letter will be useful in setting the record straight.

In this connection, the IPE indicated in its comment letter that it was not seeking to raise concerns about the EFF procedure on competitive grounds. In fact, though, there can be no dispute that the IPE does indeed have a competitive stake in the regulation of this innovative new procedure. Accordingly, NYMEX respectfully suggests that the IPE's comments should be read in light of its protectionist effort.

The first point to be made in responding to the IPE letter is that NYMEX specifically drafted its EFF rule proposal so as not to require that the two parties to the underlying transaction on the other futures exchange, i.e., the IPE, be the same parties to the transaction on the NYMEX. The rationale for doing so clearly is to avoid compelling the parties to the

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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, palladium, and the FTSE Eurotop 300® index. The COMEX Division offers trading in gold, silver, copper, aluminum, and the FTSE Eurotop 100® index.*

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NYMEX transaction to attempt to execute a liquidating transaction on the IPE with each other via a cross-trade. Consequently, an IPE customer may simply have its existing open position in Brent liquidated by competitive execution given that there is no special benefit in any respect to any party to undertaking the liquidating transaction via a cross-trade with its ultimate party on the NYMEX leg of the exchange.

The IPE hints that somehow the parties to the NYMEX transaction will coordinate price and quantity, but does not specify how this would occur. The reality is that, in lieu of the two-hour timeframe that is built into the rule, these details for the NYMEX leg of the exchange can be coordinated just as easily after both sides have separately liquidated some share of their open positions on the IPE. This outcome makes it unnecessary for the Exchange to opine on the relative frequency and ease with which cross-trades occur on the IPE.

It is worth noting that market participants already have the capability under current regulation to shift open positions from one market to another via non-competitive transactions. Specifically, as detailed in NYMEX's April 12 comment letter, market participants could effectively accomplish the same result as an EFF transaction by executing two back-to-back EFS transactions. The current availability of the noncompetitive EFS mechanism thus substantially undercuts the IPE's arguments relating to the alleged impact on its markets of implementing the noncompetitive EFF procedure.

Our proposed rule would provide that the liquidating transaction must be executed in accordance with the procedures of the other futures exchange. As a general matter, we believe that the most prudent stance for NYMEX to adopt is to give due deference to the capability of the other exchange in monitoring compliance with its own rules. Thus, in the case of the IPE, we defer to the IPE's expertise in ensuring that transactions executed on its exchange are done in a lawful manner.

The IPE also questions the suggestion that our EFF rule proposal is analogous in certain respects to block trading rules approved by the Commission and in effect at several U.S. futures exchanges. NYMEX made this analogy for the limited purpose of making clear that the EFF procedure is a hybrid of sorts in that it includes certain restrictions and conditions applicable to block trading transactions as well as certain restrictions and conditions applicable to EFF transactions. Thus, for example, with respect to block trading, the Exchange was seeking to emphasize that its proposed new rule contains several provisions, namely a limitation to eligible participants and specification of a minimum transaction size, that are also found in block trading rules.

The IPE then suggests that "that NYMEX should ensure that its members and customers are aware of the rules of the other exchange." In addition, the IPE further suggests that the resultant changes in the regulatory and legal protections associated with the EFF be disclosed to the end-users. The Exchange notes that by its terms, the proposed new rule would be limited to "eligible contract participants" and this statutory term is generally deemed to include sophisticated market participants. Therefore, NYMEX believes that a detailed disclosure of regulatory protections to such sophisticated market-users, particularly in light of such users' experiences with trading on the IPE, would be unnecessary. However, following Commission approval of the proposed rule, the Exchange would include in its notice to members a suggestion that interested participants should consult the rules of the other exchange with regard to procedures for liquidating transactions.

With regard to transaction size, NYMEX has specified in its rule a minimum transaction size of 50 NYMEX contracts. The IPE letter declines to provide any solid data regarding current transaction sizes at that exchange, and instead only includes general references to an IPE rule that has yet to be implemented.

The Exchange continues to stand by the statement included in our submission that Exchange staff understand that a transaction size of 50 lots would constitute a significant transaction in trading at other exchanges as well as in related cash markets. Also, as noted in our April 12 comment letter, 50 lots translate to 50,000 barrels of oil. By comparison, the current margin requirement at NYMEX for a 50 contract Light Sweet Crude Oil position would be \$135,000 (@\$2,700/k), an amount indicating a substantial and sophisticated market participant. In other words, a minimum 50-contract transaction size for EFF clearly would be restrictive to the upper threshold of trade size and indicative of only large, sophisticated customers.

The IPE letter goes on to question the proposed rule provisions concerning the reporting of the individually negotiated, non-competitive EFF transactions. The Exchange tailored these provisions to be consistent generally with longstanding Exchange rules for EFP transactions, which are also individually negotiated, non-competitive transactions. This treatment is appropriate in light of the regulatory posture of such transactions as exceptions to the general requirement for competitive execution.

The IPE letter next focuses upon the prices to be reported on the NYMEX. In response, the Exchange notes that some block trading rules expressly provide that the price of a block trade must be fair and reasonable in light of certain specified criteria, such as the block size, the size and price of other trades executed on that exchange and the size and price of trades in other markets. By comparison, proposed new Rule 6.21D is similar to the Exchange's EFP rules and EFP rules at a good number of other U.S. futures exchanges that do not contain this express language. However, Exchange staff routinely monitors the fairness and reasonableness of prices of EFP transactions as part of the more general assessment that such transactions are *bona fide*, and, as stated in the NYMEX rule submission, Exchange staff represents that it would undertake similar monitoring for transactions executed pursuant to Rule 6.21D.

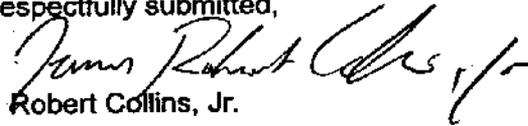
Finally, the IPE asserts in its letter that "[t]o the extent that the NYMEX proposal permits the establishment of positions on the NYMEX by EFF, it must also permit a liquidation of those positions by EFF." We want to set the record straight on this point. We are being straightforward in acknowledging that our interest is in attracting open interest. However, we also have no interest in attempting to block other exchanges from seeking to implement EFF procedures in connection with products traded on our exchange. We are not in a position to make our rule truly work in both directions, because doing so would appear to require a rule change at the IPE. However, for the record, we would be flattered if that venerable institution would be inspired by our example to imitate our pioneering efforts in this area.

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NYMEX thanks the Commission for the opportunity to submit these additional comments

concerning the Exchange's rule proposal 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,



J. Robert Collins, Jr.  
President

cc: Chairman James E. Newsome  
Commissioner Thomas J. Erickson  
Commissioner Barbara P. Holum