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COMMENT

February 24, 2000

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

**Received CFTC
Records Section**

Re: Proposed Revision of the Commission's Procedure for the Review of Contract Market Rules 64 FR 66428 (November 26, 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 Commodity Futures Trading Commission's ("CFTC" or the "Commission") proposed new Commission Regulation 1.41(z). This new rule would provide an alternative means for contract markets to file rule changes with the CFTC and generally would serve to exempt contract markets from Commission rule review requirements.¹

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

¹However, Regulation 1.41(z)(3) would expressly state that the submitting contract market would not be exempt from any provision of the Act or the Commission's regulations other than the rule review requirements of Section 5a(a)(12) of the Act and related Commission regulations. Therefore, for example, contract markets implementing rules pursuant to Regulation 1.41(z) would continue to be subject to the rule enforcement obligations of Section 5a(a)(8) of the Act.

metals products.

The comment period for the Commission's proposed new Regulation 1.41(z) has overlapped with two other significant regulatory developments, namely the promulgation of final rules for new Regulation 5.3 and, more recently, the issuance of a CFTC staff report to the CFTC's respective oversight committees in Congress entitled "A New Regulatory Framework." Each of these three initiatives either involves or ultimately would involve the Commission's exercise of its exemptive authority under Section 4(c) of the Commodity Exchange Act ("Act").² Therefore, while noting that each of these three regulatory initiatives is at a different stage of development, NYMEX believes that it is appropriate to provide comments on proposed new Regulation 1.41(z) in relation to and in the context of these other developments.

In general, NYMEX commends the Commission and Commission staff for their willingness to modernize and streamline the regulations applicable to regulated futures exchanges, including in particular the regulatory procedures that govern contract market rules and contracts listed for trading. Shortly following the enactment of the Futures Trading Practices Act of 1992 ("1992 Act"), the CFTC used its new exemptive authority under Section 4(c) to promulgate Part 35. Over the years, NYMEX has consistently stated its view that the promulgation of Part 35 was a reasonable exercise of the Commission's Section 4(c) authority.

In granting exemptive authority to the CFTC under Section 4(c), the Conferees stated: "[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."³ NYMEX strongly believes that modernization of the CFTC's regulatory structure as it pertains to futures exchanges is urgently needed, and the Exchange commends the CFTC for taking steps at this time to address this need.

Turning first to the most recent development, the staff report issued earlier this week has the potential to provide truly significant market reforms. While much depends on how a number of key terms and principles are defined subsequently, NYMEX staff have been heartened by the degree of change reflected in the scope of the suggested

²A CFTC press release issued contemporaneously with the staff report advised that the framework considered in that report was a "work in progress" and that this staff report would be used as the basis for a subsequent notice-and-comment rulemaking.

³House Conference Report No. 102-978 to H.R. 707, p. 78.

regulatory framework and by the willingness of CFTC staff to listen to the concerns of the Exchange. NYMEX looks forward to working with the Commission and Commission staff to enhance and to build upon this possible regulatory framework.

New Regulation 5.3, which became effective on January 25, 2000, generally permits exchanges that are designated in at least one non-dormant contract market to file the terms and conditions for a newly listed contract with the Commission and to make those terms effective on the next business day. Futures exchanges have long argued for the capability to respond to changing markets and new competitors by listing new contracts (and amendments to contracts) without the delay of a potentially lengthy CFTC approval process. Rule 5.3 constitutes the CFTC's effort to address this need directly within the existing regulatory framework for designated contract markets.

NYMEX sincerely appreciates this effort. Yet, two aspects of Rule 5.3, which also pertain to proposed Regulation 1.41(z), considerably restrict the attractiveness of the Rule 5.3 filing procedure. First, Rule 5.3 requires that an exchange must include in its filing to the Commission a certification that the rule amendment "neither violates nor is inconsistent with any provision of the Commodity Exchange Act or of the rules thereunder." Second, the alternative filing procedure under Rule 5.3 may only be used for amendments to contract terms and conditions in trading months having no open interest at the time of implementation. (The Federal Register release for proposed new Rule 1.41(z) sought comment on this requirement.) The problems related to these two requirements are discussed below.

I. Appropriate Standards

A. Certification Standard

The certification requirement presents two separate problems, both of which concern the "inconsistent with" prong of the certification to be made by an exchange. First, this language reasonably might be viewed as providing for the exercise of judgment or interpretation as to various regulatory provisions. Clearly, it is possible for reasonable persons, even within the Commission, to reach different conclusions in interpreting CFTC rule provisions. The second problem with the self-certification standard contained in Rule 5.3 and in proposed Rule 1.41(z) is that a number of novel or innovative rule changes, such as those pertaining to trading mechanisms, clearly would conflict with existing Commission regulations, such as the example provided in the Federal Register release under which Commission approval would be required pursuant to Regulation 1.38 for a block trading proposal.

The first certification problem noted above can be addressed by revising slightly the certification standard and thus clarifying the scope of the certification being made. The second problem, which would remain for certain types of rule proposals, highlights

the need for the more comprehensive reform contained in the CFTC staff report.

With regard to the problem of interpretation, the Federal Register release for proposed new Regulation 1.41(z) itself raises an issue as to how the Commission might interpret this term. In the release, the Commission indicated that the “neither violates nor is inconsistent with” formulation was the standard used by the Commission in determining whether to disapprove a rule, and referred to an interpretation on rule disapprovals issued by the Commission in 1980. Standard to be Applied by the Commission in Disapproving Contract Market Rules. 45 FR 34873 (May 23, 1980) (hereafter the “1980 Interpretation”). In a footnote in the 1980 Interpretation, the Commission construed the term “violation” in then Section 5a(12) of the Act to embrace rules which are in conflict or inconsistent with or contrary to the Act or the regulations of the Commission.

However, the 1980 Interpretation also engaged in a broad discussion of CFTC disapproval authority in what is now referenced as Section 5a(a)(12)(A) of the Act.⁴ In particular, in the text of the 1980 Interpretation, the Commission expressed its view that its statutory authority to disapprove rules extended to contract market rules “which conflict or are inconsistent with any of the policies, purposes and public interest considerations embodied in the Act and the Commission’s regulations.” (emphasis added).

By citing this 1980 Interpretation without qualification, the Federal Register release raises an issue as to whether an exchange’s self-certification under either Rule 5.3 or under proposed new Rule 1.41(z) might give rise to a subsequent disapproval proceeding because of a difference of views as to the application of certain Commission policies. Given the stakes involved in a disapproval proceeding,⁵ and the

⁴For example, the Commission indicated in the 1980 Interpretation that, in considering whether to disapprove a rule, contract market rules could be weighed against a number of policies that were deemed to underlie or that could be viewed as being extrapolated from the Act. Thus, contract rule proposals would be reviewed against the policies underlying Section 15 of the Act. The Commission also cited legislative history in asserting that contract market rule proposals were subject to a general “economic purpose test.” Moreover, rule proposals further would be subject to an even more general assessment as to whether such proposals would be “contrary to the public interest.”

⁵Exchanges, like other businesses, are subject to reputational risk. If an exchange submitted a filing that included a self-certification under the proposed standard in Regulation 1.41(z), that exchange would be putting itself at risk that a disapproval proceeding might subsequently be initiated by the Commission. Even if

difficulty of assessing how a differently constituted Commission might subsequently view a particular rule, this approach could mean that there might be relatively fewer instances when an exchange would determine to use the Regulation 5.3 or 1.41(z) filing procedures.

As to revising the standard, NYMEX suggests an alternative formulation that it believes can avoid these results and still accomplish the objectives sought by the Commission in proposing this new procedure. The Act itself provides guidance on a more appropriate standard to be used in exchange self-certifications submitted pursuant to proposed Regulation 1.41(z). Specifically, at the conclusion of a disapproval proceeding, Section 5a(a)(12)(A) requires the Commission, in disapproving a contract market rule under review, to cite the specific sections of the Act or the Commission regulations that would be violated.

Accordingly, NYMEX suggests that the Commission, in adopting a final version of Regulation 1.41(z), revise Regulation 1.41(z)(iii)(D) (and make conforming amendments to Rule 5.3) to provide that "[a] certification by the contract market that the rule does not conflict with any specific provision of the Act or regulations thereunder." This approach would clarify that exchanges, in conducting due diligence to make such a certification, could engage principally in a textual analysis of the Act and the CFTC regulations. This approach also would be consistent with the approach taken in the statutory language in Section 5a(a)(12)(A) and could increase the willingness of exchanges to make such a certification. Thus, this revision would fulfill the Commission's announced intent in the Federal Register release that proposed Regulation 1.41(z), in the words of Section 4(c) of the Act, should "promote responsible economic or financial innovation."

As a possible alternative approach, the Commission may wish to use its exemptive authority to permit contract markets to proceed forward with a Rule 5.3 or Rule 1.41(z) filing, even though a rule may be viewed as conflicting with a CFTC rule provision, if the Commission has previously formally approved a rule proposal that is in substance the same as the proposal to be filed. Thus, for example, if the Commission previously had formally approved a block trading proposal submitted by another

market participants were provided legal certainty that particular transactions executed while the challenged rule was in effect would not be voided, the consequences, to the reputation of an exchange, of the mere initiation of a disapproval proceeding could be substantial. Such a proceeding could create considerable uncertainty about the operation of other rules, which might be difficult for market participants to assess and to quantify. Thus, such a proceeding could harm the business reputation of the exchange by calling into issue the general reliability of that exchange as a place for doing business.

exchange, an exchange that sought to implement essentially the same block trading rule should be able to file the rule with the Commission pursuant to Rule 1.41(z) in reliance upon the prior Commission action.

B. Open Interest Restriction

It is the Exchange's understanding that in seeking comment on the appropriateness of this restriction for the Rule 1.41(z) process, the Commission is also signaling its willingness to revisit this restriction for the Rule 5.3 filing process. The Exchange believes strongly that these restrictions are not necessary and unduly restrict the flexibility intended to be provided by these procedures.

Clearly, any actively traded contract will have some level of open interest. However, the Exchange believes that this restriction is not necessary for two reasons. First, the great majority of rule changes, even rule changes pertaining to the terms and conditions of a contract with open interest, will have no material impact on the economic value of open positions in such contracts. Second, with regard to the handful of necessary rule changes whose implementation may affect a contract's value, exchanges take great care in implementing such changes so as to minimize their market impact.

Because of the reputational risk to exchanges noted above associated with decisions that affect their markets, NYMEX believes that exchanges should be permitted to use their business judgment in making filings under the Rule 5.3 and Rule 1.41(z) procedures. The Exchange also believes that these procedures should be available for all types of rules, including rules that might be viewed as affecting the pricing of contracts. Accordingly, NYMEX recommends that the Commission refrain from including this requirement in Rule 1.41(z) and delete it from Rule 5.3.

II. Other Comments

A. Eligibility for the Procedure: Previous Designation as a Contract Market

Consistent with Regulation 5.3, the Commission is proposing to make the Regulation 1.41(z) process available solely to contract markets which are designated in at least one non-dormant contract. NYMEX supports this provision.

B. Legal Certainty

In the Federal Register release, the CFTC announced its interest in ensuring legal certainty for transactions effected subject to rules implemented pursuant to Regulation 1.41(z). Therefore, consistent with a similar provision in new Regulation

5.3, the Commission's proposal would provide that transactions executed subject to rules that were implemented under Regulation 1.41(z) would not be void or voidable in the event the Commission initiates a proceeding to disapprove a contract market rule or requires the contract market to revise the rule. NYMEX also supports this provision.

C. Exclusivity of Regulation 1.41(z) Process

In the Federal Register release, the Commission noted that it was proposing the Regulation 1.41(z) procedure as an alternative to the existing Regulation 1.41 process.⁶ To avoid possible confusion as to the regulatory history of a rule, the Commission requested comment on whether it should preserve the current approval process for rules that would qualify for the Regulation 1.41(z) process or whether the proposed Regulation 1.41(z) process should be the only process available. The Commission also sought comment on whether the Regulation 5.3 procedure should be "the sole means of listing new contracts and of amending their terms and conditions."

First, in order to provide exchanges with the greatest possible flexibility, NYMEX supports the CFTC's proposed approach of offering the Regulation 1.41(z) procedure as an alternative to the other provisions of Regulation 1.41. Similarly, the Exchange believes that exchanges should be free to determine whether to file terms and conditions for contracts pursuant to Regulation 5.3 or pursuant to the standard contract market designation application process.

With regard to the issue of possible confusion by market participants as to the various procedures, the Chicago Mercantile Exchange's ("CME") comment letter on the current proposal noted that the CME had never received a request from a market participant requesting to identify the procedure by which an exchange rule became effective. NYMEX has had the same experience. Exchange staff cannot recall any instance in recent memory in which such a request was made to the Exchange by a market participant. Thus, maintenance by the CFTC of several alternative filing procedures for exchange contracts and rules would not appear to create problems for market participants.

However, one area where further clarity may be helpful concerns the interplay between Rule 5.3 and proposed new Rule 1.41(z) as those rules relate to amendments to the terms and conditions of a contract. Specifically, as previously noted, the Commission intends to offer Rule 1.41(z) as an alternative, among other things, to Regulation 1.41(b), which concerns contract terms and conditions. Yet, Rule 5.3 also

⁶Thus, as noted in the release, contract markets could still submit a rule pursuant to Regulation 1.41(b) or 1.41(c), even if that rule qualified for the Regulation 1.41(z) process.

offers a separate procedure under which amendments to contract terms and conditions could be filed. Moreover, Rule 5.3 requires exchanges to identify a "contract in its rules as listed for trading pursuant to exchange certification." It is not clear whether this requirement would apply only to the contract itself or to each individual term and condition submitted as part of a Rule 5.3 filing. If the latter approach is intended, this could lead to confusion as to the status of individual rules. As noted in the CME's comment letter, certain rule changes might be submitted under Rule 5.3, while others might be submitted pursuant to the Commission's more established rule filing procedures.

NYMEX suggests that the Commission consider clarifying that Rule 5.3 is applicable to the initial filing of terms and conditions for a new contract, and that Rule 1.41 is applicable to subsequent amendments to terms and conditions. The Exchange further suggests that the CFTC also should clarify that the requirement in Rule 5.3 (to identify a contract as listing for trading pursuant to exchange certification) applies only to the contract itself and not to the individual rules comprising the terms and conditions for that contract. Thus, for example, an exchange could comply in its rulebook with this requirement by making this declaration once in that chapter, such as a declaration placed below the chapter number in the rules for a particular contract.

D. Suspension of Effectiveness of a Rule

The Commission also requested comment on whether it should reserve the authority, under Regulation 1.41(z), to stay or to suspend the operation of an exchange rule once it has initiated a proceeding under Sections 5a(a)(10), 5a(a)(12), 8a(7) or 8a(9) of the Act. The Exchange believes that staying or suspending the operation of an exchange rule should be viewed as an extraordinary regulatory action that could further heighten the uncertainty of participants trading in a particular market. Therefore, NYMEX believes that such an action should be taken following the initiation of a rule disapproval proceeding only in rare circumstances; the Commission's exercise of its authority under Section 8a(9) of the Act to address a market emergency would appear to be the best instance of a situation where such an action may be warranted.

E. Emergency Rules

The Commission noted in the Federal Register release that proposed Regulation 1.41(z) may obviate the need for a contract market, when adopting emergency rules, to follow the procedures for adoption of emergency rules provided in Section 5a(a)(12)(B) of the Act and its implementing regulatory provision, Regulation 1.41(f). Therefore, the Commission requested comment on how to differentiate an emergency rule provision from any other rule that could be adopted pursuant to proposed Regulation 1.41(z).

There is not a great need for the Commission to differentiate an emergency rule

provision from rules adopted pursuant to proposed Regulation 1.41(z). In a true market emergency, it may be necessary to make an immediate change in an existing exchange rule. Exchanges are permitted to make immediate rule changes when acting in an emergency capacity; by comparison, under proposed new Regulation 1.41(z), a rule change could not be made effective until the following business day. NYMEX believes that, even assuming arguendo that there might be some incentive for an exchange to try to make a rule filing under Regulation 1.41(z) rather than as an emergency rule measure, other business factors would countervail any such incentive and would result in an exchange declaring an emergency. Thus, on a factual level, the existence of the Regulation 1.41(z) filing procedure generally should not be expected to provide exchanges with an alternative to declaring a market emergency and making appropriate emergency rule changes when it is necessary for them to do so.

F. New Electronic Trading Systems

The Commission also requested comment on whether proposed rules implementing a new electronic trading system at an existing contract market could be processed under Regulation 1.41(z). NYMEX believes that it may be appropriate for the Commission's initial review of a new electronic trading system to be conducted pursuant to existing rule review procedures in order to provide the Commission with an opportunity to assess the new system in light of Commission policy, such as the IOSCO Principles for Screen-Based Trading Systems, which were adopted by the Commission as CFTC policy in 1990. However, once the Commission has completed its initial review of a new trading system, NYMEX believes that all subsequent changes to the trading system involving rule changes, even with respect to substantial modifications or enhancements to the system, should be eligible for filing under the Regulation 1.41(z) procedure.

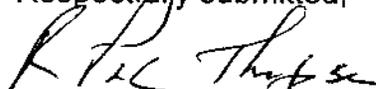
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NYMEX thanks the Commission for the opportunity to submit comments concerning its proposal and would be pleased to furnish additional information in this

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

Respectfully submitted,

A handwritten signature in black ink, appearing to read "R. Patrick Thompson". The signature is written in a cursive style with a large initial "R".

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