



New York
Mercantile Exchange

NYMEX/COMEX. Two divisions, one marketplace

October 5, 2004

Sharon Brown-Hruska
Acting Chairman
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Re: New Chicago Board of Trade Metals Futures Contracts

Dear Ms. Brown-Hruska:

The New York Mercantile Exchange, Inc. (“NYMEX” or the “Exchange”) is submitting this letter on its own behalf and on behalf of its wholly-owned subsidiary, the Commodity Exchange, Inc. (“COMEX”). The purpose of this letter is to identify certain possible regulatory issues and concerns to the Commodity Futures Trading Commission (“CFTC” or “Commission”).

As you know, on or about October 6, 2004, the Chicago Board of Trade (“CBOT”) intends to list for trading two new metals futures contracts: a 100 ounce gold futures contract (“CBOT Gold”); and a 5,000 ounce silver futures contract (“CBOT Silver”). The product specifications for both contracts mirror those of established contracts listed for trading on COMEX, and so it is clear that the CBOT further intends for both of the new contracts to compete head-on with our product slate. We welcome the competition, and we believe that the robust liquidity of our open outcry markets will ultimately prevail.

We know that you have a strong interest in “protecting and promoting free and competitive markets” and we share in that policy goal. You recently expressed your frustration with those who would seek to tie the Commission’s deliberations “up in knots through decoy issues,” and we have no interest in doing so.

That stated, it is also fair to note that problems in one market can often have spill-over effects that harm other markets. Accordingly, we wish to highlight two issues that are clearly problematic relating to the CBOT’s pending roll-out of the new products. The CBOT is apparently waiting until the last possible period permissible under the Commodity Exchange Act to make its regulatory filings with the Commission, and so the first issue is based in part upon information that CBOT staff has apparently disclosed through various marketing presentations. As we understand it, notwithstanding the fact that the electronic trading session for both new CBOT contracts will continue until 4:00

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The New York Mercantile Exchange, Inc., 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, aluminum, and the FTSE Eurotop 100[®] index, and the FTSE Eurotop 300[®] index.

p.m. (Central Time), the time frame for the new CBOT contracts that apparently will be used for settlement purposes will occur between 12:29 –12:30 p.m. (Central Time).

Perhaps it is simply a mere coincidence that these settlement periods exactly parallel the closing range periods of the established COMEX futures contracts, which are used for settlement purposes on COMEX. For purposes of this letter, we are willing to reserve comment at this time on the possibility that this approach is a ploy by the CBOT to “free-ride” on our settlement prices. Turning to market participation, though, traders in these new CBOT markets will basically know three and one-half hours before the close what the settlement price for that day’s session will be.

We believe that this approach raises a number of serious and troubling regulatory issues. This approach is flatly inconsistent with and indeed directly antithetical to the core price discovery purpose and function of centralized futures auction markets. Moreover, it may lead to serious trade practice abuses, both at the CBOT and, potentially at COMEX (since the timing of the CBOT settlements would appear to suggest that they are essentially intended to be mirrors of the COMEX settlements) as traders and customers aim to mold the settlement to take advantage of predetermined margin rates for positions yet to be traded on the CBOT. It is fair to ask whether this market vulnerability would be tolerated by the CBOT if their market was a truly independent market.

Equally of concern is the CBOT’s willingness to mark open positions daily to market on the basis of a mid-day snapshot of market information. We question the rationale for using this mid-day period for settling the market because of the significant likelihood that the markets may move away from those mid-day levels during the final three and one-half hours of trading for that day’s trading session. This procedure also appears to be inconsistent with settlement procedures otherwise in place at the CBOT for its other listed futures contracts. We therefore question why the new CBOT Gold and CBOT Silver contracts are being singled out for these aberrational settlement procedures.

Additionally, we believe that the CBOT’s intended settlement process is inconsistent with Designation Criterion 5 and Core Principle 11 for designated contract markets, which both concern the financial integrity of transactions and the need for appropriate clearance and settlement procedures for trading activity on the regulated market. (As a note, this settlement approach also presumably also calls into question the ability of the Chicago Mercantile Exchange to comply with Core Principle D (Risk Management) and Core Principle E (Settlement Procedures) when acting in the role of a derivatives clearing organization in processing these transactions.) We believe that the Commission should carefully consider whether allowing such procedures to remain in effect is consistent with the Commission’s historical role of ensuring the financial integrity of transactions executed on regulated markets.

There is also the matter of the CBOT’s intended delivery procedures. Our comments are based upon amendments recently submitted to the Commission for the

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CBOT's e-mini contracts, which apparently will be extended to the full-size contracts as well. Rather than relying upon warehouse depository receipts issued by the warehouses themselves (to serve as the certificate of title for the applicable metal), it appears that the CBOT instead will be stepping forward to issue its own warehouse receipts. As best as we can determine, this would be the first time that a futures exchange has issued its own warehouse receipts rather than following the usual business practice of accepting and approving applications from warehouses meeting the standards set to be an approved warehouse for that exchange. Will the CBOT itself take physical custody and control of the metal on deposit that is subject to its warehouse receipts? If not, the CFTC may wish to consider the appropriateness of allowing the CBOT to release its warehouse receipts into metals markets absent such custody and control.

We hope that the information and analysis included in this letter will be of some help to Commission staff in conducting their due diligence reviews of the CBOT's activities. If you have any questions, please do not hesitate to contact the undersigned.

Respectfully submitted,



Christopher K. Bowen
General Counsel and
Chief Administrative Officer

cc: Commissioner Walter Lukken