

NEW YORK MERCANTILE EXCHANGE, INC.

OVERVIEW OF FINANCIAL SAFEGUARD SYSTEM

MAY 2002

NYMEX SAFEGUARD SYSTEM HIGHLIGHTS

- CLEARING MEMBER FINANCIAL REQUIREMENTS**
- CLEARING MEMBER GUARANTY FUND**
- APPROVED BANKS**
- CLEARING MEMBER MARGIN LEVELS**
- MARGIN REQUIREMENTS**
- EMERGENCY PROCEDURES**
- SEGREGATION OF CUSTOMER FUNDS**
- COMPLIANCE DEPARTMENT ENFORCEMENT OF RULES**
- JOINT AUDIT COMMITTEE**
- DAILY SURVEILLANCE PROCEDURES**

MINIMUM FINANCIAL REQUIREMENTS

CLEARING MEMBERS

---> \$5,000,000 of "WORKING CAPITAL"

CLEARING MEMBER (Registered as FCM)

GREATER OF:

- A) \$5,000,000 of "ADJUSTED NET CAPITAL"
- B) 4% of "SEGREGATION REQUIREMENTS"
- C) **COMBINED % OF MAINTENANCE MARGIN**
(8% customer + 4% non-customer)

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WORKING CAPITAL FORMULA:

CURRENT ASSETS (per "GAAP")

(-) CURRENT LIABILITIES (per "GAAP")

WORKING CAPITAL

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ADJUSTED NET CAPITAL FORMULA:

NET CURRENT ASSETS (per CFTC 1.17)

(-) TOTAL LIABILITIES (less Subordinated Loans)

NET CAPITAL

(-) CHARGES & HAIRCUTS

ADJUSTED NET CAPITAL

FINANCIAL STATEMENT PREPARATION and SUBMISSION

PREPARATION:

**MONTHLY BASIS → GENERAL LEDGER
TRIAL BALANCE
BALANCE SHEET & INCOME STATEMENT
CAPITAL COMPUTATION**

TIMELINESS → 17 BUSINESS DAYS AFTER MONTH-END

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SUBMISSION:

CLEARING MEMBERS

QUARTERLY BASIS → UNAUDITED

ANNUAL BASIS → CERTIFIED

CLEARING MEMBERS (Registered as FCM):

MONTHLY BASIS → CAPITAL COMPUTATION (to DSRO)

QUARTERLY BASIS → UNAUDITED FORM 1-FR

ANNUAL BASIS → CERTIFIED

NYMEX EMERGENCY PROCEDURES HIGHLIGHTS

(A) FAILURE BY A CLEARING MEMBER TO MEET ITS OBLIGATION ON THE PART OF ITS "HOUSE" ACCOUNT:

- > CUSTOMER POSITIONS AND MONIES ARE TRANSFERRED TO ANOTHER SOLVENT CLEARING MEMBER**
- > NYMEX WILL TAKE CONTROL OF AND/OR LIQUIDATE THE HOUSE POSITIONS**
- > APPLY THE FIRM'S HOUSE MARGINS ON DEPOSIT**
- > APPLY THE FIRM'S GUARANTY FUND**
- > APPLY ANY PARENT COMPANY GUARANTEE (IF APPLICABLE)**
- > APPLY ANY EXCESS CLEARING HOUSE OR EXCHANGE FUNDS AS DETERMINED BY THE BOARD OF DIRECTORS**
- > APPLY IN EQUAL SHARES THE MINIMUM GUARANTEE FUND DEPOSITS REQUIRED BY OTHER CLEARING MEMBERS**
- > APPLY REMAINING GUARANTY FUND**
- > APPLY ASSETS AS MADE AVAILABLE FROM ASSESSMENTS ISSUED AGAINST CLEARING MEMBERS**
- > APPLY THE VALUE OF NYMEX SEATS OWNED BY FIRM**

(B) FAILURE BY A CLEARING MEMBER TO MEET ITS OBLIGATION ON THE PART OF ITS "CUSTOMER" ACCOUNT:

- > ATTEMPT TO TRANSFER NON-INVOLVED CUSTOMER POSITIONS AND MONIES TO ANOTHER SOLVENT CLEARING MEMBER**
- > TAKE CONTROL OF AND/OR LIQUIDATE INVOLVED CUSTOMER AND PROPRIETARY POSITIONS**
- > APPLY BOTH CUSTOMER AND HOUSE MARGINS ON DEPOSIT**
- > REMAINING PROCEDURES ARE THE SAME AS ABOVE**

MAXIMUM ASSESSMENT: The Lesser of \$10,000,000 or 25% of Regulatory Capital

GUARANTY FUND CONTRIBUTIONS

NYMEX

WORKING CAPITAL

CONTRIBUTION

\$250,000 TO \$2,000,000 ----->	\$100,000
\$2,000,001 TO \$5,000,000 ----->	5% OF CAPITAL
\$5,000,001 TO \$10,000,000 ----->	7.5% OF CAPITAL
\$10,000,001 TO \$20,000,000 ----->	10% OF CAPITAL
\$20,000,001 AND OVER ----->	\$2,000,000

(Contributions may consist of any combination of the following:

Cash {U.S.Dollars}
U.S. Treasury obligations with a maturity date of TEN years or less

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COMEX

WORKING CAPITAL

CONTRIBUTION

\$500,000 TO \$20,000,000 ----->	10% OF CAPITAL (MIN. \$100,000)
\$20,000,001 AND OVER ----->	\$2,000,000

Contributions must consist of the following:

\$20,000 Cash {U.S.Dollars}
Balance U.S. Treasury obligations

CLEARING MEMBER POSITION LIMITS

**BASIS --> "NET" POSITIONS PER SPAN MARGIN SYSTEM
--> CLEARING MEMBER'S WORKING CAPITAL**

LIMITS --> CUSTOMER --> MARGIN NOT TO EXCEED 150% OF FIRM'S CAPITAL

--> HOUSE --> MARGIN NOT TO EXCEED 75% OF FIRM'S CAPITAL

--> COMBINED --> MARGIN NOT TO EXCEED 200% OF CAPITAL

IF LIMITS EXCEEDED --> FIRMS PAY "SUPERMARGIN" ON EXCESS

SUPERMARGIN --> DOUBLE THE NORMAL MARGIN RATE

SUPERMARGIN LIMITS:

--> CUSTOMER --> 200% OF FIRM'S CAPITAL

--> HOUSE --> 100% OF FIRM'S CAPITAL

--> COMBINED --> 250% OF FIRM'S CAPITAL

IF SUPERMARGIN LIMITS EXCEEDED --> LIQUIDATE OR "EX-PIT" EXCESS

BANKING INSTITUTION REQUIREMENTS

CAPITAL REQUIREMENTS → \$250,000,000

DEBT RATING REQUIREMENTS → A-1 (STANDARD & POORS)
P-1 (MOODY'S)

AVAILABILITY FOR PAYMENT → OFFICE WITHIN 5 MILES OF EXCHANGE

FINANCIAL STATEMENT SUBMISSION

SEMI-ANNUAL → UNAUDITED

ANNUAL → CERTIFIED

MAXIMUM ISSUANCE OF LETTERS OF CREDIT

LESSER OF: \$100 MILLION or 10% of CAPITAL

NOTE: Clearing Members may not deposit with the clearinghouse Letters of Credit issued by an affiliate bank.

MARGIN POLICY

RATES

- Set at levels sufficient to protect Exchange from the risk of financial loss caused by price volatility
- 99% of plausible price movements should be covered
- Based on one day move implied from the 1st at-the-money option
- Any margin rate changes are applied retroactively to all open positions

MARGIN CALLS

- Required to be issued by FCM for each deficient customer
- Timeframe for meeting outstanding margin calls:
 - 3 days (Members)
 - 5 days (Non-members)

JOINT AUDIT COMMITTEE

--> **CFTC Approved Regulatory Group**

--> **Participants** → Domestic Exchanges & NFA

--> **Main Purpose** --> **Monitor & Audit** financial activities of FCMs

--> **Allocate Audit Responsibility & F/S Review to One SRO**

--> **Attempt to Avoid Duplication**

--> **Protecting the Interests of the Members & Customers**

--> **Standardize Audit Function**

--> **Share Findings**

--> **Meet Quarterly to Update Audit Stnds & Discuss Issues effecting FCMs**

--> **Evolution** --> **Audit Group to Financial Surveillance/Risk Mgt. Emphasis.**

--> **Work Closely with the CFTC** (attend in advisory capacity)

--> **Become a Liaison between Industry & CFTC**

--> **Efficient & Effective**

--> **Constantly Look to Improve yet Streamline our Audits (Risk based)**

--> **Crisis Mgt. & Open Lines of Communication**

--> **Front Line of Information during Problem Situations**

--> **Mock Defaults Exercises**

--> **JAC Regulatory Updates**

SEGREGATION of CUSTOMER FUNDS

OVERVIEW

- 1. Significant Aspect of CFTC Regulation**
- 2. FCM must Segregate All Funds Deposited by Customers**
- 3. FCM has very Restricted Use of Customer Funds**
- 4. Prohibited from Knowingly Using the Funds of One Customer to Cover the Margin Obligation of Another**

HANDLING CUSTOMER FUNDS

- 1. Components of Regulated Customer Funds**
 - > All Properties Received from Customer to Margin Futures Activity***
 - > All Monies Accruing to Account (ie. Open Trade Equity)***
 - > Option Premiums***
 - > Realized P/L***
- 2. Separately Account for Each Customer's Portfolio (Equity Run)**
- 3. Physically Separate from House Funds**
- 4. Specifically Identified at Depositories**
- 5. Directly Deposit Funds received into Segregated bank account**
- 6. Obtain Acknowledgement Letters from each Depository**
- 7. Co-mingling Futures & Securities Customers prohibited**
- 8. Prepare Formal "Segregation Report" on a daily basis by NOON each day**

NOTE: In the event of a bankruptcy, any funds maintained in a segregated depository are frozen and are only available for distribution to the firm's futures customers. Segregated funds are not available to general creditors.

DAILY SURVEILLANCE PROCEDURES

1. **Review Net Settlement per Clearing Member**
 - NYMEX/COMEX
 - Aggregate all Domestic Clearing Houses
2. **Compare NYMEX/COMEX "Settlement Due" with Margin on Deposit**
3. **Compare Aggregate Clearing House "Settlement Due" with Capital**
 - Follow-Up for Large payments
 - DSRO Firms (>20% of Capital)
 - Other Clearing Members (>50% of Capital)
4. **Analyze Changes in Original Margin Requirements**
5. **Determine Exposure Thresholds**
 - Review Potential Loss Amounts (Limit Moves)
 - Compare to Capital
6. **Review Settlement Price Change per Contract**
 - Obtain Large Trader Reports
 - Expand Requests for FCM Margin Call Summaries
 - Request Segregation Reports
7. **Analyze FCM Margin Call Summaries**
 - Contact Firm & Floor Member for Material Amounts
8. **Analyze "Super Margin" Reports**
 - Contact Firms Regarding Disposition of Violations
9. **Review Intraday Margin Calls**
 - Contact Firm for Material Amounts
 - Request Equity Information for Specific Customers

MONTHLY SURVEILLANCE PROCEDURES

1. **Financial Statements Analysis**
2. **Guaranty Fund Analysis**
3. **Letter of Credit Analysis**
4. **Margin & Deficit Reviews (DSRO Firms)**
5. **Leasee/Licensee Review (DSRO Firms)**
6. **Primary Clearing Member ("PCM") Review (Qualifications & Guarantees)**
7. **Clearing Member Assessment Analysis**
8. **ACCESS Loss Limit Analysis**
9. **Cash Reconciliations (Customer & House Clearing Accounts)**