

COMMITTEE FOR THE IMPLEMENTATION OF TEXTILE AGREEMENTS

Adjustment of Import Limits for Certain Cotton, Wool and Man-Made Fiber Textile Products Produced or Manufactured in Cambodia

January 29, 2003.

AGENCY: Committee for the Implementation of Textile Agreements (CITA).

ACTION: Issuing a directive to the Commissioner of Customs adjusting limits.

EFFECTIVE DATE: February 4, 2003.

FOR FURTHER INFORMATION CONTACT: Naomi Freeman, International Trade Specialist, Office of Textiles and Apparel, U.S. Department of Commerce, (202) 482-4212. For information on the quota status of these limits, refer to the Quota Status Reports posted on the bulletin boards of each Customs port, call (202) 927-5850, or refer to the U.S. Customs website at <http://www.customs.gov>. For information on embargoes and quota re-openings, refer to the Office of Textiles and Apparel website at <http://www.otexa.ita.doc.gov>.

SUPPLEMENTARY INFORMATION:

Authority: Section 204 of the Agricultural Act of 1956, as amended (7 U.S.C. 1854); Executive Order 11651 of March 3, 1972, as amended.

The current limits for certain categories are being adjusted for swing, carryover, and carryforward.

A description of the textile and apparel categories in terms of HTS numbers is available in the CORRELATION: Textile and Apparel Categories with the Harmonized Tariff Schedule of the United States (see **Federal Register** notice 68 FR 1599, published on January 13, 2003). Also see 67 FR 72921, published on December 9, 2002.

James C. Leonard III,
Chairman, Committee for the Implementation of Textile Agreements.

Committee for the Implementation of Textile Agreements

January 29, 2003.

Commissioner of Customs,
Department of the Treasury, Washington, DC 20229.

Dear Commissioner: This directive amends, but does not cancel, the directive issued to you on December 4, 2002, by the Chairman, Committee for the Implementation of Textile Agreements. That directive concerns imports of certain cotton, wool and man-made fiber textile products, produced or manufactured in Cambodia and exported during the twelve-month period which began

on January 1, 2003 and extends through December 31, 2003.

Effective on February 4, 2003, you are directed to adjust the limits for the following categories, as provided for in the agreement between the Governments of the United States and Cambodia:

Category	Adjusted twelve-month limit ¹
331/631	547,912 dozen pairs.
334/634	253,253 dozen.
335/635	105,859 dozen.
338/339	4,187,637 dozen.
340/640	1,221,446 dozen.
345	113,967 dozen.
347/348/647/648	4,696,415 dozen.
352/652	939,283 dozen.
435	23,976 dozen.
438	115,194 dozen.
445/446	140,793 dozen.
638/639	1,465,735 dozen.
645/646	343,465 dozen.

¹ The limits have not been adjusted to account for any imports exported after December 31, 2002.

The Committee for the Implementation of Textile Agreements has determined that these actions fall within the foreign affairs exception of the rulemaking provisions of 5 U.S.C. 553(a)(1).

Sincerely,
James C. Leonard III,
Chairman, Committee for the Implementation of Textile Agreements.
[FR Doc. 03-2519 Filed 2-3-03; 8:45 a.m.]

BILLING CODE 3510-DR-S

COMMODITY FUTURES TRADING COMMISSION

In the Matter of the New York Mercantile Exchange, Inc. Petition for Interpretation Pursuant to Section 1a(12)(C) of the Commodity Exchange Act

AGENCY: Commodity Futures Trading Commission.

ACTION: Order.

SUMMARY: In response to a petition from the New York Mercantile Exchange, Inc. (NYMEX or Exchange) the Commodity Futures Trading Commission (Commission), pursuant to section 1a(12)(C) of the Commodity Exchange Act (Act), is issuing an order that deems, subject to certain conditions, Exchange floor brokers and floor traders who are registered with the Commission, when acting in a proprietary trading capacity, to be "eligible contract participants" as that term is defined in section 1a(12) of the Act. Accordingly, subject to certain conditions as set forth in the Commission's order, NYMEX floor brokers and floor traders (collectively referred to hereafter as floor members),

when acting for their own accounts, are permitted to enter into certain specified over-the-counter (OTC) transactions in exempt commodities pursuant to section 2(h)(1) of the Act. In order to participate, the floor member must have its OTC trades guaranteed by, and cleared at NYMEX by, an Exchange clearing member that is registered with the Commission as a futures commission merchant (FCM) and that meets certain minimum working capital requirements. The order is effective for a two-year period.

DATES: This order is effective February 4, 2003.

FOR FURTHER INFORMATION CONTACT:

Duane C. Andresen, Special Counsel, Division of Market Oversight, Commodity Futures Trading Commission, Three Lafayette Center, 1155 21st Street, NW., Washington, DC 20581. Telephone: 202-418-5492. E-mail: dandresen@cftc.gov.

SUPPLEMENTARY INFORMATION:

I. Statutory Background

Section 1a(12) of the Act, as amended by the Commodity Futures Modernization Act of 2000 (CFMA), Pub. L. 106-554, which was signed into law on December 21, 2000, defines the term "eligible contract participant" (ECP) by listing those entities and individuals considered to be ECPs.¹ Under sections 2(d)(1), 2(g), and 2(h)(1) of the Act, OTC transactions² entered

¹ Included generally in Section 1a(12) as ECPs are financial institutions; insurance companies and investment companies subject to regulation; commodity pools and employee benefit plans subject to regulation and asset requirements; other entities subject to asset requirements or whose obligations are guaranteed by an ECP that meets a net worth requirement; governmental entities; brokers, dealers, and futures commission merchants (FCM) subject to regulation and organized as other than natural persons or proprietorships; brokers, dealers, and FCMs subject to regulation and organized as natural persons or proprietorships subject to total asset requirements or whose obligations are guaranteed by an ECP that meets a net worth requirement; floor brokers or floor traders subject to regulation in connection with transactions that take place on or through the facilities of a registered entity or an exempt board of trade; individuals subject to total asset requirements; an investment adviser or commodity trading advisor acting as an investment manager or fiduciary for another ECP, and any other person that the Commission deems eligible in light of the financial or other qualifications of the person.

² OTC transactions are transactions that are not executed on a trading facility. As defined in Section 1a(33)(A) of the Act, the term "trading facility" generally means "a person or group of persons that constitutes, maintains, or provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions by accepting bids and offers made by other participants that are open to multiple participants in the facility or system."

into by ECPs in an "excluded commodity" or an "exempt commodity," as those terms are defined by the Act,³ are exempt from all but certain requirements of the Act.⁴ Floor brokers and floor traders are explicitly included in the ECP definition only to the extent that the floor broker or floor trader acts "in connection with any transaction that takes place on or through the facilities of a registered entity or an exempt board of trade, or any affiliate thereof, on which such person regularly trades."⁵

The Act, however, gives the Commission discretion to expand the ECP category as it deems appropriate. Specifically, section 1a(12)(C) provides that the list of entities defined as ECPs shall include "any other person that the Commission determines to be eligible in light of the financial or other qualifications of the person."

II. The NYMEX Petition

A. Introduction

By letter dated May 23, 2002, NYMEX submitted a petition for a Commission interpretation pursuant to section 1a(12)(C) of the Act.⁶ Specifically, NYMEX, acting on behalf of Exchange

floor members and member clearing firms, requested that the Commission make a determination pursuant to section 1a(12)(C) of the Act that floor members, when acting in a proprietary capacity, may enter into certain specified OTC transactions in exempt commodities pursuant to section 2(h)(1) of the Act if such Commission registrants have obtained a financial guarantee for such transactions from an Exchange clearing member that is registered with the Commission as an FCM.⁷ NYMEX suggested that the permissible OTC transactions be limited to trading in a commodity that either (1) is listed only for clearing at the Exchange,⁸ or (2) is listed for trading and clearing at the Exchange and where Exchange rules provide for the exchange of futures for swaps (EFS) in that contract.⁹ NYMEX further proposed that such transactions would be subject to additional conditions and restrictions detailed in the petition and described below.¹⁰

The NYMEX petition was published in the **Federal Register** for public comment on June 19, 2002.¹¹ The

Commission received comments from NYMEX and from the Intercontinental Exchange, an ECM. In its comment letter of July 17, 2002, NYMEX reaffirmed its strong interest in the determination requested in the petition and its strong belief that such a determination would have numerous pro-competitive results.¹²

B. Public Interest Considerations

In its petition, NYMEX stated that the requested determination is best considered against the overall context of the connection between the OTC and exchange markets, and that it is good public policy for the Commission to permit the strengthening of these ties when it is possible to do so. The petition stated that NYMEX has concluded that the ability of its floor members to trade OTC transactions pursuant to an FCM guarantee, particularly OTC swaps involving NYMEX or NYMEX "look-alike" products, is a pivotal component, for the four reasons described below, of the Exchange's business strategy to better serve its customers.

First, NYMEX stated that permitting its floor members to enter into OTC swaps would enhance their ability to provide liquidity to the Exchange's markets. Second, NYMEX stated that access to OTC markets would enhance floor members' ability to make tight markets in new Exchange products that would compete against the standardized look-alike contracts traded in the OTC markets.¹³ Third, NYMEX stated that permitting its floor members to enter into EFS transactions with OTC counterparties would expand the pool of potential counterparties for OTC market participants and facilitate liquidity in the OTC marketplace. Finally, with respect to the clearing of OTC transactions, the Exchange intends that the open positions in futures

³ Section 1a(14) defines the term "exempt commodity" to mean a commodity that is not an excluded commodity or an agricultural commodity. Section 1a(13) defines the term "excluded commodity" to mean, among other things, an interest rate, exchange rate, currency, credit risk or measure, debt instrument, measure of inflation, or other macroeconomic index or measure. Although the term "agricultural commodity" is not defined in the Act, Section 1a(4) enumerates a non-exclusive list of several agricultural-based commodities and products. The broadest types of commodities that fall into the exempt category are energy and metals products.

⁴ OTC transactions in excluded commodities entered into by ECPs pursuant to Section 2(d)(1) are generally not subject to any provision of the Act. OTC transactions in exempt or excluded commodities that are individually negotiated by ECPs pursuant to section 2(g) are generally not subject to any provision of the Act. OTC transactions in exempt commodities entered into by ECPs pursuant to section 2(h)(1) are generally not subject to any provision of the Act other than anti-manipulation provisions and anti-fraud provisions in certain situations.

⁵ Section 1a(12)(A)(x) of the Act.

⁶ In its petition, NYMEX also requested that the Commission make a determination pursuant to section 1a(11)(C) of the Act that floor members, when acting in a proprietary capacity, may also be considered to be eligible commercial entities (ECE) when they enter into certain specified transactions. Such a determination would permit NYMEX floor members to enter into transactions in exempt commodities on exempt commercial markets (ECM) pursuant to Section 2(h)(3) of the Act. On January 9, 2003, the Commission issued an order that deems, subject to certain conditions, floor brokers and floor traders who are registered with the Commission, when acting in a proprietary trading capacity, to be ECEs as that term is defined in Section 1a(11) of the Act. That order was published in the **Federal Register** on January 16, 2003. 68 FR 2319 (January 16, 2003).

⁷ To qualify for the Section 2(h)(1) exemption, the transaction must: (1) Be in an exempt commodity, (2) be entered into by ECPs, and (3) not be entered into on a trading facility.

⁸ By letter dated May 24, 2002, NYMEX filed rule changes that would implement an initiative to provide clearing services for specified energy contracts executed in the OTC markets. NYMEX certified that the rules comply with the Act and the Commission's regulations. Under the provision, NYMEX initially listed 25 contracts that are entered into OTC and accepted for clearing by NYMEX, but are not listed for trading on the Exchange. In connection with the NYMEX initiative, on May 30, 2002, the Commission issued an order pursuant to section 4d of the Act. The order provides that, subject to certain terms and conditions, the NYMEX Clearing House and FCMs clearing through the NYMEX Clearing House may commingle customer funds used to margin, secure, or guarantee transactions in futures contracts executed in the OTC markets and cleared by the NYMEX Clearing House with other funds held in segregated accounts maintained in accordance with section 4d of the Act and Commission Regulations thereunder.

⁹ EFS transactions are permitted at the Exchange pursuant to NYMEX Rule 6.21A, Exchange of Futures for, or in Connection with, Swap Transactions. The swap component of the transaction must involve the commodity underlying a related NYMEX futures contract, or a derivative, by-product, or related product of such a commodity. In furtherance of its effort to permit OTC clearing at the Exchange, NYMEX amended the rule to include as eligible EFS transactions "any contract executed off the Exchange that the Exchange has designated as eligible for clearing at the Exchange."

¹⁰ NYMEX also suggested a further limitation on floor members' permissible transactions by not permitting, initially, any transactions in electricity commodities.

¹¹ 67 FR 41698 (June 19, 2002). In that same **Federal Register** release, the Commission also requested comments with respect to NYMEX's request that the Commission make a determination pursuant to section 1a(11)(C) of the Act that floor members, when acting in a proprietary capacity,

may also be considered to be ECEs when they enter into certain specified transactions, as well as a petition filed by the Intercontinental Exchange, Inc., requesting that the Commission issue an order pursuant to section 1a(11) that would expand the ECE category to include floor brokers and floor traders registered as such in the U.S. or with the U.K. Financial Services Authority. As previously noted, on January 9, 2003, the Commission issued an order that deems, subject to certain conditions, floor brokers and floor traders who are registered with the Commission, when acting in a proprietary trading capacity, to be ECEs as that term is defined in section 1a(11) of the Act.

¹² The Commission also received a comment letter, dated September 27, 2002, from the Managing Member of Hudson Capital Group, L.L.C., an options trading group. The commenter strongly supported the petition to allow NYMEX members to trade OTC energy products.

¹³ In this regard, the petition states that 80 to 90 percent of energy swaps transactions involve standardized economic terms.

contracts created by the exchange of an OTC swap for a NYMEX future would be offset by an opposite transaction in the OTC market, thus providing a larger pool of market participants who would enter into a transaction initiating or liquidating a position on the Exchange.

With respect to the economic impact on OTC markets, the petition stated that permitting floor members to trade OTC transactions would increase competition and efficiency, enhance price discovery, and reduce the liquidity risk and the resultant increased market risk that arises from artificial barriers to entry in the markets. NYMEX stated that floor members participating in the OTC markets would perform the same functions they perform in the Exchange market including, among others, enhancing price discovery through the speed and efficiency of market adjustment to new fundamentals and facilitating adjustment of the market price to new information.

C. NYMEX's Analysis of the ECP Definition

In its petition, NYMEX contended that section 1a(12) of the Act supports its requested treatment of floor members as ECPs for a number of reasons. First, NYMEX stated that the treatment of floor members under the section 1a(12) ECP definition appears to be inconsistent in that it treats floor members differently based upon how they organize their businesses. Specifically, floor members who operate as natural persons are only considered ECPs if they satisfy a total asset standard.¹⁴ By comparison, floor members that are organized as partnerships or proprietorships are considered ECPs if they are guaranteed by a specified entity and are not required to meet any total asset requirement.¹⁵ The Exchange

represented that floor trader registrations are generally made in the name of the individual and that exchange membership or seat ownership historically has been held in the name of one individual.¹⁶

Second, the petition stated that the treatment of floor members under Section 1a(12) is inconsistent with the treatment of brokers or dealers or foreign persons (performing similar roles or functions subject to foreign regulation) who are natural persons or proprietorships. Under section 1a(12)(viii), these persons may be considered to be ECPs by meeting either the total assets test of section 1a(12)(xi) or satisfying one of the provisions of 1a(12)(v). Thus, under section 1a(12)(v) a broker or dealer or foreign person operating as a natural person, but not a floor member similarly operating, is permitted to trade OTC products with a guarantee from one of the specified entities and without meeting any total asset requirements.

Third, NYMEX contended that floor members with FCM guarantees should be considered ECPs because the Act permits other entities to use guarantees as a substitute for meeting a total assets requirement. Specifically, NYMEX stated that section 1a(12)(v) of the Act permits a corporation, partnership, proprietorship, organization, trust, or other entity to obtain a guarantee or support via a letter of credit from a financial institution, insurance company, investment company, commodity pool, or governmental entity.

Finally, NYMEX argued that it is reasonable for floor members to rely on FCMs as guarantors.¹⁷ Under section 1a(12)(A)(v), "a corporation, partnership, proprietorship, organization, trust, or other entity" may

incurred by the entity in the conduct of the entity's business."

¹⁶ NYMEX's argument on this point is premised on the assumption that floor brokers and floor traders may alternatively qualify as ECPs under provisions of the ECP definition that specifically refer to "a corporation, partnership, proprietorship, organization, trust, or other entity" (section 1a(12)(A)(v)) and to "an individual" (section 1a(12)(A)(xi)). At present, the Commission is neither accepting nor rejecting the Exchange's interpretation of the ECP definition, but is exercising the authority granted under section 1a(12)(C). As previously noted, the only provision of the ECP definition that specifically refers to floor brokers or floor traders is section 1a(12)(A)(x), which includes within the definition of ECP a floor broker or floor trader to the extent that the floor broker or floor trader acts in connection with any transaction that takes place on or through the facilities of a registered entity or an exempt board of trade, or any affiliate thereof, on which such person regularly trades.

¹⁷ The Commission believes that the FCM guaranteeing the OTC transactions should also have the obligation to clear the transactions at NYMEX.

be considered an ECP if it is guaranteed by a commodity pool with more than \$5 million in total assets. NYMEX pointed out that commodity pools generally are not in the business of conducting risk management for or providing guarantees in connection with trading in the OTC markets. NYMEX stated that if commodity pools are allowed to provide guarantees, then FCMs, who are in the business of monitoring trading by the Exchange members that they guarantee, should be permitted to provide such guarantees for floor members. NYMEX stated that its rules provide that each Exchange clearing member registered as an FCM must maintain minimum working capital of at least \$5 million.¹⁸

D. Trading Restrictions and Exchange Oversight

In its petition, NYMEX represented that it would have appropriate compliance systems in place to monitor OTC trading by Exchange floor members. Because all the permissible OTC trading subsequently would be cleared at the Exchange, NYMEX would be able to obtain information concerning the OTC transactions as part of a review of the exchange of futures for physicals (EFP) or the EFS transaction bringing the transaction to the Exchange for clearing. Failure to comply with a request to provide such information pursuant to the Exchange's EFP or EFS rules would result in a referral to the Exchange's Business Conduct Committee for further action.

NYMEX also suggested that, consistent with the standards which already apply to floor members with respect to their trading on the Exchange, the Commission should provide that floor members' transactions in the permissible contracts that are not executed on a trading facility be executed only pursuant to the section 2(h)(1) exemption. As indicated above, all section 2(h)(1) transactions would be subject to the Commission's anti-manipulation provisions and, in certain situations, anti-fraud provisions.¹⁹ Finally, the Exchange represented that it would agree, as a condition for its members participating in the OTC markets, to limit OTC trading by floor members such that the counterparties to their trades must not be floor members

¹⁸ Pursuant to NYMEX Rule 9.21(B), each clearing member registered with the Commission as an FCM must have and maintain minimum working capital equal to or in excess of the greater of \$5 million or the amount prescribed in Commission Regulation 1.17. As an additional safeguard for the clearing system, the Commission believes that a higher capitalization standard would be appropriate where the clearing member FCM is guaranteeing the OTC transactions of a floor member.

¹⁹ See *supra* note 4.

¹⁴ Section 1a(12)(A)(xi) provides that an individual who meets either of two total asset tests is an ECP. An individual must either have total assets in an amount in excess of \$10,000,000, or of \$5,000,000 and enter "into the agreement, contract, or transaction in order to manage the risk associated with an asset owned or liability incurred, or reasonably likely to be owned or incurred, by the individual."

¹⁵ Section 1a(12)(A)(v) provides that a corporation, partnership, proprietorship, organization, trust, or other entity that meets one of three tests is an ECP. The entity must either (1) have total assets exceeding \$10,000,000; (2) have its obligations guaranteed or otherwise supported by (subject to total assets or other requirements) a financial institution, insurance company, investment company, commodity pool, or governmental entity; or (3) have a net worth exceeding \$1,000,000 and enter "into an agreement, contract, or transaction in connection with the conduct of the entity's business or to manage the risk associated with an asset owned or liability incurred or reasonably likely to be owned or

for contracts that are listed for trading on the Exchange. Thus, for example, floor members could not be counterparties in connection with an OTC natural gas swap to be exchanged for a futures position in the NYMEX Natural Gas futures contract. NYMEX floor members could be counterparties in connection with a Chicago Basis swap that is subsequently cleared at NYMEX through EFS procedures because that contract is listed only for clearing at the Exchange.

IV. Conclusion

After consideration of the NYMEX petition and review of the comments, the Commission has determined that NYMEX floor members, subject to certain conditions and for a two-year period commencing on the date of publication of the order in the **Federal Register**, are eligible to be ECPs as that term is defined in section 1a(12) of the Act.²⁰ The floor members meet the financial qualifications of an ECP by having a financial guarantee for the OTC transactions from a NYMEX clearing member that is registered as an FCM and must satisfy certain minimum working capital requirements.

The Commission is aware that the execution and clearing of such transactions has financial implications for the clearing system.²¹ Thus, the Commission is adding the following safeguards to limit the possibility of a trader entering into OTC transactions that could create financial difficulty for the guarantor FCM, the clearing entity or other clearing firms. First, the guarantor FCM must clear, at NYMEX, every OTC transaction for which it provides such a guarantee. Second, in order to assure that the guarantor FCM is adequately capitalized, the guarantor FCM must have and maintain at all times minimum working capital of at least \$20 million; provided that, however, during the first 18 months following publication of the order a clearing member must have and maintain minimum working capital of at least:

(a) \$5 million during the first twelve months of the two-year period; and

(b) \$10 million during the thirteenth through eighteenth months of the two-year period.

If, during the 18-month period, a clearing member does not maintain working capital of at least \$20 million, it must further reduce its working capital, to determine if it is in compliance with paragraphs (a) or (b) above, by 100 percent of the NYMEX margin requirements for the OTC contracts, agreements or transactions of floor brokers and floor traders that it is guaranteeing pursuant to the order. A clearing member must compute its working capital in accordance with exchange rules and generally accepted accounting principles consistently applied.²²

Another qualification of floor members that the Commission finds significant with respect to the eligibility of floor members to be ECPs is trading expertise. The Commission believes that the participation of floor members in the OTC markets under the circumstances described here potentially could, among other things, increase liquidity on the Exchange and in the OTC marketplace, increase competition and efficiency, and expand the pool of counterparties for OTC market participants.

The Commission has determined to make the order effective for a two-year period in order to provide the opportunity to evaluate the impact of the OTC trading on both the OTC market and on NYMEX. Thus, the Commission is requiring that NYMEX submit a report reviewing its experiences and the experiences of its floor brokers, floor traders and clearing members with respect to OTC trading, including the levels of OTC trading and related clearing activity; the number of floor brokers, floor traders and clearing members who participated in these activities; and an evaluation of whether the Commission should extend this Order and, if so, whether any modifications should be made thereto. This report would address the first eighteen months of the two-year period, and must be submitted to the Commission no later than 30 days after the conclusion of eighteen months.

Accordingly, the Commission has determined, consistent with the NYMEX petition, that it is appropriate to issue an order, pursuant to section 1a(12)(C) of the Act, that includes, subject to certain conditions and for a two-year period commencing on the date of publication of the order in the **Federal Register**, NYMEX floor brokers and floor traders within the definition of ECPs who can enter into OTC transactions pursuant to section 2(h)(1) of the Act. Although this order applies only to NYMEX and NYMEX members, the Commission would welcome, in response to a petition so requesting, providing substantially similar relief to other designated contract markets and members of designated contract markets.

IV. Cost Benefit Analysis

Section 15 of the Act, as amended by section 119 of the CFMA, requires the Commission to consider the costs and benefits of its action before issuing a new regulation or order under the Act. By its terms, section 15 does not require the Commission to quantify the costs and benefits of its action or to determine whether the benefits of the action outweigh its costs. Rather, section 15 simply requires the Commission to "consider the costs and benefits" of the subject rule or order.

Section 15(a) further specifies that the costs and benefits of the proposed rule or order shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may, in its discretion, give greater weight to any one of the five enumerated areas of concern and may, in its discretion, determine that, notwithstanding its costs, a particular rule or order is necessary or appropriate to protect the public interest or to effectuate any of the provisions or to accomplish any of the purposes of the Act.

The order is intended to reduce regulatory barriers to permit NYMEX members registered with the Commission as floor brokers or floor traders, when acting in a proprietary capacity, to enter into OTC transactions in exempt commodities pursuant to section 2(h)(1) of the Act if such floor members have obtained a financial guarantee for such transactions from an Exchange clearing member that is registered with the Commission as an FCM. The Commission has considered

²⁰ A NYMEX floor member who is determined to be an ECP based upon compliance with the provisions set forth in the Commission's order is an ECP only for the purpose of entering into transactions executed pursuant to Section 2(h)(1) of the Act and as described in the order.

²¹ The Commission notes that the guarantor FCM could restrict or otherwise condition the trading for which the guarantee is provided. The guarantor could, for instance, limit trading to certain commodities, place financial limits on overall or daily positions, or restrict trading by number or size of acceptable transactions.

²² The Commission believes that the guarantor FCM should ultimately have and maintain minimum working capital of \$20 million, but is providing less-capitalized FCMs that wish to guarantee OTC transactions with the opportunity to do so during the 18-month transition period in which they increase their working capital. The Commission notes that the \$20 million requirement is somewhat analogous to the eligible trader requirements for trading on a registered derivatives transaction execution facility (DTEF). Pursuant to section 5a(b)(3) of the Act, to trade on a DTEF, a person must either be an ECP or trade through an FCM that, among other things, has net capital of at least \$20 million.

the costs and benefits of the order in light of the specific provisions of section 15(a) of the Act.

A. Protection of Market Participants and the Public

The order would permit, for a two-year period commencing on the date of its publication in the **Federal Register**, a registered floor broker or floor trader to participate in the OTC markets, subject to a guarantee from an Exchange clearing member registered as an FCM, as well as to Exchange oversight and certain trading restrictions. Accordingly, there should be no effect on the Commission's ability to protect market participants and the public.

B. Efficiency and Competition

The order is expected to benefit efficiency and competition by, among other things, increasing the flow of trading information to the Exchange, enhancing the ability of floor members to make tight markets in products that compete against standardized look-alike contracts traded in the OTC markets, and increasing the pool of potential counterparties for OTC market participants.

C. Financial Integrity of Futures Markets and Price Discovery

The order should have no effect, from the standpoint of imposing costs or creating benefits, on the financial integrity of the futures and options markets. The order may have a favorable effect in creating benefits with respect to the price discovery function of such markets.

D. Sound Risk Management Practices

The order should have no effect, from the standpoint of imposing costs, on the risk management practices of the futures and options industry. Clearing member FCMs that would, on a case-by-case basis, be extending guarantees to floor members for OTC trading have developed risk management practices in connection with extending similar guarantees to floor members for trading executed at the Exchange. Because the scope of permissible trading would be limited to OTC transactions that subsequently are cleared at the Exchange, clearing member FCMs could apply existing risk management practices and procedures. The order would enhance the ability of floor members to manage the risks associated with the positions they establish in Exchange contracts.

E. Other Public Interest Considerations

The order is consistent with one of the purposes of the Act as articulated in

Section 3 in that it would promote responsible innovation and fair competition among boards of trade, other markets and market participants.

V. Order

Upon due consideration, and pursuant to its authority under section 1a(12)(C) of the Act, the Commission hereby determines that a NYMEX member who is registered with the Commission as a floor broker or a floor trader, when acting in a proprietary trading capacity, is deemed to be an eligible contract participant and may enter into Exchange-specified OTC contracts, agreements or transactions in an exempt commodity under the following conditions:

1. This Order is effective for two years commencing on the date of its publication in the **Federal Register**.

2. The contracts, agreements or transactions must be executed pursuant to section 2(h)(1) of the Act.

3. The floor broker or floor trader must have obtained a financial guarantee for the contracts, agreements or transactions from a NYMEX clearing member that:

(a) Is registered with the Commission as an FCM; and,

(b) Clears the OTC contracts, agreements or transactions thus guaranteed.

4. Permissible contracts, agreements or transactions must be limited to trading in a commodity that either:

(a) Is listed only for clearing at NYMEX or

(b) Is listed for trading and clearing at NYMEX and NYMEX's rules provide for exchanges of futures for swaps in that contract, and each OTC contract, agreement or transaction executed pursuant to the order must be cleared at NYMEX.

5. The floor broker or floor trader may not enter into OTC contracts, agreements or transactions with another floor broker or floor trader as the counterparty for contracts that are listed for trading on the Exchange.

6. NYMEX must have appropriate compliance systems in place to monitor the OTC contracts, agreements or transactions of its floor brokers and floor traders.

7. Clearing members that guarantee and clear OTC contracts, agreements or transactions pursuant to this Order must have and maintain at all times minimum working capital of at least \$20 million; provided, however, that during the first 18 months following publication of the order a clearing member must have and maintain minimum working capital of at least:

(a) \$5 million during the first twelve months of the two-year period; and

(b) \$10 million during the thirteenth through eighteenth months of the two-year period.

If, during the 18-month period, a clearing member does not maintain working capital of at least \$20 million, it must further reduce its working capital, to determine if it is in compliance with paragraphs 7(a) or 7(b) of the order, by 100 percent of the NYMEX margin requirements for the OTC contracts, agreements or transactions of floor brokers and floor traders that it is guaranteeing pursuant to the order. A clearing member must compute its working capital in accordance with exchange rules and generally accepted accounting principles consistently applied.

8. NYMEX will submit a report to the Commission reviewing its experiences and the experiences of its floor brokers, floor traders and clearing members under this Order, including the levels of OTC trading and related clearing activity; the number of floor brokers, floor traders and clearing members who participated in these activities; and an evaluation of whether the Commission should extend this Order and, if so, whether any modifications should be made thereto. This report will address the first eighteen months of this Order's two-year period, and must be submitted to the Commission no later than 30 days after the conclusion of those eighteen months.

This Order is based upon the representations made and supporting material provided to the Commission by NYMEX. Any material changes or omissions in the facts and circumstances pursuant to which this Order is granted might require the Commission to reconsider its finding that the provisions set forth herein are appropriate. Further, if experience demonstrates that the continued effectiveness of this Order would be contrary to the public interest, the Commission may condition, modify, suspend, terminate or otherwise restrict the provisions of this Order, as appropriate, on its own motion.

Issued in Washington, DC, on January 29, 2003, by the Commission.

Jean A. Webb,

Secretary of the Commission.

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