

In support of its request for a determination that floor members be able to trade as ECEs on ECMs, NYMEX stated, among other things, that floor brokers and floor traders, if determined to be ECPs, would meet the ECE definition requirements of section 1a(11)(A) of the Act in that the floor brokers and floor traders provide risk management and market-making activities in energy and metals derivatives products. NYMEX further stated that allowing floor brokers and floor traders with an FCM guarantee to execute transactions as ECEs on ECMs would simply be an extension of the services and expertise that such entities currently provide to users of NYMEX's markets.

B. Intercontinental

By letter dated June 3, 2002, Intercontinental⁹ requested that the Commission issue an order pursuant to section 1a(11) of the Act that would expand the ECE category to include CFTC-registered floor brokers and floor traders, thus permitting them to trade on ECMs.¹⁰ Intercontinental proposed that the floor broker or floor trader must be a member of a designated contract market (DCM) or otherwise have trading privileges on a DCM. The floor broker or floor trader must have as a part of its business the business of acting as a floor broker or floor trader, but need not have any connection or experience in the underlying products traded on the ECM. Finally, the floor broker or floor trader must be an ECP or, if the floor broker or floor trader is not an ECP, its trades on the ECM must be guaranteed by a clearing member of a U.S.-registered clearing organization.

Intercontinental stated that including floor brokers and floor traders as ECEs would be consistent with the CFMA and would recognize their value as both liquidity providers, and dealers and market makers. Intercontinental noted that the Commission has previously included floor brokers and floor traders

in the definition of ECE as it relates to trading on a Derivatives Transaction Execution Facility (DTEF),¹¹ and contended that there is no meaningful distinction between allowing floor brokers and floor traders to trade as ECEs on a DTEF and allowing them to trade as ECEs on an ECM.¹²

C. Comments

The NYMEX and Intercontinental petitions were published in the **Federal Register** for a 15-day public comment period on June 19, 2002.¹³ In addition, the **Federal Register** release included a series of questions posed by the Commission regarding the petitions. The Commission received comments from NYMEX and from Intercontinental.¹⁴ In its comment letter of July 17, 2002, NYMEX generally 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. NYMEX also commented that Intercontinental's petition contained fewer conditions than NYMEX's petition for the recognition of registered floor brokers and floor traders as ECEs for trading on ECMs. Thus, NYMEX requested that if the Commission made a determination along the lines proposed in the Intercontinental petition for registered

floor brokers and floor traders generally, NYMEX floor brokers and floor traders be permitted to trade on ECMs consistent with the scope of that determination.

In its comment letter of July 3, 2002, Intercontinental generally noted that under the Act, ECEs include: Certain types of ECPs who, in connection with their businesses, make or take delivery of the underlying commodity or provide hedging and risk management services in the commodity; ECPs other than natural persons or state or local governments that regularly enter into transactions in commodity derivatives; and certain types of investment funds. Intercontinental stated that the Commission, under section 1a(11)(C), has the authority to include within the ECE definition floor brokers and floor traders and, as previously noted, has already issued a rule pursuant to this authority with respect to DTEFs. Intercontinental suggested that any relief mandated by the Commission in response to the petition be broadly based and applicable to any floor brokers or floor traders that wish to be considered to be ECEs for purposes of trading on an ECM.

Intercontinental also responded to a series of questions posed by the Commission. The questions and responses are summarized below:

1. The Commission understands that at some ECMs traders have the capability of specifying the entities that are acceptable counterparties. In light of this capability, would it be reasonable and prudent to maintain a restriction on eligible counterparties, *i.e.*, limit trading by floor brokers and floor traders acting as ECEs such that the counterparties to their trades must not be floor brokers or floor traders, at least with respect to ECMs that provide for such a counterparty pre-approval mechanism.

Intercontinental responded that the Commission should not impose restrictions on eligible counterparties for ECMs, other than requiring that they qualify as ECEs. Intercontinental stated that it provides credit and risk management support capabilities, designed to provide market participants with maximum flexibility and control over their trades, as a service to its participants at no additional cost. ECEs can pre-approve trading counterparties and establish credit limits for trading with each counterparty. Use of this credit management system is voluntary, and Intercontinental is not required, by contract or applicable law or regulation, to maintain these capabilities. Intercontinental noted that because participation on its trading platform is limited to ECEs, all participants are

¹¹ Specifically, Commission regulation 37.1(b) states that, for the purpose of DTEF trading, "the term 'eligible commercial entity' means, and shall include, in addition to a party or entity so defined in section 1a(11) of the Act, a registered floor trader or floor broker trading for its own account, whose trading obligations are guaranteed by a registered futures commission merchant."

¹² DTEFs are registered with the Commission and generally must meet various standards of operation set forth in section 5a of the Act and part 37 of the Commission's regulations and are subject to the Commission's regulatory oversight. By comparison, ECMs are exempt from Commission regulatory oversight. While ECMs must submit to the Commission a notice of operation that satisfies the filing requirements of section 2(h)(5) of the Act and Commission regulation 36.3, ECMs are not "registered with, or designated, recognized, licensed or approved by the Commission." See section 2(h)(5) of the Act.

¹³ 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(12)(C) of the Act that NYMEX floor brokers and floor traders, when acting in a proprietary capacity, may also be considered to be ECPs when they enter into certain specified transactions. Such a determination would permit NYMEX floor brokers and floor traders to enter into over-the-counter (OTC) transactions in exempt commodities pursuant to section 2(h)(1) of the Act.

¹⁴ 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 over-the-counter energy products, but did not address particular Commission questions.

⁹ Intercontinental operates an OTC commodities trading platform for energy and metals and is itself an ECM. Intercontinental submitted its notice of operation as an ECM to the Commission on December 27, 2001. Intercontinental also owns the International Petroleum Exchange (IPE), a U.K. FSA-regulated futures exchange for the trading of energy futures products.

¹⁰ In its petition, Intercontinental also requested that the Commission expand the ECE category to include U.K. local member floor traders who are authorized by the U.K. Financial Services Authority. On November 1, 2001, Intercontinental advised Commission staff that it has decided not to seek relief at this time on behalf of non-U.S. floor brokers or floor traders. Accordingly, the Commission is not, at this time, making any determination with respect to non-U.S. floor brokers and floor traders.