

sufficiently sophisticated to make their own credit determinations with respect to other participants. In addition, requiring maintenance of a function that ECM and market participants might later decide is unnecessary would limit the flexibility of ECMs and is unwarranted. Intercontinental also noted that the Commission currently does not impose any counterparty restrictions on trades executed on its trading platform. Finally, Intercontinental noted that its proposal requires that floor brokers and floor traders must qualify as ECPs or have their trades be guaranteed by a clearing member of a registered clearing organization that is itself an ECP, and that the satisfaction of these requirements reduces any concern by potential counterparties with respect to the credit or collection risk posed by the execution of trades with floor brokers and floor traders.<sup>15</sup>

2. The Commission requested comments regarding whether the transactions that could be entered into by floor brokers and floor traders as ECEs on ECMs should be limited to any of the following: (a) Specifically identified contracts; (b) transactions that would be cleared; (c) commodities in which the floor broker or floor trader had trading expertise; (d) transactions for which the floor broker or floor trader was guaranteed by an Exchange clearing member; or (e) in some other way.

With respect to a limitation to specifically identified contracts, Intercontinental stated that floor brokers and floor traders should be permitted to execute transactions in all exempt commodities pursuant to section 2(h)(3) of the Act. Intercontinental noted that the Act, as amended by the CFMA, generally defines three categories of ECE: (a) Commercials who deal in the underlying physical commodity; (b) dealers and market makers; and (c) collective investment vehicles that generally are liquidity providers. Intercontinental contended that the second and third categories of ECE recognize that traders with no direct connection to the underlying physical market are eligible and valuable contributors to the efficiency of commercial markets.<sup>16</sup> Accordingly,

Intercontinental further contended that including floor brokers and floor traders as ECEs would be consistent with the CFMA and would recognize the value of floor brokers and floor traders as both liquidity providers, and dealers and market makers. Intercontinental noted that floor brokers and floor traders understand trading markets, are sophisticated and capable as traders to the same extent as commercials, and would be valuable participants trading in all exempt commodities on Intercontinental's trading platform.

With respect to requiring that transactions be cleared, Intercontinental stated that floor broker and floor trader transactions on ECMs should not be required to be cleared in order for these entities to be included in the ECE definition. The reduction in credit risk that clearing provides would not be necessary in light of Intercontinental's proposed requirement that the floor broker or floor trader must be an ECP or that its trades must be guaranteed by a clearing member of a registered clearing organization that is itself an ECP.<sup>17</sup>

As to limiting floor brokers and floor traders to trading only those commodities in which they have trading expertise, Intercontinental argued that floor brokers and floor traders are desirable because of their expertise in trading, not their specific commodity expertise, and should not be limited to trading in particular commodities in which they have trading expertise. Intercontinental pointed out that its proposal would require floor brokers and floor traders to be registered and have as a part of their business the business of acting as a floor broker or floor trader on the DCM's open outcry market or performing an equivalent function on the DCM's electronic market<sup>18</sup> and that, accordingly, floor

can qualify as an ECE based upon dealing or engaging in market-making activities must be an entity (floor brokers, floor traders and individuals are ineligible) that, in connection with its business, regularly provides risk management or hedging services or engages in market-making activities with other ECEs involving transactions to purchase or sell the commodity or derivative agreements, contracts, or transactions in the commodity. Under paragraph 1a(11)(B), the ECP that can qualify as an ECE based upon its status as a collective investment vehicle cannot be a natural person and regularly enters into transactions to purchase or sell the commodity or derivative agreements, contracts, or transactions in the commodity.

<sup>17</sup> As previously noted, the requirement that the clearing member guaranteeing the trades must itself be an ECP was added in Intercontinental's comment.

<sup>18</sup> The provision concerning performing an equivalent function on the electronic market was not included as a criterion in the original petition, but was added in Intercontinental's November 1, 2002, submission. Intercontinental represents that the intent is to include those floor brokers and floor

brokers and floor traders that satisfied these requirements would have sufficient qualifications and experience to trade in any commodity product on an ECM. Intercontinental contended that allowing floor brokers and floor traders to participate would expand the pool of potential counterparties for market participants, increase competition and efficiency, enhance price discovery and reduce liquidity risk.

With respect to a limitation to transactions for which the floor broker or floor trader was guaranteed by an Exchange clearing member, the Intercontinental proposal would require that the floor broker or floor trader must be an ECP or that its trades must be guaranteed by a clearing member of a registered clearing organization that is itself an ECP. Intercontinental stated that when a floor broker or floor trader qualifies as an ECP, that floor broker or floor trader has been deemed by the Act to be sufficiently responsible to execute trades and there is no need to require further mitigation of credit risk by having a clearing member guarantee the floor broker's or floor trader's payment obligations. Alternatively, when a floor broker or floor trader does not qualify as an ECP, it is appropriate to require that a clearing member of a registered clearing organization that is itself an ECP guarantee the trades in order to mitigate the credit and collection risk created by executing trades with a floor broker or floor trader.

3. The Commission requested comment on the assertion that there would be no meaningful distinction between allowing floor brokers and floor traders to trade as ECEs on a DTEF, as the Commission has already permitted, as compared to trading as ECEs on an ECM, and particularly on whether there should be any distinction in the treatment of floor brokers and floor traders as ECEs based upon the different regulatory regimes applicable to DTEFs and ECMs.

Intercontinental commented that the primary regulatory difference between ECMs and DTEFs is that DTEFs must comply with certain core principles, including monitoring trading and enforcing compliance with rules; making certain trade data publicly available if the Commission determines that the contract performs a price discovery function; recordkeeping; applying fitness requirements for board members, market participants and

traders who, as part of their business, provide liquidity to the markets as dealers and market makers, either on the exchange's open outcry market or on the exchange's electronic market.

<sup>15</sup> The requirement that the clearing member guaranteeing the trades must itself be an ECP was not included as a criterion in the original petition but was added in Intercontinental's comment letter dated July 3, 2002.

<sup>16</sup> The Commission notes that, while it is not agreeing or disagreeing with this assertion at this time, the two general categories of ECE identified by Intercontinental require, by statute, a strong connection to either derivatives transactions in the particular commodity or the underlying physical market. Under paragraph 1a(11)(A), the ECP that