

others; and addressing potential conflicts of interest. The regulatory concerns addressed by these core principles primarily relate to the protection of the integrity of DTEF markets rather than particular participants within those markets.

Intercontinental stated that the current ECM regulatory framework similarly provides the Commission with sufficient authority to protect the integrity of the market.<sup>19</sup> Intercontinental pointed out that the Commission has real-time access to Intercontinental's trading screens and can observe and evaluate prices and trading activity on a real-time basis. In the event that the Commission detected possible problems in the market, such as manipulation or attempted manipulation, it has the authority to take action against the appropriate market participants. Intercontinental further noted that the Commission also retains anti-fraud authority with respect to transactions on ECMs.

Intercontinental noted that since trading on its trading platform is entirely electronic, there are no trading rules to be enforced because buy and sell orders are electronically matched by the platform. Intercontinental represented that it applies rigorous standards to the selection of directors and all of its board members have significant experience in the commodity trading industry and many are executives of major corporations in the industry. Intercontinental concluded that the participation of floor brokers and floor traders would not require any additional regulation beyond that which already applies to ECMs under Sections 2(h)(3)–(5) and that this approach is consistent with the CFMA which was designed, in part, to provide a more flexible and less burdensome regulatory framework for futures and derivatives markets.<sup>20</sup>

### III. Conclusion

After consideration of the NYMEX and Intercontinental petitions and review of the comments, the Commission has determined, consistent with the Intercontinental petition, that it is appropriate to issue an order, pursuant to section 1a(11)(C) of the Act, that includes CFTC-registered floor brokers and floor traders, subject to

certain conditions, within the definition of ECEs who can trade on ECMs.<sup>21</sup> Although the Commission is neither agreeing nor disagreeing with Intercontinental's contention that two of the three general categories of ECE defined under the CFMA recognize that traders with no direct connection to the underlying commodity are eligible and valuable contributors to the efficiency of commercial markets,<sup>22</sup> the Commission does believe that its action is consistent with the purposes of the CFMA and that it will provide floor brokers and floor traders access to a wider range of products and expand the pool of potential counterparties for ECM participants. The Commission also believes that its action potentially could increase competition and efficiency and reduce liquidity risk on ECMs. As noted above, the Commission has previously determined, for purposes of trading on a DTEF, to include within the ECE definition registered floor brokers and floor traders trading for their own accounts, whose trading obligations are guaranteed by a registered FCM.<sup>23</sup>

In order to qualify as an ECE under the Commission's order, a CFTC-registered floor broker or floor trader must be a member of a 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, either on a DCM's open outcry market or performing an equivalent function on the DCM's electronic market, but need not have any connection to or experience in the underlying physical commodity. The Commission believes that the trading expertise that floor brokers and floor traders would bring to the ECM would be applicable to trading in any commodity product being traded. A floor broker's or floor trader's ability to, among other things, interpret market momentum and facilitate the adjustment of the market price to new information, is more a function of trading expertise than of experience in the underlying physical commodity.

The floor broker or floor trader must either be an ECP or have its trades on the ECM guaranteed by a clearing member that is both a member of a CFTC-registered derivatives clearing organization and an ECP. The Commission believes that the requirement that either the floor broker or floor trader or the guarantor of the trades must be an ECP provides sufficient financial backing for the floor broker or floor trader and mitigates any credit and collection risk that might otherwise arise in executing trades with a floor broker or floor trader.<sup>24</sup>

### 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 CFTC-registered floor brokers and floor traders, when acting in a proprietary capacity, to enter into transactions in

<sup>19</sup> Pursuant to paragraph 2(h)(5)(F) of the Act, an ECM shall not represent to any person that the facility is registered with, or designated, recognized, licensed or approved by the Commission.

<sup>20</sup> The Commission posed an additional question concerning ECE treatment for non-U.S. registrants. That question and response are not discussed here because, as previously noted, Intercontinental has decided not to seek relief at this time on behalf of non-U.S. floor brokers or floor traders. See note 10.

<sup>21</sup> The Commission notes that the Intercontinental petition is broader in scope than the NYMEX petition in that Intercontinental requested that, subject to the condition discussed above, all CFTC-registered floor brokers and floor traders be included in the definition of ECE. As previously stated, NYMEX requested that if the Commission made a determination along the lines proposed in the Intercontinental petition, NYMEX floor brokers and floor traders be permitted to trade on ECMs consistent with the scope of that determination. Accordingly, a single order addressing Intercontinental's petition eliminates the need for an order separately addressing the NYMEX petition.

<sup>22</sup> See note 16.

<sup>23</sup> Commission regulation 37.1(b).

<sup>24</sup> The Commission notes that although the guarantor for the trading on the ECM, if one is required, must be a clearing member of a CFTC-registered derivatives clearing organization, there is no requirement that the trades thus executed must be cleared. No liability resulting from a guarantor's guarantee of an uncleared ECM transaction would extend to any of the guarantor's fellow clearing members. The Commission also notes that the guarantor could restrict or otherwise condition the trading for which the guarantee is provided. The guarantor could, for instance, limit trading to certain commodities or ECMs, place financial limits on overall or daily positions, or restrict trading by number or size of acceptable transactions.