

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.<sup>20</sup> 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.<sup>21</sup> 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.<sup>22</sup>

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

<sup>20</sup> 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.

<sup>21</sup> 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.

<sup>22</sup> 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.