



New York
Mercantile Exchange

STILL MORE. Traditions, not stereotypes.

SAFEGUARDS AND
STANDARDS



OVERVIEW

The New York Mercantile Exchange is not only the premier market for energy and metals trading, it is the safest. A sophisticated, intricate system of safeguards virtually guarantees against counterparty credit risk and default, an assurance that is absent from over-the-counter markets and many foreign exchanges.

Because the rules of the Exchange give it broad self-regulatory responsibilities, market participants can trade confident of the financial protection offered through a fully margined clearinghouse.

This self-regulatory authority derives from regulations of the Commodity Futures Trading Commission (CFTC), which in turn is overseen by the U.S. Congress.

The Exchange maintains absolute neutrality toward the markets, as its rules apply to both sides of a transaction. The Exchange does not trade futures or options, does not take positions in the market, nor does it advise others on what positions to take. Instead, the Exchange provides a forum where members, on behalf of their customers, their employers, or themselves, can trade the Exchange's standardized contracts in an safe, efficient, and orderly manner.

This booklet shows how the Exchange's rules and procedures are designed to assure all who use its markets — commercial hedgers and investors, alike — of the highest standards of integrity and financial security.

Organization of the Exchange

The Exchange is a membership organization. It merged with the Commodity Exchange, Inc., on August 3, 1994; as a result, trading is conducted through two divisions, the NYMEX Division and the COMEX Division.

The NYMEX Division consists of 816 seats held by approximately 770 individual members who conduct trading in energy and platinum group metals futures and options and have proprietary electronic trading rights for all COMEX Division contracts. The COMEX Division is comprised of 772 seats held by approximately 640 individuals who conduct futures and options trading in gold, silver, copper, and the Eurotop 100*, as well as the NYMEX Division platinum group metals contracts on a proprietary basis. COMEX Division members also have proprietary electronic trading rights for NYMEX Division products.

The Exchange's members include approximately 60 clearing member firms and 120 non-clearing member firms. The Exchange is owned by its members and is governed by an elected board of directors who set policy and establish the future direction and scope of Exchange activities. Members need to be approved by the board and must meet strict business integrity and financial solvency standards. These standards are even higher for clearing member status.

* "Eurotop 100 Index" and "E100" are proprietary names of the Optiebeurs N.V. (European Options Exchange) and have been licensed for use by COMEX.

They include rigidly enforced capitalization requirements which are continually monitored by the Exchange.

Regulation of Market Participants

Among the more important Exchange rules and regulations are those governing position and price limits, margin requirements, and delivery procedures. These rules and regulations, which allow the Exchange to maintain fair and orderly markets, are vital to the smooth operation of the Exchange. Enforcement rests with the Exchange's compliance department, which is divided into three groups: trade, market, and financial surveillance. Trade surveillance focuses on floor trading activity. Market surveillance reviews large trader data and surveys physical activity in the various contract markets. Financial surveillance monitors the fiscal suitability of participants in the Exchange's markets and conducts periodic audits of certain member firms.

Price Limits

The Exchange has daily price limits for all futures contracts in all trading months except during the spot months of the NYMEX Division natural gas, platinum, and palladium contracts, and during the last 20 minutes of a day's trading in COMEX Division metals. These limits protect both market participants and the Exchange in the event of large price moves.

POSITION LIMITS

Clearing Member Capital-Based Position Limits

Position limits are one important way the Exchange ensures that each of its clearing members possesses the requisite financial capability relative to the number of contracts it clears on the Exchange. Limits apply to all contracts outstanding at the Exchange. These position limits are based on the capitalization of each clearing firm and are monitored closely through information collected by the financial surveillance group of the compliance department.

Market-Participant Position Limits

In addition to clearing member position limits, the NYMEX Division imposes customer position limits on contracts held in the current delivery month, as well as in any one month and in all months combined, calculated on a futures-equivalent basis. There are also gross position limits for futures contracts and options contracts. The spot month, all-month, and any one month position limits for NYMEX Division contracts are, respectively, as follows:

	<u>Spot month</u>	<u>All months</u>	<u>Any one month</u>
Light, sweet crude	1,000	10,000	5,000
Sour crude	500	5,000	5,000
Heating oil	1,000	7,000	5,000
New York Harbor gasoline	1,000	7,000	5,000
Gulf Coast gasoline	500	2,500	2,500
Natural gas	750	7,000	5,000
Propane	250	1,500	500
Platinum	700	1,500	1,500
Palladium	225	625	625

The COMEX Division imposes position limits for the spot month contracts and accountability levels for overall positions. The Exchange takes into account the company or customer holding the position, his financial standing, and the market participant's position relative to the open interest of the contract. The position limits for the spot month, and overall accountability limits are:

	Position Limits, <u>Spot month</u>	Accountability <u>Limits</u>
Gold	3,000	7,500
Silver	1,500	7,500
Copper	2,500	6,000
Eurotop	10,000 (all months)	

Hedge Exemption from Position Limits

An exemption from position limits can be granted for swap transactions and bona fide hedging transactions. Hedgers wishing to exceed the position limits for the purpose of establishing a hedge, must file a hedge notice and obtain approval of the Exchange president or his designee. The applicant must document that the positions it will hold are bona fide hedge positions by providing the company's current, previous, or anticipated exposure in the physical or derivative market. Hedge exemptions can be granted for the position limit in any month.

In granting hedge exemptions the Exchange considers the following criteria: 1) hedge or swap exposure; 2) financial condition and stability of the company; 3) futures and options market liquidity; 4) trading history of the company; and 5) internal procedures

and controls suitable to oversee the position. If limits are exceeded in a non-spot month without a previously approved hedge exemption notice, the participant has a five-day period to file a notice with the Exchange to seek a hedge exemption, whereupon a decision will be made, based on the participant's evidence of exposure in the physical or derivative market. The Exchange president may also elect to revoke the hedge exemption in the event the company is unable to meet the above requirements or if market factors change. Firms must refile annually, since exemptions are granted for a one-year period. Non-commercial firms exceeding the limits are required to liquidate excess positions, and subject their clearing firms to penalties.

Reporting Levels

Customers maintaining large positions in the Exchange's futures and options markets are reported to the CFTC and to the Exchange daily by the respective futures commission merchant (FCM). Positions of more than 300 futures contracts in light, sweet crude oil; 250 in gold, silver, copper, and the Eurotop 100; 175 in heating oil; 150 in New York Harbor unleaded gasoline; 50 in natural gas and platinum; and 25 in sour crude, Gulf Coast gasoline, propane, and palladium; must be reported.

Options positions in excess of 50 light, sweet crude oil and heating oil con-

tracts and 25 gasoline, natural gas, and platinum contracts each month, in each quadrant (long and short puts and calls) must also be reported. Reportable positions in COMEX Division options are: gold, 250; silver, 200; copper and Eurotop 100, 50. For five-day options in gold, silver, and copper, it is 50.

MARGIN REQUIREMENTS

In commodity futures markets, margin requirements are essentially good-faith deposits or performance bonds which can be used to cover adverse movements in futures prices. The Exchange must ensure that participants have sufficient funds to handle losses. In order to protect market participants and the integrity of the market, the Exchange establishes margins at sufficiently high levels to adequately guard against the risks associated with changing market conditions. The Exchange establishes specific margin requirements for clearing members and separate minimum margin requirements for customers of clearing members, which are calculated to be at least 110% greater for member accounts and 135% greater for all other customers. Margin levels are determined by the staff.

The Exchange requires that the original margin on all futures and short options positions be deposited by clearing members on a gross basis for long and short customers. Accordingly, the Exchange requires that clearing members obtain initial margins from their customers. In addition to initial margin deposits, daily variation margin payments are made in cash to the Exchange by clearing members who have sustained losses on their futures positions. In turn, gains on futures positions are remitted to the appropriate clearing member. For customers, variation margin is required by clearing members if an adverse price movement erodes

margin on deposit below the maintenance margin levels established by the Exchange.

Margins are set by the Exchange – primarily on the basis of market volatility – and are subject to change as conditions warrant. The Exchange requires higher margins for any NYMEX Division spot-month position open on the day prior to expiration of the futures contract. COMEX Division spot-month assessments are decided on a case-by-case basis as warranted by market conditions. Since positions remaining open as expiration nears are more likely to result in delivery, higher margin requirements are designed to ensure that customers are financially able to stand for delivery.

The Exchange requires that margin payments from customers be posted in either cash or U.S. government obligations with less than 10 years to maturity. Clients must deposit these funds with their futures commission merchant, which in turn must place this money in a segregated depository. The clearinghouse will accept cash or securities and letters of credit from its clearing members to fulfill margin requirements.

FINANCIAL INTEGRITY OF THE EXCHANGE

The financial strength of the Exchange and its clearing system is based upon the combined financial capability of its clearing member firms, which include some of the largest and most well capitalized names in the banking and financial services industries. The NYMEX Division clearinghouse is a department of the Exchange. As part of the merger, the COMEX Clearing Association functions and rules are being consolidated with the NYMEX Division clearinghouse.

Upon acceptance of a trade, the clearing organization, in effect, becomes the seller to every buyer and buyer to every seller.

Clearinghouse Operations

The clearinghouse ensures that trading is conducted in an orderly manner by matching and recording trades, collecting and maintaining margins, allocating margins according to the positions of the clearing members, matching open short with open long positions for delivery, allocating delivery notices, and generating trading and delivery statistics. The clearinghouse acts as a fiscal transfer agent, transferring money from the margin funds of traders who have incurred a loss in the futures market on any given day to the margin funds of traders who have generated a gain - all via the Exchange's clearing members.

Capitalization Requirements

In order for firms to qualify for clearing member status, they must show a minimum working capital of \$2 million as calculated in accordance with generally accepted accounting principles, or – if a registered futures commission merchant – in accordance with CFTC regulations, and must maintain an account with a bank in the City of New York which meets Exchange capital and rating requirements. In addition, the clearing member, like all member firms, must own and hold two seats.

Clearing members must also make a deposit to the guaranty fund of the clearinghouse of an amount which reflects the firm's capital (and the size of trades they can guarantee). On the NYMEX Division, the minimum deposit is \$100,000 in cash or U.S. Treasury Bills having a face value of \$120,000. The maximum deposit is \$2 million. The floating scale for NYMEX Division clearing members is as follows:

Capital	Percentage or Amount
\$250,000 to \$2,000,000	\$100,000
\$2,000,001 to \$5,000,000	5% of capital
\$5,000,001 to \$10,000,000	7.5% of capital
\$10,000,001 to \$20,000,000	10% of capital
\$20,000,001 and over	\$2,000,000

COMEX Division clearing members, as of year-end 1995, must deposit the equivalent of 10% of the firm's capital, up to \$2 million. The funds' current sizes are approximately \$80 million for each division of the Exchange.

Safety Net

In the event of a clearing member's failure to meet its clearinghouse obligations, that is, if it cannot meet a margin payment, a system is in place to restore the loss. Funds would be appropriated from: 1) that clearing member's assets under the Exchange's control; 2) the Exchange's surplus as determined by the board of directors; 3) the Guaranty Fund; and 4) funds based on a prorated assessment of other clearing members, according to trading participation.

Joint Exchange Surveillance

To further safeguard all commodity exchanges, several inter-exchange information sharing agreements are in place that monitor the financial solvency of futures commission merchants who are their members. The U.S. exchanges, together with the National Futures Association (NFA), have entered into a joint audit agreement. Each exchange monitors the financial and operational conditions of specific futures commission merchants through annual audits of the firms, margin examinations, and analysis of financial statements. A copy of this audit information is made available to all exchanges of which the futures commission merchant is a member.

In addition, U.S. exchanges and their clearing organizations share certain clearing information on a daily basis includ-

ing aggregate “pay and collect” information which indicates the magnitude of daily variation margin payments made by common clearing members.

An Intermarket Financial Surveillance Group, the Clearing Organization and Clearing Bank Roundtable, and the Unified Clearing Group (UCG) also assist in the evaluation of the financial integrity of members. The Roundtable group is comprised of representatives of securities, options, and futures clearing houses; the banking community; the Federal Reserve Board; the Securities and Exchange Commission (SEC); and the CFTC. The group meets to discuss issues affecting financial solvency including capital required of clearing organizations, credit risk in marking-to-market operations, and the implications of 24-hour trading. The Intermarket Financial Surveillance Group is comprised of commodities, securities, and options exchanges; the CFTC; SEC; NFA; and the National Association of Securities Dealers (NASD). This group meets semi-annually to discuss specific financial information on common members. The UCG consists of representatives from securities, options, and futures clearinghouses.

The New York Mercantile Exchange has also entered into an international memorandum of understanding with the U.K. Securities Investment Board (SIB) to share financial information on common members.

In developing the NYMEX ACCESSSM electronic trading system, every effort was made to extend the integrity of the daytime open outcry market to the after-hours market.

Only two categories of individuals are allowed to operate a trader workstation, electronic traders and NYMEX ACCESSSM operators. The electronic trader is the person in whose name the trader workstation is placed and who is accountable for all trading activity associated with that terminal. An electronic trader can generally enter orders for himself, his employer, or his employer's customers. However, if he is not a member or employed by a member firm, he can only trade for a proprietary account.

An operator can only enter orders for his employer or his employer's customers. To trade directly on the system, you must be a member of the Exchange or lease electronic trading privileges from a member. Electronic traders and operators must meet certain financial requirements.

The Trade Limit Monitoring System (TLMS) is a position monitoring tool integrated into the NYMEX ACCESSSM system software. It allows clearing members to control and monitor customer-based aggregate position limits by commodity, aggregate position limits at any one price by commodity, maximum size limit per order, and session loss limit. When trades are executed on NYMEX ACCESSSM, the system updates the information pertinent to a clearing member's accounts, giving the

clearing member an on-line, real-time view of his customers' positions, and allowing him to monitor each account against its set limit. Orders that exceed established limits are automatically rejected by the system.

Clearing members can set account limits before the start of a session, can carry them over from the previous NYMEX ACCESSSM session, or can change limits at any time during an electronic trading session. During the session, the TLMS calculates the profit and loss for each account by actual as well as marked-to-market gains and losses for all activity in the account. Profits and losses are calculated every two minutes or whenever a trade is executed. If loss limits are hit or exceeded, resting orders are canceled. New orders can be accepted only if a market move changes the account's loss, dropping it below the limit, or if the clearing member raises the limit.

Workstations may not be used in such a way that would violate any provision of the Exchange rules. The NYMEX ACCESSSM Control Center (NACC) is manned by Exchange staff around the clock. Personnel can shut down any trader workstation and prohibit the entry of orders should the responsible electronic trader lose his financial guaranty, or if other security issues make it necessary. NACC staff can monitor trading activity for market and financial surveillance purposes. Disciplinary matters are referred to the compliance department the following day.

ROLE OF THE CFTC

The federal government has long recognized the unique economic benefit futures trading provides for price discovery and offsetting price risk. In 1974, Congress created the Commodity Futures Trading Commission, giving it authority to regulate commodity futures and related trading in the U.S. Prior to the establishment of the CFTC, the futures industry was regulated by the Commodity Exchange Authority, an agency of the Department of Agriculture which had limited jurisdiction over agricultural and livestock commodities. A primary function of the CFTC is to ensure the economic utility of futures markets as hedging and price discovery vehicles - encouraging competitiveness, efficiency, and market and trade practice integrity and fairness.

The CFTC approves all futures and options contracts before they can be listed for trading. It reviews the terms and conditions of proposed contracts and oversees registration of firms and individuals who either handle customer funds or give trading advice. It also conducts and monitors rule enforcement at U.S. exchanges.

ENFORCEMENT OF EXCHANGE RULES

With margin requirements, price and position limits, and other rules and regulations in place to provide a fair and orderly market, the Exchange turns to its compliance department to ensure these rules are followed. The department is composed of three divisions:

- Market Surveillance
- Financial Surveillance
- Trade Surveillance

Market Surveillance

Through daily market surveillance, the Exchange monitors market participants, analyzing speculative and commercial participation, and examining the relationship between trading activity on the Exchange and fundamental factors in the cash market.

Market surveillance is required under CFTC regulations. Each day, the compliance staff compiles a profile of participants, identifying members and their customers holding reportable positions. In addition, daily surveillance is performed to ensure that Exchange prices reflect cash market price movements, that the futures market converges with the cash market at contract expiration, and that there are no price distortions and no market manipulation. A surveillance meeting is held weekly and more often if necessary to review research reports on fundamental economic factors affecting each commodity.

Participants in these meetings include members of the compliance and research departments and - when necessary - senior Exchange officers.

Financial Surveillance

The Exchange's financial surveillance staff serves in an audit capacity, ensuring that clearing members continually meet all minimum capital requirements. That unit is also responsible for closely monitoring on a daily basis original and variation margin collections and payments as well as clearing member position limits. In the event of an abrupt price movement, they contact clearing members with large positions to ascertain whether the movement has caused a decrease in the firm's capital or a substantial deterioration in the quality of customer's accounts.

The Exchange president may deem the financial condition of a clearing member inadequate to carry additional transactions and prohibit the firm from entering into them. In the event a clearing member fails to maintain sufficient capitalization, it may be summarily suspended by the executive committee of the Exchange.

Trade Surveillance

Compliance department analysts are trained to spot instances of trading

ahead of a customer; wash or accommodation trading (transactions creating the appearance of trading activity but which have no real economic effect); cross trading (matching customer orders without offering them competitively); and prearranged trading.

If the data appears suspicious, the review advances to the second stage, and an official investigation is launched. The Exchange obtains the broker's original trading card, the order ticket, the branch order ticket, and the envelope submitted on the day in question. It also identifies key opposite brokers and collects their trading records, including order tickets, and systematically reconstructs the audit trail, establishing a chronology of the transaction.

Combining sophisticated computer programs that provide real-time trade data with continuous on-the-floor monitoring, the trade surveillance staff keeps a close watch on floor trading activity.

AUDIT TRAIL

The Exchange's NYMEX Division is unique in that it requires trade information to be submitted to the Exchange and time-stamped within one minute of a trade. To comply with the stricter audit trail provisions of the Futures Trading Practices Act, NYMEX Division traders since October 30, 1995, are required to use an integrated trading pad, further refining the Exchange's dual record system of trade submissions, creating an unalterable audit trail.

The pad consists of a three-ply carbonless form (also called an NCR form), with four thin sheets of cardboard, also called hard-ply paper, lying underneath each form. There are nine lines on the forms. As the trader records his trades on the top sheet, it is also recorded on other sheets of the NCR form and on the top piece of hard-ply. Each time a broker executes a sell transaction, the hard ply is submitted to the Exchange within one minute, even though it may contain earlier buys. The next trades are recorded on the next sheet of hard-ply until a sale is recorded and it, too is submitted within a minute of the sale.

When the hard-ply is submitted to the Exchange, it is scanned into the computer system which creates an unalterable, time-stamped image. Each set of three-ply NCR forms and hard-plies carry the same serial number, allowing the original and the copies to be easily matched in the audit trail.

When the last trade recorded on the top sheet is a buy, the corresponding hard-ply page is immediately submitted to the Exchange. The buys are not used for data entry purposes, because the Exchange uses a single-sided system based on information provided by the selling broker, but the dual submissions further add to the accuracy of the audit trail.

Brokers must also record the time of the first trade and every fifth trade thereafter.

A copy of each NCR form is retained by the broker for his records.

On the COMEX Division, the time of a trade must be noted on the broker's trading pad within one minute of execution, and further enhancements to the audit trail are planned. The procedures under development on both divisions of the Exchange ensure that floor trading practices conform to the highest standards of integrity.

While the first visit to the Exchange trading floor can be a daunting experience for the uninitiated, in fact there is an exquisite order behind the men and women gesturing wildly as they bark cryptic buy and sell orders to their counterparts across the pit; the individuals in bright yellow jackets using hand-held computers to transmit price changes to the outside world; and the huge wallboards flashing a never-ending series of numbers with no apparent cohesion at all.

Each individual, each gesture, each bit of paper, is an essential element in a system which allows the efficient execution of trades, the rapid and accurate documentation of transactions, and the transmission of prices around the globe within seconds.

Despite the heavy volume of trading activity and data that is processed each business day, the Exchange continuously modifies its rigorous record-keeping, trade surveillance, and rule enforcement programs. At any given time, there are approximately 800 traders on the floor along with their clerks. Approximately 300,000 contracts change hands daily, breaking down to about 30,000 transactions a day.

With the evolution of computer technology, clearing speed has accelerated. Larger orders are more efficiently executed, and all orders regardless of size are matched with ease.

The sheer volume of trades and the volatility of the Exchange's markets makes an accurate audit trail imperative. By requiring floor brokers to document each step in the trade execution process, a painstakingly detailed record of each trade is sequentially recorded. Brokers recognize that a reliable audit trail protects them and their customers; the system guarantees that errors are quickly discovered and rectified.

Exchange floor operations employees are supplemented by 140 floor committee members spread out among more than

a dozen trading rings. The floor committee is comprised of Exchange members who — while conducting their own trading — help regulate activity on the floor by watching for disruptive trading practices or conduct, and violations of decorum and other floor rules.

Exchange rules authorize floor committee members to take summary action in enforcing the floor rules, including fines of up to \$5,000 for each rule violation. The floor committee may also refer matters within its jurisdiction to the business conduct committee or to the compliance department for further disciplinary action.

Order Tickets

In a typical transaction, the audit trail begins when a customer contacts an account executive at a recognized brokerage firm to place an order. The customer gives his trading instructions, including the commodity to be bought or sold, the quantity, and the type of order.

After receiving the call from his customer, the account executive records the trading instructions on his firm's order ticket. He time stamps the order ticket and relays the instructions to a booth operated by a floor broker on the Exchange trading floor. A floor broker must be a member of the Exchange who is registered with the CFTC through the National Futures Association and has met certain training and financial requirements.

At the booth, the floor broker's telephone clerk prepares his own order ticket based on the account executive's instructions. The clerk assigns a coded order number that guarantees customer anonymity yet ensures proper assignment of each transaction. He stamps the order ticket and immediately passes the order to the floor broker standing in the appropriate trading ring. The floor broker executes the trade through open outcry. Upon the execution of the order, the order ticket must be time stamped once more.

One-Minute Submission Requirement

When a trade is executed on the NYMEX Division, floor brokers must record the particulars of each transaction on the dual-record trading pad; the quantity, delivery month, price, the broker's badge symbol, and that of the broker taking the opposite side of the trade. The selling broker submits the hard-ply copy into the center of the ring; submission is required within one minute of the completion of a transaction.

Because the reliability of the audit trail depends on compliance with the one-minute rule, members are sanctioned for untimely submissions. This enforcement policy complements the overall surveillance effort. Since the early 1970s, the Exchange has required one-minute submission of pit cards.

In the center of the ring, an Exchange employee time-stamps the card (eventually scanners will be installed in all trading rings that will enable the immediate creation of an unalterable time-stamped record). The card is then handed to the podium for a spot check and is sent to the data entry room, where scanners are initially in use. Operators see the image of the hard-copy on half of a split screen on their computer workstations, the other half is a data entry template, making for a smooth, accurate process. Before scanners were installed, data was entered into the Exchange's central computer within five to 10 minutes of the execution of a trade. This time will be further reduced when scanner technology is fully installed.

Buying and selling brokers on the COMEX Division record their trades on trading cards which are submitted to the Exchange every 30 minutes. By the first quarter of 1996, the COMEX Division will use a single-sided system, with the record submitted by the selling broker. Eventually, the trade reporting system will be unified for both divisions.

As floor brokers execute their trades, Exchange floor reporters in the ring use hand-held computers to relay the month and price of the transactions into a high-speed computer driving an electronic ticker that transmits trading data to the wallboards on the trading floor and to the international

wire services that report commodity prices. This information also provides the basis for the Exchange's time and sales register, which is a daily record of prices, ordered chronologically, that can be accessed to cross-check the accuracy of pit-card times.

Once the trade has been executed, the floor broker relays details to his clerk, who confirms the trade with the account executive or with the customer directly. The clerk then stamps the order ticket a second time.

Compliance analysts regularly collect trading records from FCMs and floor brokers solely to review the accuracy of the audit trail requirements. At any given time, the Exchange may collect one week's worth of trading records to determine that the trading card is perfectly sequential with no lines skipped and that opening and closing trades are clearly denoted. Any deficiencies in these records are brought to the broker's attention with a warning letter. Continued violations eventually result in fines.

The compliance department monitors the integrity of the audit trail. Each day, compliance analysts monitor a computer that independently measures each broker's trading record submissions to determine their accuracy and timeliness. The records are immediately available in the event of any discrepancies.

Each trade executed on the Exchange is subject to this computer analysis. The program isolates a broker's trades by type (personal account, customer order), and against those of other traders. Should the program flag a potentially conflicting trade, the analyst launches a preliminary review, which entails a comparison of the broker's personal trading and customer order executions performed during the times in question.

INVESTIGATIVE AND DISCIPLINARY PROCESS

If the trade, market, or financial surveillance units determine there is a possible rule violation, an investigation will be opened. All members must respond to compliance department requests for documentation and/or interviews with compliance staff.

When a broker appears for a tape-recorded interview to give his version of the transaction, he has the right to appear with an attorney. Should the analyst conclude that a violation has occurred, those conclusions are documented in an investigative report. The report is reviewed by several levels of authority within the compliance department and presented to the broker, who has the opportunity to respond. The report is next forwarded to the business conduct committee for further review and possible action.

The business conduct committee is made up of one public member and 10 Exchange members, reflecting specific categories of participants within the trading community. It functions similarly to a grand jury, which does not make findings as to fact, but determines, based on the evidence of the investigative report and any written response of the trader, whether there is a reasonable basis to believe a rule violation occurred. It then may direct the compliance department to issue a complaint, or, in the case of minor violations, to issue a written warning.

A respondent in a disciplinary action has 10 days to respond to the com-

plaint. He may make an offer to settle the case at any time prior to the conclusion of a hearing. Such offers of settlement must be approved by the Exchange board of directors.

Offers of settlement exceeding \$25,000, or cases contested by the respondent, are referred to the adjudication committee for consideration of a settlement or for a full disciplinary hearing.

The adjudication committee consists of two panels, each with representatives from specific categories of the Exchange's membership, plus one public member. The panels are authorized to conduct hearings at which the facts of the case are presented and argued by the respondent or his attorney and Exchange compliance counsel.

Hearing procedures include the introduction of evidence and opening and closing statements by both sides. Any finding that a respondent violated a rule must be supported by the weight of the evidence. At the conclusion of the hearing, the panel issues a decision.

Sanctions can include a cease and desist order, a fine of up to \$250,000 for each rule violation, suspension, or expulsion from membership.

A respondent may appeal an adjudication panel decision by filing a Notice of Appeal. The appeal is heard by the appeals

panel, which is made up of the appeals committee chairman and three disinterested members of the committee. The panel is empowered to decide the appeal on the basis of the record and memoranda from the respondent and compliance department counsel. It may request oral presentations. The panel may overturn, modify, or affirm the adjudication panel's decision. The appeal panel's determination is final within the Exchange.

The Exchange publicly posts and publishes each settlement or decision and notifies the CFTC of final action. The respondent may further challenge the decision by appealing to the CFTC, which is rare, and then to Federal court, which is rarer still.

CONCLUSION

The New York Mercantile Exchange enforces a rigorous self-regulatory program closely monitoring and regulating floor trading activity to prevent market manipulation and other anti-competitive activity. The Exchange has taken the lead in developing and maintaining new trade surveillance enhancements including the addition of public representatives to a revamped disciplinary panel, increased penalties, and tightened recording procedures. During numerous hearings on the reauthorization of the CFTC, Exchange officials stressed the Exchange's intolerance of wrongdoing, and encouraged legislation aimed at further preserving public confidence in the markets.

The Exchange's rules and procedures have been carefully honed as a result of nearly 125 years of experience in building one of the world's safest and most liquid futures and options markets.

The Exchange board of directors and staff remain committed to providing the vigilance and financial support necessary to preserve the highest levels of customer confidence in the integrity of our market.

This brochure reflects Exchange rules as of January 2, 1996. Rules are subject to change. Please contact the Exchange or your broker for the latest information.

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EXCHANGE INFORMATION

The New York Mercantile Exchange's public information office makes information available to the public 24 hours a day through *Fastfacts*, a state-of-the-art phone system that puts you in touch with vital Exchange information faster than ever. Information such as price and volume data is updated every five minutes by the Exchange mainframe computer. New information is available within 30 minutes of real-time. Open interest and recent membership quotes are also included. Announcements from the Exchange regarding new contract openings, seminar registration information, and trading hour changes are all available through *Fastfacts*.

Call *Fastfacts*: (212) 513-7405

For a directory of access codes for all Exchange messages, call (212) 748-3350.

The Exchange publishes quarterly and semi-annual magazines, a monthly newsletter, and brochures relating to energy and metals markets and the Exchange's contracts. For a list of publications, or to order, contact the New York Mercantile Exchange Publications Office, 4 World Trade Center, Eighth Floor, New York, NY 10048. Telephone: (212) 748-3350.

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