



Special Executive Report

DATE: 16 September 2015

SER#: 7450

SUBJECT: **Close-Out and Re-Establishment of Open Interest of the In Delivery Month European Union Allowance Futures Contract from NYMEX to CME Europe**

New York Mercantile Exchange, Inc. (“NYMEX” or “Exchange”) is providing advance notice of a proposal to effectuate a process to close-out and re-establish (“CORE” or “CORE process”) NYMEX In Delivery Month European Union Allowance futures contract (“EUA Futures”) open interest (CME Globex Code: 6T; Clearing Code: EAF; NYMEX Rulebook Chapter: 1250) to CME Europe Limited (“CMEE”).¹ Under the proposal, the CORE process would be effectuated by a closeout of futures positions on NYMEX and a re-establishment of equivalent positions on CMEE.

Overview

CMEE is seeking approval from its primary regulator, the United Kingdom’s Financial Conduct Authority (“FCA”), to list and trade emission allowance futures contracts. At the same time, CMEE’s clearinghouse, CME Clearing Europe (“CMECE”) is seeking regulatory approval from its primary regulator, the Bank of England (“BOE”), to clear emission allowance futures contracts. As of this writing, CMEE and CMECE are awaiting the issuance of such approval to list and clear these contracts, which is required in order to facilitate the proposed CORE process.

In anticipation of FCA and BOE approval, the Exchange is providing advance notice to Clearing Members and market participants of proposed operational procedures that the Exchange may implement to closeout EUA Futures positions on NYMEX and re-establish equivalent positions on CMEE.

Should the Exchange determine to move forward with the CORE process, it will do so through a submission of the proposed procedures described below to the Commodity Futures Trading Commission (“CFTC” or “Commission”) in accordance with the requirements of Part 40 of the Commission’s Regulations. Furthermore, the Exchange would implement the CORE process only after the expiration of all relevant regulatory review periods and upon obtaining all required regulatory approvals.

The Exchange notes that participation in the proposed CORE process would be voluntary. However, based upon feedback received from market participants, the Exchange believes that the overwhelming majority of NYMEX EUA Futures position holders would prefer to hold their current positions in contracts listed on CMEE and cleared by CMECE and therefore would support the Exchange’s effort to facilitate the CORE process. Market participants often trade the associated products (e.g., European Power or European Natural Gas contracts) alongside their European allowance contracts as part of wider risk management strategies, and CMEE has recently launched a suite of such energy contracts. Market participants have informed the Exchange that they envisage that a migration of the EUA Futures open

¹ References herein to the NYMEX In Delivery Month European Union Allowance (EUA) futures contract also include the NYMEX Daily European Union Allowance (EUA) futures contract (CME Globex Code: EUL). As of this writing, there is no open interest in this contract.

interest from NYMEX to CMEE & CMECE could significantly increase the number of active traders and enhance liquidity.

Because only a balanced book of positions can be re-established on CMEE and CMECE, NYMEX EUA Futures position holders would be requested to provide a firm commitment to “opt-in” to the migration of their EUA Futures positions by a fixed date prior to the implementation date. Subsequent to the CORE process, such opted-in EUA Futures positions would cease to be subject to the rules of NYMEX and be cleared by CME Inc. (“CME”) and instead would be subject to the rules of CMEE and cleared by CMECE².

To the extent participants choose not to opt-in to the CORE process, open positions in such participants’ EUA Futures contracts would continue to be listed and traded on NYMEX and cleared by CME.

CORE Process

The Exchange notes that the proposed CORE process, which is detailed below, is largely consistent with the general historical practice of wholesale transfers of customer positions from one FCM to another at US exchanges, enabling such transfers from one FCM to another at the closing price on the day of the transfer. The proposed CORE process is also generally consistent with prior migrations of open interest from US exchanges to non-US exchanges.

To ensure consistency with precedent and to ensure a commercially viable CORE process to migrate open interest, and unless bespoke arrangements are requested by a position holder, the Exchange proposes to closeout all opted-in positions in NYMEX EUA Futures and then re-establish equivalent positions in CMEE EUA Futures by:

1. Issuing notices to NYMEX Clearing Members and market participants describing the procedures to be utilized and the relevant timeframes.
2. Requiring NYMEX Clearing Members carrying open positions in EUA Futures (or whose customers seek to initiate new EUA Futures positions on NYMEX) to notify their customers of the proposed procedures.
3. Requiring position holders who wish to close-out and re-establish their open positions to opt-in to the CORE process by a fixed date prior to the implementation date.
4. Following the close of trading on the implementation date, directing each NYMEX Clearing Member carrying opted-in positions in EUA Futures to execute a “back office” bookkeeping entry for each EUA contract involving CME (in its capacity as the clearinghouse for NYMEX) and the Clearing Member. The “back office” bookkeeping entry would close out the opted-in positions in NYMEX EUA futures by placing CME (in its capacity as the clearinghouse for NYMEX) opposite the open positions in each account.
5. Simultaneously, and as may be needed, assisting each CMECE Clearing Member selected by participating position holders (e.g. the NYMEX Clearing Member’s local affiliate or other UK entity) to execute a “back office” bookkeeping entry to establish the equivalent of each closed out EUA Futures position with CMECE. CME shall simultaneously further direct each NYMEX Clearing Member to execute a “back office” bookkeeping entry involving the relevant CMECE Clearing Member and the NYMEX Clearing Member, in which the NYMEX Clearing Member receives a position from the CMECE Clearing Member on the same side of the market and in the same quantity as the original position in the EUA Futures previously carried on NYMEX as of the close of trading on the implementation date.
6. To the extent that position holders maintain funds at a NYMEX Clearing Member in preference to clearing directly through a CMECE Clearing Member, requiring each NYMEX Clearing Member to

² While best efforts will be made to transfer all opted-in positions, it may be necessary, because only a balanced book of positions would migrate to CMECE, for certain opted-in positions to remain on NYMEX, or to be liquidated and not be re-established under the CORE process. Subsequent references to “opted-in positions” being transferred should be understood in this context.

transfer participating customers' segregated funds from the futures account in which the customer's funds were carried to a CFTC Regulation 30.7 account for foreign futures and options. Any funds in the house account of NYMEX Clearing Members will be returned to them by CME.

7. With assistance of the Exchange, CMEE, CMECE, and CMECE Clearing Members, matching each customer's re-established positions on CMECE and carried by CMECE Clearing Members with the customer's relevant accounts.

By way of example, if an FCM carries ten customer accounts, each with an opted-in NYMEX EUA Futures position, the Exchange and the FCM would record a bookkeeping entry to close out each such customer position. Likewise, each CMECE Clearing Member would execute a "back office" bookkeeping entry to establish the equivalent of each closed out EUA Futures position with CMEE/CMECE. Concurrently, the books and records of the carrying FCM would reflect a bookkeeping entry involving a CMECE Clearing Member and the FCM in which the FCM receives positions from the CMECE Clearing Member on the same side of the market and in the same quantity as its former positions in EUA Futures on NYMEX.

In summary, the opted-in positions in the re-established EUA Futures would be closed out on NYMEX and re-established as contracts listed on CMEE and cleared by CMECE. The opening price of the EUA Futures contract listed on CMEE and cleared by CMECE would be the closing price of the EUA Futures contract on NYMEX on the implementation date. The opted-in CMEE positions would thereafter be governed by English law and their trading would be subject to the rules of CMEE – a UK exchange regulated by the FCA – and their clearing would be subject to the rules of CMECE – a UK clearinghouse and EMIR authorized CCP supervised by the Bank of England.

Remarks

The Exchange does not believe that the one-time procedure described above would pose any potential anticompetitive effects on market participants or others. The Exchange believes that the CORE process would increase liquidity and competitive trading and should not generate material burdens on market participants. Moreover, given the specific characteristics of the EUA Futures market on NYMEX, the proposed CORE process would avoid any market disruptions by migrating open interest in an organized and transparent manner.

As noted, the Exchange and CMEE would not seek to change the material economic terms of the EUA Futures contract upon migration to CMEE. NYMEX Clearing Members and their customers would be notified that:

1. On and after the implementation date, the trading of the opted-in and migrated EUA Futures would occur only on CMEE, which is an FCA-regulated exchange, and, unlike NYMEX, is not a CFTC-regulated designated contract market. For the avoidance of doubt, opted-out positions would continue to be tradable on NYMEX.
2. The rules governing the trading and clearing of migrated contracts would be those of CMEE and CMECE, not those of NYMEX and CME, and the trading and clearing of such contracts would be subject to English law, not U.S. law.
3. For customers maintaining funds at a NYMEX Clearing Member in preference to clearing directly through a CMECE Clearing Member, all customer margin funds supporting such positions would be held by FCMs in CFTC Regulation 30.7 accounts. To the extent that such funds are transferred by the FCM to its local affiliate CMECE Clearing Member or other UK entity, these funds may be subject to applicable local client money protections. The Exchange would suggest that position holders speak to their legal advisers as to the potential effect of the transfer in this regard.
4. It is possible that for some NYMEX Clearing Members and their customers the tax treatment of opted-in EUA futures would be affected. Accordingly, NYMEX Clearing Members and their customers would be alerted to take the advice of their tax advisors as to the potential effect of the migration of the opted-in EUA futures.
5. The close-out and re-establishment of opted-in EUA Futures positions would occur as described above unless bespoke arrangements are requested and accommodated.

6. Opting-in to the CORE process is voluntary, and NYMEX Clearing Members and their customers can maintain their positions on NYMEX through and after, or liquidate or offset such open positions prior to and after, the implementation date.
7. While best efforts will be made to close-out and re-establish all opted-in positions, it may be necessary, in order to ensure that a balanced book of positions can be migrated to CMECE, for certain opted-in positions to remain on NYMEX, or to be liquidated, instead of being migrated. In opting-in to the CORE process, position holders will be deemed to agree to this potential alternative treatment of their positions. If such action is necessary, all affected market participants holding such opted-in positions will be treated in a fair manner.

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