CME Group

Craig S. Donohue
Chief Executive Officer

March 8, 2011

VIA ON-LINE SUBMISSION
David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Core Principles and Other Requirements for Swap Execution Facilities (RIN number 3038-AD18); (Federal Register Vol. 76, No 5, Page 1214)

Dear Mr. Stawick:

CME Group Inc. ("CME Group"), on behalf of its four designated contract markets, appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "CFTC" or "Commission") Notice of Proposed Rulemaking ("Release" or "NOPR") that was published in the Federal Register on January 7, 2011. In the Release, the Commission seeks comment on proposed rules, guidance and acceptable practices, which apply to the designation and operation of swap execution facilities ("SEFs").

CME Group is the world's largest and most diverse derivatives marketplace. CME Group includes four separate Exchanges, including Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX"). The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products.

CME includes CME Clearing, one of the largest central counterparty clearing services in the world, which provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter derivatives transactions through CME ClearPort®.

As a pioneer in the globalization of the futures markets, CME has helped to expand the customer base for futures products. CME Globex, for example, is available to users around the world for more than 23 hours a day, five days a week. To satisfy the increasing demands of the international marketplace, customers can access the CME Globex platform in more than 150 countries and foreign territories around the world. Telecommunications hubs in Singapore, London, Amsterdam, Dublin, Milan, Paris, Seoul, São Paulo, Kuala Lumpur and Mexico reduce our customers' connectivity costs, increase accessibility, and deliver faster, more efficient trading. Additionally, CME has established international offices in London, Singapore, Tokyo, Hong Kong, São Paolo and Calgary. CME believes that its significant global expertise

and experience will provide the Commission with a unique and valuable perspective on the matters discussed herein.

I. Overview

The financial crisis focused well-warranted attention on the lack of regulation of over-the-counter financial markets. With the Dodd-Frank Act ("DFA"), Congress crafted legislation that, we hope, reduces the likelihood of repeating that near disaster. DFA was intended to: (i) reduce systemic risk through central clearing and exchange trading of derivatives, (ii) increase data transparency and price discovery, and (iii) prevent fraud and market manipulation. CME Group supports these overarching goals and recognizes that enacting rules governing the establishment and operation of swap execution facilities ("SEFs") is one of the critical rulemakings necessary to achieve them. To this end, the Commission has proposed the rules set forth in the Release. In many respects, however, the rules proposed in the Release are not required by or are inconsistent with DFA, impose unnecessary and costly burdens on the industry, and require unnecessary increases in Commission staff and expenses.

Many of the rules proposed in the Release related to the SEF core principles are identical to the rules proposed in the Commission's Notice of Proposed Rulemaking regarding Core Principles and Other Requirements for Designated Contract Markets (RIN number 3038-AD09) (Federal Register Vol. 75, No 245, Page 80572) (the "DCM Release"). Thus, we object to these proposed rules for the very reasons we objected to the rules proposed related to DCMs' core principle obligations in the DCM Release. In particular, we object to the Commission's apparent effort to evade the principles-based regulatory regime that Congress established for SEFs in DFA by enacting a litany of prescriptive rules that would dictate every detail of a SEF's day-to-day operations.[1] Had Congress wanted the Commission to abandon principles-based regulation, it certainly would not have reinforced that regime for DCMs by adding an additional five core principles and established the regulatory framework for SEFs and swap data repositories ("SDRs") through core principles.

As discussed in detail in our comment letter in response to the DCM Release (the "DCM comment letter"), Congress' decision to maintain principles-based regulation for the futures markets and extend that regime to the newly-regulated swaps market makes sense when one considers the transformative effect that principles-based regulation has had on the U.S. futures markets over the last decade. Since the adoption of the Commodity Futures Modernization Act of 2000 ("CFMA") — which converted the Commodity Exchange Act ("CEA") from a rules-based regime to a principles-based regime — the regulated U.S. futures markets have experienced unparalleled growth and innovation. We believe strongly that principles-based regulation of futures exchanges and clearing houses permitted U.S. exchanges to regain and maintain their competitive position in the global market. Specifically, it allowed U.S. futures exchanges to keep pace with rapidly changing technology and market needs by introducing new products, new processes and new methods by certifying compliance with the CEA and thereby avoiding

[1] Rather than repeat the comments made in our comment letter in response to the rules governing DCM core principle obligations in the DCM Release, we attach the DCM comment letter in its entirety as Exhibit A to this letter and submit it as part of our formal comment on the rules proposed in the Release.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

stifling regulatory review. U.S. futures exchanges operate more efficiently, more economically and with fewer complaints under this system than at any time in their history.

Moreover, as has been publicly discussed many times over the past several years, CFTC-regulated futures exchanges — which list contracts that not only perform a price discovery function but a risk management function as well — and clearing houses operated flawlessly, performing all of their essential functions without interruption during the recent financial crisis. Indeed, while large financial firms regulated by other oversight agencies failed, our clearing house experienced no default and no customers on the futures side lost their collateral or were unable to immediately transfer positions and continue managing risk. Thus, it is appropriate to conclude that by bringing a significant portion of trades in the OTC swaps market into regulated clearing houses and on to SEFs, and modeling the SEF regulatory regime on the futures regulatory regime, Congress believed that if we experienced substantial market turmoil again, the newly regulated swaps market would perform like the futures markets did in 2008.

It is not appropriate to conclude, however, that Congress intended for the Commission, through the rulemaking process, to remove markets and market participants from the regulated futures regime and force them into the newly established swaps regime. In fact, this defies logic. Yet, this is exactly what the Commission seeks to do with its proposed rules on Core Principle 9 for DCMs. For example, proposed rule 38.502(a) would require that 85% or greater of the total volume of any contract listed on a DCM be traded on the DCM's centralized market, as calculated over a 12 month period. Specifically, in relevant part, proposed rule 38.502 provides that no DCM "may continue to list a contract for trading unless an average of 85% or greater of the total volume of such contract is traded on the designated contract market's centralized market, as calculated over a 12 month period" (the "85% Requirement"). This proposed rule would apply to contracts that are listed as of the effective date of the rule and any products listed subsequent to the effective date of the rule. If a contract fails this test, the DCM is required to delist the contract and transfer the open positions in the contract to a SEF (either one it operates or one operated by another) or liquidate the contract within 90-days of performing the requisite calculation. Notably, the Commission appears to have given no consideration to the adverse consequences that its proposed rule will have on the affected markets or market participants.

While not explicitly stated in the DCM Release, proposed rule 38.502(a) effectively requires that every contract listed for trading on a DCM: (i) trade in the centralized market and (ii) serve a price discovery function. As Commissioners Sommers and O'Malia noted in their dissent to the DCM Release, with this proposed rule, among other related rules, the Commission is "interpreting Core Principle 9 in a way that does not comport with the plain language of the statute." DCM Release, 75 FR 80572, 80635-36. Core Principle 9 provides that a DCM "shall provide a competitive, open and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market." Core Principle 9 also expressly authorizes off-exchange futures transactions so long as those transactions are executed pursuant to DCM rules. Specifically, Core Principle 9 provides that "the rules of a board of trade may authorize . . . (i) transfer trades or office trades; (ii) an exchange of (I) futures in connection with a cash commodity transaction; (II) futures for cash commodities; or (III) futures for swaps; or (iii) a futures commission merchant, acting as principle or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if that contract is reported, recorded, or cleared in accordance with the rules of the contract market or [DCO]."

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

The only rational reading of Core Principle 9 is that where a listed futures contract is being traded in the centralized market and there is sufficient liquidity for price discovery to be occurring, DCMs have an obligation to ensure that its rules governing off-exchange transaction do not interfere with or detract from that price discovery process. As Commissioners Sommers and O'Malia put it, "[Core Principle 9] requires a mechanism for protecting the price discovery function for those contracts that do trade in the centralized market." 75 FR 80572, 80635. Further support for Commissioners Sommers' and O'Malia's reading of Core Principle 9 can be found in the comment letters filed in response to the DCM Rulemaking.[2] As one commenter explained, the regulated futures markets, under the oversight of the Commission, has grown to include not only contracts that perform a price discovery function, but those that serve the risk management needs of the public:

> To be sure, as enshrined in the [CEA] as enacted in 1936, a paramount goal of the CEA and the Commission and its predecessor agencies was, and is, to protect the price discovery function of U.S. futures exchanges. Much has changed since 1936, however. In 1936, futures exchanges traded contracts tied to agricultural commodities. For those commodities, at that time, the futures exchanges did generally serve as the primary price discovery venues. Since then, DCMs have introduced contracts on a panoply of futures on everything from metals, energy, interest rate and equity indexes to weather and other esoteric commodities. In many cases, DCMs, after some time and enormous investment of resources, have developed futures contracts that have become the dominant price discovery mechanism for the underlying commodity involved. In other cases, DCMs have developed contracts that serve as important tools for segments of the market to achieve risk exposure to the price action in a commodity or an asset class. Although these contracts may still play a role in overall price discovery their primary value to market participants may be in serving other important risk management functions.[3]

Moreover, as the commenters also discuss in their letters on the DCM Rulemaking,[4] proposed rule 38.502, if adopted, would have a profound adverse impact on the regulated futures markets without any regulatory or public benefit. Market participants would not benefit; the sole beneficiaries of such a rule would be SEFs, swap dealers and other eligible contract participants ("ECPs") trading swaps not subject to the trade execution requirement on a principal-to-principal basis in the over-the-counter market. To be clear, as the commenters on the DCM Release explain, such a rule would require many existing and potential futures contracts to be listed as swaps for trading on a SEF, providing no enhanced regulatory value and stifling growth and innovation in the futures industry.

Specifically, the commenters explained that the Commission's proposed 85% requirement would have a detrimental effect on the development of new products by DCMs. New products take time to gain traction in the marketplace and often initially build open interest and gain trading momentum in off-exchange

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[2] The Comment Letter file for the DCM Release is available at http://comments.cftc.gov/PublicComments/CommentList.aspx?id=934.

[3] Comment letter filed by NYSE Liffe in response to the DCM Release, dated Feb. 22, 2001. The comment letter is available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27910&SearchText=

[4] We understand that additional comment letters on the DCM Release are forthcoming, and in particular, will address the Commission's proposed rules with respect to Core Principle 9.

transactions. In many instances, it takes years before trading on the centralized market becomes the predominant mode of trading. With the threat that a contract will be delisted, market participants will be deterred from trading in the contract. Customers prefer trade certainty, which they would lack if this rule is adopted. As such, the 85% Requirement — or any prescriptive rule arbitrarily limiting the amount of trading off the centralized market — would deter DCMs from investing in developing new products. As some commenters also noted, the 85% exchange-trading requirement will decrease competition in the futures industry by making it more difficult for new DCMs to enter the market. That is, a new DCM will not have the benefit of existing and well-established products; with all its products threatened by such a rule, it would be exceedingly difficult for a new DCM to even raise capital to attempt to enter the market.[5]

Had Congress intended for Core Principle 9 to take from the futures market and give to the swaps market, the language of this provision would read very differently. In fact, as the Commission knows, many of our listed energy futures products — which have been listed for almost a decade and trading pursuant to DCM rules and Commission oversight — would fail that test. As Commissioners Sommers and O'Malia note in their dissent to the DCM Release, "Congress was aware of this specialized marketplace when it amended Core Principle 9. If Congress had intended to outlaw this activity it could have done so by explicitly requiring all DCM contracts to trade in the centralized market. It did not do so." DCM Release, 75 FR 80572, 80636. To the extent that the Commission would have preferred that Core Principle 9 (i) limit DCMs' product offerings to only those products that trade in the centralized market and perform a price discovery function, and (ii) ban certain types exchange of futures for swap transactions, the Commission could have proposed clear language to this end during the legislative phase for inclusion in the final law, which regulatory agencies commonly do.

Nothing else in DFA confers upon the Commission the authority to take from the futures market and give to the swaps market. In fact, the definition of "swap" in DFA expressly excludes futures contracts. Specifically, the definition of "swap" in DFA states "[e]xcept as provided in subparagraph (B), the term 'swap' means . . ." 7 U.S.C. § 1a(47)(A). Subparagraph (B) provides, in relevant part, "any contract of a sale of commodity for future delivery (or option on such a contract) . . . ." 7 U.S.C. § 1a(47)(B). Clearly, a contract for the sale of a commodity for future delivery, by definition, is not a swap, and by law, is required to be traded *only* on or subject to the rules of a DCM. 7 U.S.C. § 4(a). Thus, all current and future products listed as futures contracts on a DCM, by definition, are *not* swaps.

If the plain language of the statute is not convincing for the Commission, well-established law governing statutory interpretation supports this reading. One such cardinal principle of statutory interpretation is to read a statute as a whole, giving meaning and effect to every clause and provision.[6] Accordingly,

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[5]The commenters also discuss the potential adverse consequences of such a rule to market participants. If a contract is delisted, market participants may be required to hold existing positions to expiration, which could, under certain circumstances, have serious negative financial consequences. Even if a product is transitioned to an SEF, the transition would cause a disruption to the market, including a detrimental effect on liquidity. Significantly, market participants who were not eligible to trade on a SEF would be forced to involuntarily liquidate their positions.

[6] Another, related statutory construction principle is that where exceptions to a general rule are specified by statute, other exceptions are not to be implied or presumed. *See, e.g.*, *Andrus v. Glover Const. Co.*, 446 U.S. 608, 616-17 (1980). If the Commission were to treat futures as swaps notwithstanding the futures exclusion from the "swap"

constructions that render any statutory language surplusage must be avoided. *See, e.g.*, *Hibbs v. Winn*, 542 U.S. 88, 101 (2004). By requiring futures contracts listed on DCMs to be traded as swaps on SEFs under certain circumstances, the Commission's DCM proposal in effect treats futures and swaps as though they were the *same* product. The proposal thus renders superfluous the *exclusion* of futures contracts from the "swap" definition in subparagraph (B) of CEA section 1a(47). Moreover, ignoring the distinction between futures and swaps (established by section 1a(47)(B)(i)) so that a contract listed as a future on a DCM could become a swap traded on a SEF, would effectively nullify section 4(a). That section clearly requires that all futures contracts be traded on or subject to the rules of a DCM. Thus, in failing to give effect to the futures exclusion in section 1a(47)(B)(i) and to section 4(a), the Commission's proposal would contravene longstanding statutory construction principles.[7]

It appears that the Commission disagrees with many of Congress' decisions regarding DFA, including Congress' position on Core Principle 9. Though some might debate the merits of whether Congress or the Commission has the better position, the Commission is bound by the law as written. Indeed, it is well-established that the Commission does not have authority to correct what it perceives as flaws in legislation. *See Bd. of Governors of Fed. Reserve Sys. v. Dimension Fin. Corp.*, 474 U.S. 361, 374 (U.S. 1986) (finding that the Federal Reserve had no power to correct flaws that it perceived in the statute it was empowered to administer and stating that "rulemaking power is limited to adopting regulations to carry into effect the will of Congress *as expressed in the statute.*") (emphasis added). Accordingly, it is inappropriate — and unlawful — for the Commission to attempt to use its position as a regulatory agency to undermine the functioning and competitiveness of the U.S. futures markets in the manner that it proposes.[8]

II. Detailed Comments

Below are CME Group's detailed comments on the rules proposed in the Release that are unique to SEFs and the SEF regulatory regime.

The Definition of Swap Execution Facility and Proposed Rule §37.9 on Permitted Execution Methods.

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definition it could be viewed as creating an exception to the exclusion in violation of this statutory construction principle.

[7] Even if the Commission had authority to contravene the plain language of the statute in this manner (which it clearly does not), it would be arbitrary and capricious to adopt a rule that says that contracts that do not trade in the open and competitive market are swaps and must be traded on a SEF without adopting a corollary rule that says that contracts which *can and do* trade in the open and competitive market are futures contracts that must be traded on a DCM.

[8] In this regard, as we commented in response to the Commission's Notice of Proposed Rulemaking on Real-Time Public Reporting of Swap Transaction Data, RIN 3038-AD08, 75 Fed. Reg. 76140 (December 7, 2010, with a comment deadline of February 7, 2011), rules for block trading of swaps and futures that are economic equivalents must be comparable. Our comment letter in response to this proposal is available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27555&SearchText=

The Commission's proposal does not appropriately implement the statutory directive that a SEF provide *multiple* participants with the ability to execute or trade swaps by accepting bids and offers made by *multiple* participants in the facility or system. DFA defines "swap execution facility" as a "trading system or platform in which multiple participants have the ability to execute or trade swaps by accepting bids and offers made by multiple participants in the facility or system, *through any means of interstate commerce*, including any *trading facility* that . . ." 7 U.S.C. § 1a(51). As several commentators have discussed in their pre-comment letters on this topic, the legislative history of the SEF definition underscores what the plain language of the statute makes clear — Congress intended the definition of SEF to have broad application and includes a host of existing trading platforms or facilities, including traditional RFQ systems and voice-brokered systems.[9]

Under the Commission's proposal, a "trading facility," as defined by the CEA, qualifies as an acceptable order book model SEF. A "trading facility" is defined as

> a person or group of persons that constitutes, maintains, or provides a physical or electronic facility or system in which multiple participants have the ability to execute or trade agreements, contracts, or transactions (i) by accepting bids or offers made by other participants *that are open to multiple participants* in the facility or system; or (ii) through the interaction of multiple bids or multiple offers within a system with a pre-determined non-discretionary automated trade matching and execution algorithm.

The only substantive differences between clause (i) of the definition of "trading facility" and "SEF" are (i) the phrase "that are open to multiple participants" was deleted from the definition of SEF and (ii) the definition of SEF includes the phrase "through any means of interstate commerce." Therefore the definition of SEF encompasses all models that satisfy the definition of "trading facility" and encompasses a wider array of trading models. Congress certainly was aware of the definition of "trading facility" when it drafted and enacted DFA. Thus, the only reasonable inference is that Congress deliberately deleted the phrase "that are open to multiple participants" and added the phrase "through any means of interstate commerce" in the SEF definition to allow for an interpretation of the term that was broader than "trading facility."

The Commission's proposal purports to allow a wide variety of facilities or platforms to qualify as SEFs, including order book and request for quote ("RFQ") models; however, the Commission's rules, if adopted, would substantially curtail the manner in which SEFs can operate these models. Specifically, the Commission's proposal requires that a SEF provide "*all* market participants" with: (i) "the ability to make any bid or offer transparent to *all* other market participants of the SEF"; *and* (ii) "the ability to post both firm and indicative quotes on a centralized screen such that they can be executed or traded against by other multiple market participants." With respect to the RFQ model, the Commission also would require

[9] *See, e.g.* Comment Letter from ISDA dated October 1, 2010, available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission13_100110-isda.pdf; Comment Letter from Cleary Gottlieb Steen & Hamilton LLP dated October 5, 2010, available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission13_102510-cgsh.pdf; Comment Letter from Hunton & Williams dated November 19, 2010, available at http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission13_111910-email1.pdf.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

that a request for quote be disseminated to at least five market participants. The Commission asserts that these requirements are necessary to ensure that "multiple participants have the ability to reach multiple counterparties." (Release at 1220). Contrary to the Commission's assertion, nothing in DFA requires the Commission to place such prescriptive parameters on the market.
As noted above, the definition of a SEF itself contemplates that transactions will be permitted to be executed without all transactions being open to all market participants. Moreover, the definition of "trading facility" — which was known to Congress when it enacted DFA and expressly incorporated into the SEF definition — contemplates "multiple to multiple" trading and does not require the all bids and offers on the system be open to everyone on the system. There is no requirement that each bid or offer be open to all, or any specific subset, of the participants in a SEF, provided that it is open to "multiple" participants. Nor is there a requirement that a request for quote go to at least 5 market participants. Thus, requiring a SEF to offer "all-to-all" trading or that its rules require a request for quote be sent to at least 5 market participants is in express contradiction to DFA.

Contrary to the Commission's assertion, the "impartial access" requirement does not require "all-to-all" trading. As an initial matter, if Congress intended that SEFs be required to provide "all-to-all" trading, the natural place for imposing such a requirement would have been in the SEF definition. However, Congress did not impose such a requirement vis-à-vis the core principles. Core Principle 2, in relevant part, states that a SEF must "establish and enforce trading, trade processing, and participation rules that will deter abuses and have the capacity to detect, investigate, and enforce those rules, include means . . . to provide market participants with impartial access to the market." By its plain terms, Core Principle 2 relates only to the criteria established by SEF for *gaining access to* — in other words, trading privileges on — a SEF. Core Principle 2 does not dictate that SEFs have any particular business model nor does it dictate the manner in which trading must occur on the SEF. Thus, the Commission may not use this provision to rewrite the SEF definition passed by Congress. *See Dimension Financial Corp.*, *supra*, 474 U.S. at 374 (finding that the Federal Reserve had no power to correct flaws that it perceived in the statute it was empowered to administer); *Cf. Ill. Commerce Comm'n v. Interstate Commerce Comm'n*, 879 F.2d 917, 926-27 (D.C. Cir. 1989) (reversing decision by Interstate Commerce Commission that federal law preempted state regulation of particular intrastate tracks, because, in part, the agency disregarded the rule that specific statutory provisions trump general provisions).

Finally, the Commission should clarify that platforms that execute solely illiquid or bespoke products (products that are outside the trade execution requirement) are not *required* to register as SEFs, but may voluntarily choose to do so. Although the Release makes clear that these transactions may be done by voice, it is unclear whether those who execute such trades by voice are required to register as SEFs. This clarification would be consistent with the statement in the Securities Exchange Commission's proposal that security-based swaps that are not subject to trade execution requirement "would not have to be traded on a registered SB SEF."

§ 37.10 – Swaps Made Available for Trading.
In the Release, the Commission states that DFA requires that swaps subject to the clearing mandate be executed on a SEF or DCM (the "trade execution requirement"). The Commission states that the trade execution requirement will not apply if (i) the Commission has not made a determination regarding the clearing requirement with respect to a swap, (ii) an eligible counterparty availed itself of an exception to

the clearing requirement and does not wish to transact the swap on a SEF or DCM, or (iii) no DCM or SEF "makes the swap available to trade."

With respect to whether a DCM or SEF "makes a swap available to trade," the Commission is proposing to require SEFs (but not DCMs) to make annual assessments to determine whether a swap has been made available for trading. The Commission is specifically seeking comment on the factors that should be considered when making the determination.

We agree with the Commission that frequency of transactions and open interest should be among the factors considered when determining whether a swap is "made available to trade." In addition to these factors, CME Group believes that the factors that should be required to be considered include those discussed in the report recently published by the International Organization of Securities Commissions ("IOSCO Report").[10] Specifically, these factors include: (i) the number and types of market participants (*i.e.,* the need for speculators and market makers to serve as liquidity providers and liquidity takers), (ii) the product characteristics (including the breadth of interest in a product), and (iii) the transaction size.

CME Group also agrees with the position of the International Swaps and Derivative Association as articulated in its pre-comment letter on this topic that listing or minimal trading activity on a platform does not render that swap "available for trading" on a SEF.

> A single swap that does not generate any trading activity beyond one transaction cannot be said to be "available to trade" on a SEF. The exemption from the execution requirement, in other words, is more expansive and is premised on Congress's expectation that not all cleared transactions will necessarily be traded on a SEF. Second, the exemption from SEF execution applies to swaps that are not made "available to trade," regardless of whether they are "listed" on a SEF. In our view, the phrase "available to trade" connotes a SEF that has created an actual trading market, with market liquidity that can accommodate the needs of market participants, and not merely listed a swap for which there is no liquidity and no trading activity. As a result, the listing of a swap, standing alone, is insufficient to bring it within the execution requirement, unless the applicable regulator has made a separate determination that liquidity is at a level that makes the swap "available to trade." The phrase "available to trade," in our view, can only be interpreted to mean that the SEF has taken steps to facilitate the development of an actual trading market with adequate liquidity to accommodate the needs of market participants.

In considering whether a swap is "made available to trade," the Commission must balance its interest in promoting pre-trade price transparency against the increased costs that could arise through pre-trade transparency in the context of swaps trading, particularly trading in large orders of illiquid products. In some cases, the need to protect the functioning of the markets outweighs the concern for pre-trade transparency. If quotes are made public before a trade can occur in a less liquid swap, third parties may be tipped off to the upcoming trade, resulting in an unlevel playing field. Allowing the market access to

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[10] The IOSCO Report is available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD345.pdf.

this information encourages "front-running" and an increased bid/ask spread which will result in increased costs to the end-user client rather than decreased costs. Such concerns necessitate the use of block trading and other off-exchange transactions in the futures markets. In illiquid markets and markets where there are few market participants, information about the positions and trading strategies of counterparties to a trade can be conveyed to the market, and in some instance, may be used to infer the identity of at least one of the counterparties to the trade. In these markets, if market participants do not retain the ability to execute trades without, in effect, announcing their positions or trading strategy prior to making such trades, they will refrain from trading these instruments or trade in markets outside the Commission's jurisdictional reach.

It is also important to note that the execution method and other trade rules of a particular SEF are relevant for purposes of determining whether a swap is "made available to trade." For example, if a request for quote on an RFQ platform is required to be sent to at least 5 participants in a market where there are not 5 active participants or where traders are concerned about sharing their positioning and trading strategy with 5 other participants, those swaps may not be "available for trading;" however, those same swaps may be "available for trading" if the request for quote could be sent to just one other market participant. Thus, whatever the final rules are for permitted execution methods, the trade execution requirement must be appropriately tailored.

Finally, the Release does not make clear whether the determination regarding whether a swap is "made available for trading" will be made by SEF or by the Commission. While we understand the efficiency of requiring each SEF to assess the trading of swaps it offers pursuant to objective criteria established by the Commission, we believe that assessment made by the SEFs should be reviewed by the Commission and the Commission should make the determination as to whether a particular swap is subject to the trade execution requirement. Having this determination made by the Commission will eliminate the motivation that might exist for a SEF to determine that it has made a swap available to trade and force the market to trade such swap on a SEF before it is appropriate in order to attempt to gain a first mover advantage.

§37.3 – Requirements for Registration.
In this proposed rule, the Commission proposes to offer grandfather relief to existing exempt commercial markets ("ECMs") and electronic boards of trade ("EBOTs") and other facilities or platforms operating pursuant to exemptions under the CEA. The stated purpose of the grandfathering provision is to "avoid undue market disruption as well as to ensure continuity of the [entity's] business operations" that are in existence at the time final SEF rules are adopted. Release at 1216. In order to effectuate the purpose of the grandfathering provision, CME Group submits that the Commission must amend the proposed rule and expand the relief provided to this provision to DCMs that may wish to operate a SEF.

Extending the grandfathering relief provided for in the Release to DCMs comports with the Commission's stated objective and the language of DFA. DFA expressly permits DCMs to register and operate a SEF. Specifically, Section 5h(c) of the CEA provides:

> IDENTIFICATION OF FACILITY USED TO
> TRADE SWAPS BY CONTRACT MARKETS. — A

> board of trade that operates a contract market shall, to the extent that the board of trade also operates a swap execution facility and uses the same electronic trade execution system for listing and executing trades of swaps on or through the contract market and the swap execution facility, identify whether the electronic trading of such swaps is taking place on or through the contract market or the swap execution facility.

Thus, if a DCM has listed cleared swaps prior to the adoption of final rules, there is no reason to exclude them from the coverage of the grandfathering provision. Such a result serves only to competitively disadvantage DCMs, which is supported by neither DFA nor any other regulatory or policy concerns.

Finally, the Commission should clarify that entities that are neither ECMs nor EBOTs but are currently operating pursuant to another exemption or exclusion provided under the CEA are permitted to make changes to their business operations in anticipation of registering as a SEF.

§ 37.204 and § 37.403 – Regulatory Services Provided by a Third Party.
Through these proposed rules, the Commission requires SEFs to share information with other SEFs and regulatory services providers in order to conduct effective surveillance of fungible swap products trading on multiple SEFs. In particular, proposed § 37.403, requires a SEF with a linked market to have an information sharing agreement with the other venue or the capacity to assess positions or trading in the swap or commodity to which its swap is cash-settled.

CME Group does not believe that it is appropriate for the Commission to mandate that competing execution venues share market information with each other. Rather, this information should be reported to the Commission by each of the respective venues. Indeed, the Commission is uniquely situated to add regulatory value to the industry in the context of reviewing for potential cross-venue rule violations as it is the central repository for position information delivered to it on a daily basis in a common format across all venues. In the interest of efficient and effective industry regulation that minimizes the costs of redundant efforts, CME Group believes this is an appropriate area in which the Commission should allocate resources.

The proposed alternative is for the Commission to impose onerous burdens on SEFs, DCMs and their customers by requiring the reporting of information the Commission is already privy to; however, this would clearly be the more inefficient option, may impair liquidity because participants do not desire to take on the burden of reporting or the regulatory risk of failing to do so, and is also less effective because the trader may not report the positions to the SEF or DCM as timely or as accurately as the clearing firm will report to the Commission via its routine reporting. The regulation also provides that instead of requiring the duplicative reporting, the SEF or DCM could instead enter into an information-sharing agreement with the other venue, but this too has additional costs to both entities and it may not be practical or prudent for a SEF or DCM to enter into such an agreement with the other venue.

CME Group rules already allow it to request such information on an as-needed basis from market participants and it is also a party to various information sharing agreements with other entities. When a market position is of concern to CME Group's regulators, they have the ability to request such information in one of these ways. The benefit of mandating duplicative reporting by all participants, even where there is no identified basis for concern, is burdensome and a poor use of regulatory resources.

Subpart P – Designation of Chief Compliance Officer

Among the many new requirements under DFA is the mandate in Section 733 CEA that each SEF designate an individual to serve as its chief compliance officer ("CCO"). CME Group is committed to promoting and maintaining a strong culture of compliance throughout our organization. In furtherance of that commitment, we devote substantial time and resources to developing compliance policies and procedures and providing compliance education and training to our personnel. These efforts involve officers and employees in various departments throughout CME Group and its subsidiaries, including but not limited to CME and CME Clearing. CME Group supports creating a culture of compliance of CFTC registrants, including SEFs, and concurs with the regulatory policy underlying the requirement for every SEF to have a CCO.

As with the Commission's proposal on the rules governing CCOs of DCO, while we believe that certain aspects of proposed Regulation 37.1500 and 37.1501 are appropriate, other provisions in the proposal stray too far afield from Dodd-Frank's mandate and established compliance practices in the financial services industry with respect to the appropriate scope of CCO responsibilities. Most of the proposed rules related to a SEF's CCOs obligations are substantively the same as those proposed for a DCO's CCO; therefore, we have the same objections here as we did with the DCO CCO proposed rules. Rather than repeat those detailed comments in their entirety, we incorporate our comment letter in response to the Commission's DCO CCO proposal in its entirety.[11]

Worth mentioning here is proposed rule § 37.1501(b)(2), which requires the CCO to "have the background and skills appropriate for fulfilling the responsibilities of the position" and prohibits anyone who would be disqualified from registration under Sections 8(a)(2) or (a)(3) of the CEA from serving as CCO. Proposed Regulation 37.1501 also states that the CCO "may not be a member of the swap execution facility's legal department and may not serve as its general counsel." The CFTC requests comment on whether these restrictions are adequate and whether additional limitations should be placed on the person who may be designated as the CCO.

CME Group recognizes that it may be preferable for a CCO to only perform compliance activities, and that compliance staff, and in particular the CCO, should not be placed in a position where possible conflicts of interest may arise between their compliance responsibilities and other duties they perform at the SEF. Nevertheless, it is commonplace for CCOs to have certain other job responsibilities, most typically in related "control areas" such as the Legal Department or Internal Audit.[12] At a minimum, the CCO

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[11] That comment letter is attached as Exhibit B.

[12] Recent surveys indicate that about 35 to 40 percent of companies polled have a CCO that does not have other job responsibilities, and that where the CCO job is shared with another title, it is most commonly someone from the legal department (at around 20 percent of survey participants), or Internal Audit (at around 10 percent of survey

inevitably will share some functions with Legal and Internal Audit, and will engage in ongoing coordination and information sharing with those departments in order for each to carry out its role efficiently and effectively. We believe the CFTC should retain an approach that gives SEFs flexibility to determine whether their CCOs may perform certain tasks that are not strictly compliance-related.

As a whole, the proposed rules governing the CCO and its obligations are overly prescriptive and afford SEFs no flexibility to implement and operate its compliance structure. There is an array of different compliance structures that a SEF might choose to employ that would allow the SEF to satisfy its obligations under the core principles. DFA expressly grants SEFs "reasonable discretion in establishing the manner in which the [SROs] compl[y] with the core principles." The Commission should enforce Congress' intent in this regard.

Appendix C, §§ (c)(3)(ii) & (g)(ii).
Both proposed rules provide "The cash-settlement survey should include a minimum of four independent entities if such sources do not take positions in the commodity (e.g., if the survey list is comprised exclusively of brokers) or at least eight independent entities if such sources trade for their own accounts (e.g., if the survey list is comprised of dealers or merchants)." Rules, such as these, that would require DCMs or SEFs to use a minimum and specific classification of index providers is problematic in some markets, including agriculture, livestock and OTC Energy. For example, many of the more complex products are regional and even localized to specific urban areas, thus having more localized liquidity and participation size that may not have the required index providers to meet the requirement. Therefore, the Commission's prescriptive approach, which does not take into account market differences, is unsound. As with other rules proposed by the Commission in the Release, a "one-size-fits-all" approach does not work here.

We employ a number of robust techniques to manage the pricing of instruments listed for trading on our markets. For example, the final and daily marks are derived from highly transparent benchmarks published for very liquid regulated futures contracts such as WTI, Natural Gas, Brent and Gasoil. Furthermore this is widely accepted by the market participants as a number of products are a function of different delivery points, grades, and cracks of an underlying product which are highly correlated and have well established differentials based upon transport cost, seasonality, and grade premiums. In fact, with respect to our energy products, OTC Energy Voice Broker quotes are also used to derive and validate current market differentials to create the best fair market value on our products. Additionally, there are a significant number of our OTC products whose final settlement is based on an index derived from daily cash market assessments provided by independent and industry known pricing services as such as Platts, Argus or OPIS.

We believe that the flexibility currently afforded under Part 38 has allowed us to satisfy our obligations under Core Principle 3 with respect to all of our products, and see no problem with continuing to employ these, and other, varying techniques for managing the pricing of instruments listed for trading on our markets. Our markets are efficient, orderly and well regulated today, thus there is no sound basis for requiring us to change our approach. On the contrary, we believe that there is substantial risk of

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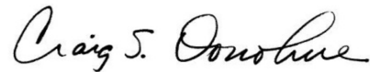
participants). Melissa Klein Aguilar, Chief Compliance Officer Now a Full-Time Job, Compliance Week (Dec. 15, 2009).

disrupting our markets if we are forced to employ the Commission's rigid and inflexible proposed rules across all of our products.[13]

* * * * *

CME Group thanks the Commission for the opportunity to comment on this matter. We would be happy to discuss any of these issues with Commission staff. If you have any comments or questions, please feel free to contact me at (312) 930-8275 or via email at Craig.Donohue@cmegroup.com, or Christal Lint, Director, Associate General Counsel, at (312) 930-4527 or Christal.Lint@cmegroup.com.

Sincerely,



Craig S. Donohue

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia

[13] The Commission should clarify that these proposed rules do not apply to futures contracts that are currently listed on DCMs. Core Principle 3 is not a new core principle for DCMs and CME Group has always maintained compliance with our regulatory obligations in this regard. If any of our products were susceptible to manipulation, our market regulation team would have detected any such issues while performing their market oversight functions. Requiring that DCMs such as CME Group go back and perform the specific analysis set forth in these rules for all our products would be incredible onerous – and virtually impossible with the proposed 60-day deadline – and we see no regulatory benefit conferred by requiring us to do this.

Exhibit A

CME Group

Craig S. Donohue
Chief Executive Officer

February 22, 2011

VIA ON-LINE SUBMISSION
David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Core Principles and Other Requirements for Designated Contract Markets (RIN number 3038-AD09); (Federal Register Vol. 75, No 245, Page 80572)

Dear Mr. Stawick:

CME Group Inc. ("CME Group"), on behalf of its four designated contract markets, appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "CFTC" or "Commission") Notice of Proposed Rulemaking ("Release") that was published in the Federal Register on December 22, 2010. In the Release, the Commission seeks comment on proposed rules, guidance and acceptable practices, which apply to the designation and operation of contract markets.

CME Group is the world's largest and most diverse derivatives marketplace. CME Group includes four separate Exchanges, including Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX"). The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. CME includes CME Clearing, one of the largest central counterparty clearing services in the world, which provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter derivatives transactions through CME ClearPort®.

As a pioneer in the globalization of the futures markets, CME has helped to expand the customer base for futures products. CME Globex, for example, is available to users around the world for more than 23 hours a day and five days a week. To satisfy the increasing demands of the international marketplace, customers can access the CME Globex platform in more than 150 countries and foreign territories around the world. Telecommunications hubs in Singapore, London, Amsterdam, Dublin, Milan, Paris, Seoul, São Paolo and Kuala Lumpur reduce our customers' connectivity costs, increase accessibility, and deliver faster, more efficient trading. Additionally, CME has established international offices in London, Singapore, Tokyo, Hong Kong, São Paolo and Calgary. CME believes that its significant global expertise and experience will provide the Commission with a unique and valuable perspective on the matters discussed herein.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

I. Overview

We support the overarching goals of the Dodd-Frank Act ("DFA") to reduce systemic risk through central clearing and exchange trading of derivatives, to increase data transparency and price discovery, and to prevent fraud and market manipulation. Unfortunately, DFA left many important issues to be resolved by the regulators with little or ambiguous direction and set unnecessarily tight deadlines on rulemakings by the agencies charged with implementation of the Act. In response to the urgent schedule imposed by DFA, the Commission has proposed hundreds of pages of new or expanded regulations.

Within those hundreds of pages of regulations issued thus far, the Commission has put forth proposals aimed at implementing the overarching goals of DFA. Such proposals include proposed rules that will, among other things, serve as the foundation for the reporting of swap data to the Commission and determining which swaps will be subject to the clearing mandate. While we disagree with the substance and sequencing of some of those proposals, we commend the Commission's efforts to effectuate Congress' goals of bringing transparency to the previously un-regulated swaps market and reducing systemic risk.

Other proposals, however, are far outside the bounds of the Commission's statutory mandate. Specifically, many of the Commission's proposals are not required by or are inconsistent with DFA, impose unnecessary and costly burdens on the industry, and require increases in CFTC staff and expenditures to adopt and enforce. These proposals are particularly objectionable in light of the Commission's repeated complaints that it lacks the funding necessary to implement and enforce DFA. Rather than focusing its resources on implementing the rules and regulations necessary to achieve the principle objectives of DFA, the Commission has warned the industry that alleged resource constraints may cause it to enact rules or prioritize tasks in ways that will stifle innovation and competition. For example, Commissioner Dunn recently stated that if the CFTC's "budget woes continue, my fear is that the CFTC may simply become a restrictive regulator. In essence, we will need to say "No" a lot more . . . No to anything we do not believe in good faith that we have the resources to manage" and that "such a restrictive regime may be detrimental to innovation and competition."[1]

We do not object to the CFTC's receiving an appropriate budget; however, we do object to the CFTC's wasting scarce resources to impose uncalled-for regulations and duplicate the oversight of self-regulatory organizations ("SROs") subject to its jurisdiction. While the financial crisis focused well-warranted attention on the lack of regulation of OTC financial markets, and Congress crafted legislation that, we hope, reduces the likelihood of a repetition of that near disaster, it is important to emphasize that regulated futures markets and futures clearing houses did not contribute to that crisis. Indeed, CFTC-regulated futures exchanges and clearing houses operated flawlessly, performing all of their essential functions without interruption. Significantly, while large financial firms regulated by other oversight agencies failed, our clearing house experienced no default and no customers on the futures side lost their collateral or were unable to immediately transfer positions and continue managing risk.

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[1] Commissioner Michael V. Dunn, Opening Statement, Public Meeting on Proposed Rules Under Dodd-Frank Act (January 13, 2011), available at http://www.cftc.gov/PressRoom/SpeechesTestimony/dunnstatement011311.html

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

Despite the exemplary performance of the CFTC-regulated futures exchanges and clearing houses during this time of severe market turmoil, the Commission, in its Release, is proposing to rewrite the regulatory regime for DCMs that served the market so well during the crisis. Specifically, many of the Commission's proposed rulemakings, if adopted, would convert the regulatory system for the futures markets from the highly successful principles-based regime that has permitted U.S. futures markets to prosper as an engine of economic growth for this nation, to a restrictive, rules-based regime that will stifle growth and innovation. The Commission's action in this regard would be contrary to both the letter and spirit of the Commodity Exchange Act ("CEA"). In fact, not only did Congress preserve principles-based regulation in DFA, it reinforced the vitality of that regime by expanding the list of core principles applicable to DCMs and DCOs and creating a regulatory regime for swap execution facilities ("SEFs") and swap data repositories ("SDRs") cemented in core principles. Although DFA granted the Commission the authority to adopt rules with respect to core principles, it did not direct the Commission to eliminate principles-based regulation. DFA made clear that SROs were granted "reasonable discretion in establishing the manner in which the [SROs] compl[y] with the core principles."

Congress' decision to maintain principles-based regulation for the futures market and extend that regime to the newly-regulated swaps market makes sense when one considers the transformative effect that principles-based regulation has had on the U.S. futures market over the last decade. Since the adoption of the Commodity Futures Modernization Act of 2000 ("CFMA") — which converted the CEA from a rules-based regime to a principles-based regime — the regulated U.S. futures markets have experienced unparalleled growth and innovation. We believe strongly that principles-based regulation of futures exchanges and clearing houses permitted U.S. exchanges to regain and maintain their competitive position in the global market. Specifically, it allowed U.S. futures exchanges to keep pace with rapidly changing technology and market needs by introducing new products, new processes and new methods by certifying compliance with the CEA and thereby avoiding stifling regulatory review. U.S. futures exchanges operate more efficiently, more economically and with fewer complaints under this system than at any time in their history.

Moreover, abandoning this successful regulatory regime, as the Commission proposes in the Release, would convert the Commission's role from an oversight agency, whose role is to assure compliance with sound principles, to a front line decision-maker that imposes its business judgments on every operational aspect of derivatives trading and clearing. This role reversal will require doubling of the Commission's staff and budget and impose astronomical costs on the industry and the end users of derivatives. Yet, the Commission fails to offer any evidence that DFA supports this approach or that such an approach will be beneficial to the public or to the functioning of the markets. In fact, the Commission totally abdicates its statutory obligation to perform a "cost benefit analysis." *See* 7. U.S.C. §15(a). To be sure, in requiring the CFTC to consider costs and benefits of its action, Congress is calling for an actual and concrete estimate of costs of agency action. *See Public Citizen v. Federal Motor Carrier Safety Administration*, 374 F.3d 1209, 1221 (D.C. Cir. 2004). ("The agency's job is to exercise its expertise to make tough choices about which of the competing estimates is most plausible, and to hazard a guess as to which is correct, even if . . . the estimate will be imprecise.") The mere uncertainty of cost estimates does not excuse the CFTC from issuing such an estimate. *See Public Citizen*, 374 F.3d at 1221. ("Regulators by nature work under conditions of serious uncertainty, and regulation would be at an end if uncertainty alone were an excuse to ignore a congressional command to 'deal[] with' a particular regulatory issue.").

It is clear that this prescriptive, rules-based approach will unnecessarily deplete the agency's limited resources, while also stifling innovation and competition. In keeping with the President's Executive Order to reduce unnecessary regulatory cost, the CFTC should reconsider the proposed rules included in the Release, with an eye toward performing those functions that are clearly mandated by DFA. As discussed in more detail below, in many instances we believe that this can comply with the President's directive by making the proposed rules acceptable practices or safe harbors.

A. Core Principle 9

One example of the Commission's unnecessary and problematic departure from the principles-based regime is its proposed rule under Core Principle 9 for DCMs – Execution of Transactions, which states that a DCM "shall provide a competitive, open and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market." Core Principle 9, however, expressly authorizes off-exchange futures transactions so long as those transactions are executed pursuant to DCM rules. Specifically, Core Principle 9 provides that "the rules of a board of trade may authorize . . . (i) transfer trades or office trades; (ii) an exchange of (I) futures in connection with a cash commodity transaction; (II) futures for cash commodities; or (III) futures for swaps; or (iii) a futures commission merchant, acting as principle or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if that contract is reported, recorded, or cleared in accordance with the rules of the contract market or [DCO]." That off-exchange futures transactions are permissible and not limited in any fashion is further supported by CEA § 4(a), which expressly prohibits any person to execute or even offer to enter into a futures contract unless such transaction is "conducted on <u>or subject to the rules of</u> a board of trade which has been designated or registered by the Commission as a contract market." 7 U.S.C. § 4(a) (emphasis added).

Proposed rule 38.502(a) would require that 85% or greater of the total volume of any contract listed on a DCM be traded on the DCM's centralized market, as calculated over a 12 month period. Specifically, in relevant part, proposed rule 38.502 provides that no DCM "may continue to list a contract for trading unless an average of 85% or greater of the total volume of such contract is traded on the designated contract market's centralized market, as calculated over a 12 month period" (the "85% Requirement"). This proposed rule would apply to contracts that are listed as of the effective date of the rule and any products listed subsequent to the effective date of the rule. If a contract fails this test, the DCM is required to delist the contract and transfer the open positions in the contract to a SEF (either one it operates or one operated by another) or liquidate the contract within 90-days of performing the requisite calculation.

The Commission asserts that the proposed 85% Requirement is necessary to "balance the goal of protecting the price discovery process of trading in the centralized market, with the goal of allowing off-exchange transactions for bona fide business purposes." 75 Fed. Reg. at 80588. As an initial matter, as Commissioners Sommers and O'Malia note in their dissent, Core Principle 9 does <u>not</u> require that every contract listed for trading on a DCM "trade in the centralized market. Nor does it require that every contract listed for trading serve a price discovery function. Rather, it requires a mechanism for protecting the price discovery function for those contracts that do trade in the centralized market." 75 FR 80635.

Moreover, Congress gave no indication in DFA that it considered setting an arbitrary limit as an appropriate means to regulate under the Core Principles. Indeed, in other portions of DFA, where Congress thought that a numerical limit could be necessary, it stated so. For example, in Section 726 addressing rulemaking on Conflicts of Interest, Congress specifically stated that rules "may include numerical limits on the control of, or the voting rights" of certain specified entities in DCOs, DCMs or SEFs. Thus, we agree with Commissioners Sommers and O'Malia that, with the proposed rules relating to Core Principle 9, the Commission is "interpreting Core Principle 9 in a way that does not comport with the plain language of the statute." 75 FR 80635.

The 85% centralized market trading requirement is completely arbitrary. The Commission justifies the requirement only with its observations as to percentages of various contracts traded on various exchanges — it provides no support for a position that the 85% Requirement provides or is necessary to provide a "competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade." In fact, to better understand the Commission's proposal, on December 10, 2010, CME Group filed a request pursuant to the Freedom of Information Act ("FOIA") seeking the data and analysis relied on to support the Commission's proposed 85% Requirement. 75 FR 80589. As of February 22, 2011 – the date on which the comment period closed for this proposed rulemaking – we had not yet received a substantive response from the Commission to our FOIA request. The Commission was obligated to provide the data it reviewed and the analysis it conducted in conjunction with this rulemaking to the public in the Release. By omitting that information from the Release, the Commission has not afforded the public notice and meaningful opportunity to comment on the proposed rulemaking.[2] *See*, *Am. Radio Relay League, Inc. v. FCC*, 524 F.3d 227, 237 (D.C.Cir. 2008) (noting that "it would appear to be a fairly obvious proposition that studies upon which an agency relies in promulgating a rule must be made available during the rulemaking in order to afford interested persons meaningful notice and an opportunity for comment" and requiring the FCC to produce empirical data relied upon in a rulemaking in response to a FOIA request).

Moreover, certain off-exchange transactions executed pursuant to appropriately tailored DCM rules — which are expressly authorized by DFA — enhance the price discovery process.[3] For example, if the Commission forces transactions which would normally be executed as blocks through the centralized market, which its proposed rule would do, prices on the screen would chase large orders and then would bounce back after the order is filled, increasing volatility in the market. Congress certainly did not intend

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[2] We note for the record, that when we do receive a substantive response to our FOIA request that includes the data the Commission reviewed and the analysis it performed in arriving at the 85% Requirement, we may have further comment on the Release.

[3] With respect to appropriate rules, we submit that "one-size-fits-all" does not apply to off-exchange transactions. Stated differently, the rules that govern permissible off-exchange transactions need to be tailored to the characteristics of each particular market and periodically adjusted in response to trading activity in the respective markets. DCMs are in the best position to evaluate and establish the rules that should govern these transactions and should retain the flexibility to make changes to such rules during the lifecycle of a product.

the Commission to interpret Core Principle 9 in a manner that introduces unwarranted volatility into the market.

Further, the Commission's proposed rule would seem to arbitrarily limit the number of exchange of derivatives for related position ("EDRP") transactions that can occur in a particular product as those transactions are negotiated outside the central market. EDRPs are not part of the price discovery process for the related futures or options contract. Price discovery for the underlying has already occurred before and during the physical or OTC transaction and the EDRP is simply an efficient way to liquidate or transfer the underlying hedge protection. Moreover, these transactions have a bona fide business purpose and must not be artificially constrained by the Commission's rules as they preserve the basis relationship between the two component legs of the EDRP. Without EDRPs, the basis can be altered by changes in the futures price during the time required to execute separate cash and futures transactions creating what many market participants refer to as "slippage," significantly increasing risk and costs for the parties involved.[4]

The Commission does not assert in its proposal that the 85% Requirement has any regulatory benefit for either it or market participants. Indeed, there is no such benefit. The Commission does not receive any additional information regarding the market by implementing the proposed 85% Requirement. That is, if an instrument does not meet the 85% Requirement and therefore cannot be traded on an exchange, it will in many cases simply be traded on an SEF or in the OTC market as a swap. Following DFA, the swap and OTC markets, like the futures market, are regulated by the Commission. Thus, the Commission will not receive any additional information for use in regulation by forcing the instrument to trade on a SEF or in the OTC market, and market participants will not obtain any benefit; on the contrary, market participants may lose access to a vibrant and liquid centralized market that simply failed the arbitrary 85% test.

Further, imposition of the proposed 85% exchange trading requirement will have extremely negative effects on the industry. The 85% requirement will significantly deter the development of new products by existing exchanges like CME Group, and likewise deter any new futures exchanges from being established. New futures products often initially build open interest and gain trading momentum in off-exchange transactions, and in many instances, it takes years before trading on the centralized market becomes the predominant mode of trading. Based on our internal studies on new product performance, we have found that on average, it takes approximately 36 months for most new products to "achieve traction," which was defined as ADV>1,000 contracts. Specifically, the study showed that:

- New Ag and FX Products follow the overall trend, although their growth from months 6 to 36 is less pronounced so it takes them longer on average to achieve traction.

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[4] EDRPs transactions are particularly important in many of our financial products. With respect to Treasury futures, EDRPs typically are a convenient method to execute a "basis trade" by traders that wish to express a view on the value of the embedded delivery options within Treasury futures. With their participation in both cash and futures markets, Treasury basis traders provide an important source of liquidity to both markets and also serve an integral part of the cash-futures price convergence that occurs upon physical delivery. Including EDRPs in the calculation that could ultimately cause the removal of Treasury futures from the DCM would potentially remove a vital risk management tool that primary dealers rely on, allowing them to competitively bid at U.S. Treasury security auctions.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

- Equity and Interest Rate products exhibited above-average growth and generally needed less time to achieve traction.
- Alternative investment products exhibited sporadic growth, possibly due to their reliance on seasonal factors like weather and their lack of correlation with existing successful products.

However, with a prescriptive rule requiring a futures product to be delisted if it fails the centralized market trading requirement threshold, customers likely will not establish new futures positions if there is any risk that in 12 months, the product they were utilizing to hedge their position would no longer be available as a futures contract on a DCM. Customers prefer trade certainty, and, instead, likely will trade the same product on a SEF with a “swap” label, assuming the product is not a physically-delivered futures contract that would be ineligible to trade on a SEF.

Indeed, several of our highly successful and long-standing products would have failed the Commission’s arbitrary proposed rule. For example, the foreign exchange suite of products developed and offered by CME Group would not have met the 85% Requirement until four years after it was initially offered. Specifically, these products collectively traded 32% off-exchange when the suite was first offered in 2000; 31% off-exchange in 2001; 25% in 2002; 20% in 2003; finally moving within the 85% Requirement at 13% off-exchange in 2004; 10% in 2005; 7% in 2006; 5% in 2007; 3% in 2008; and 2% in 2009 and 2010.[5] Other examples include our flagship S&P 500 futures, NASDAQ 100 futures, S&P 400 Midcap futures, $10 Dow futures, and $25 Dow futures, which would all fail the 85% test.[6] These contracts have large notional contract sizes designed to appeal to particular customer segments, and privately negotiated transactions comprise more than 15% of the overall contract volume for these instruments. Under the proposed rule, CME Group would have to delist these products for no apparent regulatory or public purpose.[7]

Additionally, imposition of an 85% exchange trading requirement would have substantial adverse effects on market participants. As an initial matter, the cost of executing large orders, which often times are placed on behalf of hedgers or retail investors through pension funds, will increase and that cost will be passed down to the very group of people the Commission seeks to protect with this rule. Moreover, if transactions that are presently cleared as futures are forced to clear as swaps, customers will lose cross-margin efficiencies that they currently enjoy and will be forced to post additional cash or assets as margin.

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[5] As this data demonstrates, permitting DCMs to seek an exemption from the Commission to allow a new contract that fails the 85% Requirement to continue trading for another 12 months if at least 50% of the contract’s volume is transacted on the centralized market does not address our concerns.

[6] Clearly linked or related products should be considered together for purposes of any centralized market trading calculation.

[7] Another adverse consequence of an arbitrary centralized market trading requirement is that where a listed futures contract fails the requirement and a listed option on that futures contract satisfies the requirement, both the futures contract and the option thereon would have to be delisted. Again, we fail to see any regulatory or other public benefit from such a result.

For example, customers who currently hold open interest in CME Clearport® products will be required to post approximately $3.9 billion in additional margin (at the clearing firm level, across all clearing firms). These customers may also experience a taxable event and/or substantial operational difficulties in converting their open positions to swaps. Finally, the new "swap" label may also require these market participants to register as swap dealers or major swap participants. These important ramifications of the Commission's proposal are not addressed in the Release, nor are they considered as part of the Commission's "Cost Benefit Analysis."

Significantly, the 85% Requirement may undercut the overarching objectives of DFA, including mitigating systemic risk. To be sure, some of our currency products would fail the Commission's arbitrary 85% Requirement. These products, which are considered foreign exchange products, may be exempted from the definition of "swap" in DFA by the Treasury Department, which would mean this class of products may be exempted from the trading and clearing mandates. Consequently, products that are voluntarily traded pursuant to the rules of a CFTC-regulated DCM and voluntarily submitted for clearing to a CFTC-regulated DCO today might, in the future, be executed in an unregulated OTC space and subject to counterparty credit risk if the 85% Requirement is adopted as a final rule. Surely, Congress did not intend such a result.

With no regulatory or public benefit resulting from this proposed rule, the Commission is not justified in imposing such substantial costs on market participants, competitively disadvantaging DCMs and potentially increasing systemic risk to the financial system. While the Commission might propose a certain percentage of trading volume be transacted on the centralized market as a safe harbor or an acceptable practice demonstrating compliance with Core Principle 9, for the reasons stated above, it should not be the exclusive means of compliance. Indeed, as the Commission is aware, every market is different and the value of the core principles regime is that it allows registered entities the flexibility to tailor rules to fit the characteristics of the various markets it hosts. No public benefit is gained by one-size-fits-all rules, whether set by DCMs or the Commission. We submit that if a DCM makes a good faith effort to support a competitively traded market and has in place meaningful market maker programs or other incentives aimed at gaining traction in the centralized market, it has fulfilled its obligations under Core Principle 9 to "provide a competitive, open and efficient market and mechanism for executing transactions."

B. Core Principle 2

In the case of certain proposed fee restrictions to be placed on DCMs, the Commission not only retreats needlessly from principles-based regulation but also greatly exceeds its authority under DFA. DCM Core Principle 2, which appears in DFA Section 735, states, in part, that a DCM "shall establish, monitor, and enforce compliance with rules of the contract market including . . . access requirements." Under this Core Principle, the Commission has proposed rule 38.151, which states that a DCM "must provide its members, market participants and independent software vendors with impartial access to its market and services including . . . comparable fee structures for members, market participants and independent software vendors receiving equal access to, or services from, the [DCM]."

The CFTC's attempt to regulate DCM member, market participant and independent software vendor fees is unsupportable. Nothing in Core Principle 2 or the CEA confers authority on the Commission to set or

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

limit the fees charged by DCMs. Although the CEA expressly authorizes the CFTC to charge reasonable fees to recoup the costs of services it provides, 7 U.S.C. 16a(c), the Commission may not bootstrap that authority to set or limit the fees charged by DCMs or to impose an industry-wide fee cap that has the effect of a tax. *See Federal Power Commission v. New England Power Co.*, 415 U.S. 345, 349 (1974) ("[W]hole industries are not in the category of those who may be assessed [regulatory service fees], the thrust of the Act reaching only specific charges for specific services to specific individuals or companies."). To the extent the CFTC believes it has authority to oversee impartial access to DCMs – an authority conferred upon the Commission with respect to SEFs, not DCMs – we believe that the Commission would need to read the CEA to confer upon it new and significant powers not provided therein. The Commission does not have the authority to *sua sponte* expand its regulatory reach in this manner.

II. Provisions Common to Registered Entities

Before providing our detailed comments on the proposed rules in the Release, we believe another of the Commission's proposals — Provisions Common to Registered Entities[8] — bears noting here. The CFMA streamlined the procedures for listing new products and amending rules that did not impact the economic interests of persons holding open contracts. These changes recognized that the previous system required massive, worthless paper pushing efforts by exchanges and by the CFTC's staff. It slowed innovation and offered no demonstrable public benefit. Our ability to compete on a global scale, which had been progressively eroded by the disparity between the U.S. process and the rules under which foreign competitors operated, was restored.

Under current rules, before a product is self-certified or a new rule or rule amendment is proposed, DCMs and DCOs conduct a due diligence review to support their conclusion that the product or rule complies with the Act and Core Principles. Registered entities that list new products have a self-interest in making sure that the new products meet applicable legal standards: Breach of this certification requirement potentially subjects the DCM or DCO to regulatory liability. In addition, in some circumstances, a DCM or DCO may be subject to litigation or other commercial remedies for listing a new product, and the avoidance of these costs and burdens is sufficient incentive for DCMs and DCOs to remain compliant with the Act.

Nothing in the last decade of self-certification suggests that this concept is flawed or that registered entities have employed this power recklessly or abusively. During 2010, CME Group launched 438 new products and submitted 342 rules or rule amendments to the Commission. During this time, there were no substantive issues with the process. Put simply, the existing process has worked, and there is no reason for the Commission to impose additional burdens to impair that process.

In fact, DFA retains the self-certification process. Specifically, section 745 of DFA states, in relevant part, that "a registered entity may elect to list for trading or accept for clearing any new contract, or other instrument, or may elect to approve or implement any new rule or rule amendment, by providing to the Commission a written certification that the new contract or instrument or clearing of the new contract or instrument, new rule, or rule amendment complies with this Act (including regulations under this Act)."

[8] 75 Fed. Reg. 67282 (proposed Nov. 2, 2010) (to be codified at 17 C.F.R. pt. 40)

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

Nowhere is the Commission directed to require the submission of all documents supporting such a certification nor to require a review of the legal implications of the product or rule with regard to laws other than DFA. Essentially, it requires exactly what was required prior to the passage of DFA—a certification that the product, rule or rule amendment complies with the CEA.

Even as the Commission complains about a funding shortage, it nevertheless proposes to rewrite a rule that it is neither required to rewrite nor is justified in rewriting. As discussed in more detail below, the new requirements are likely to significantly impair the speed and value of innovation by U.S. exchanges and clearing houses, which will find themselves watching their innovations brought to market by foreign competitors while the U.S. agency checks boxes to ensure that filings are complete. Moreover, given the volume of filings required by the Notice of proposed rulemaking, the Commission will require significant increases in staffing and other resources. The Commission's resources should be better aligned with the implementation of the goals of DFA rather than "correcting" a well-functioning and efficient process.

These proposed rules greatly and unnecessarily increase the documentation burden associated with this submission process, and it seems inevitable that they will greatly slow the process of new rule and product introduction. First, a registered entity must submit "all documentation" relied upon to determine whether a new product, rule or rule amendment complies with applicable Core Principles. To begin with, this requirement is vague, and will likely result in the submission of unnecessary and non-useful information. More importantly, this requirement imposes an additional burden on both registered entities, which must compile and produce all such documentation, and the Commission, which must review it. Any benefits to be gathered by this requirement would be significantly outweighed by the costs imposed both on the marketplace and the Commission.

Second, the proposed rules require registered entities to examine potential legal issues associated with the listing of products and include representations related to these issues in their submissions. Specifically, a registered entity must provide a certification that it has undertaken a due diligence review of the legal conditions, including conditions that relate to contractual and intellectual property rights. The imposition of such a legal due diligence standard is clearly outside the scope of DFA and is unnecessarily vague and impractical, if not impossible, to comply with in any meaningful manner. An entity such as CME Group, involved in product creation and design is always cognizant of material intellectual property issues that might arise. An amorphous and potentially vast legal diligence requirement could require registered entities to expand what could reasonably be considered to be a material or colorable intellectual property analysis, and instead undertake extensive, cumbersome intellectual property analysis, including patent, copyright and trademark searches, in order to satisfy the regulatory mandates. This would greatly increase the cost and timing of listing products without providing any true corresponding benefit to the marketplace. Indeed, the Commission itself admits in its NOPR that these proposed rules will increase the overall information collection burden on registered entities *by approximately 8,300 hours per year*. 75 Fed. Reg. at 67290.[9]

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[9] Further, these rules steer the Commission closer to the product and rule approval process currently employed by the SEC, about which those regulated by the SEC complained at the CFTC-SEC harmonization hearings. Indeed, William J. Brodsky of the Chicago Board of Options Exchange testified that the SEC's approval process "inhibits innovation in the securities markets" and urged the adoption of the CFTC's certification process.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

III. Detailed comments on proposed rules

A. PART 38 – DESIGNATED CONTRACT MARKETS

§ 38.3 – Procedures for designation.
38.3(d) – Request for Transfer of Designation: The proposed revisions to Regulation 38.3(d) require that a DCM's request for transfer of its contract market designation be submitted to the Commission no later than three months prior to the anticipated transfer date unless the DCM reasonably could not have known of the anticipated change three months prior; in the latter circumstance, the DCM is required to "immediately" file the request. The proposed regulation would also require that a DCM, at the time of its request, provide the Commission with a narrative description of the corporate change giving rise to the transfer request which addresses the reason for the change and its impact on the DCM, including the impact on its governance, operations and the rights and obligations of market participants holding positions. Additionally, the request must include, among other submissions, the underlying agreement governing the corporate change, a discussion of the transferee's ability to comply with the Act, the governing documents of the transferee, the transferee's rules marked to show changes from the current rules of the DCM, as well as a number of specific representations.

As a practical matter, if the DCM reasonably could not have known of the anticipated change three months prior to the anticipated transfer date, then it cannot "immediately" file both the request and all of the required submissions once it does know. Preparing the required submissions manifestly takes time and does not lend itself to meeting the "immediately" standard that is proposed; "promptly" would be an improved word choice in this context that conveys a more appropriate reasonableness standard.

Although CME Group appreciates the need for the Commission to properly understand the circumstances of the transfer and evaluate its impact on the DCM's capacity to comply with the Act, we do not believe that a prescriptive "one-size-fits-all" approach is appropriate given that the circumstances and complexity of each such transfer is likely to be unique. We have no dispute with the minimum three-month standard for initial notification to the Commission prior to the anticipated change, provided it is known at that time, but requiring the broad scope of additional documentation to be submitted simultaneously is unnecessary, may result in later notification to the Commission than would otherwise be the case, and may impede the DCM's ability to act with appropriate dispatch to protect its interests and those of its customers. The Commission should instead take into account the particular circumstances giving rise to the transfer and the nature of the requested transfer, and then tailor the information required as necessary to satisfy the Commission that the transferee will comply with all applicable provisions of the Act and the Commission's regulations.

38.3 (g) – Requirements for Existing Designated Contract Markets: Under proposed Regulation 38.3(g), each DCM will be required to provide the Commission with a signed certification representing that it is in compliance with each of the 23 new or amended core principles and all associated Commission regulations under Part 38 within 60 days of the effective date of the publication of the final rules in order to maintain its designation status.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

The Dodd-Frank Act amended the majority of the existing DCM core principles and added five new core principles, and the Commission has separately elected to promulgate a host of new and very prescriptive regulations. These proposed changes are significant and substantial, and we do not agree with the Commission's assertion that the proposed new regulations simply codify requirements and practices that are commonly accepted in the industry. Given the scope and highly prescriptive nature of the proposed new regulations and their impact on existing DCMs, CME Group believes that 60 days is a patently unreasonable timeframe in which to expect that DCMs will have implemented the necessary strategic, operational, system and rule changes that would be required in order for such a certification to be made to the Commission - assuming such certification could be made at all given the sweeping and absolute language contained in certain of the new prescriptive regulations.

Notwithstanding CME Group's view that it broadly models best practices for DCMs today, it cannot in the context of this comment period reliably estimate the time that it would take to implement all of the required changes. Should the proposed rules become final, CME Group estimates that it would need a minimum of 180 days to assess the impact of the new requirements and to identify, design and appropriately plan the projects necessary to implement them; DCMs would further require the flexibility to certify compliance with the broad core principles subject to a petition for relief from certain prescriptive regulations for which the DCM would identify timelines in which it reasonably expected to be able to achieve compliance.

As noted previously in this letter, Congress, by virtue of the Dodd Frank Act, clearly preserved the fundamental philosophy of principles-based regulation and did so for good reason based upon the very clear success of that model over the past decade. During that period, CME Group's exchanges have made tremendous advancements in their product offerings, risk management services and in their regulatory and operational capabilities to protect market integrity. This growth, innovation and commitment to continuous improvement did not occur because it was prescriptively required by regulation; it occurred because we were motivated to better serve the marketplace, and thereby the interests of our stakeholders, and because the regulatory structure fostered the freedom and flexibility to innovate within the boundaries of ensuring compliance with the core principles.

The discretion Congress afforded the Commission was not intended to be used to devitalize the principles-based paradigm, to impose unnecessary costs and inefficiencies that fail to create commensurate value, or to support a level of market oversight that arbitrarily intrudes upon the independent exercise of a DCM's business judgment and self-regulatory authority. The Commission, the exchanges and market participants would be much better served if the Commission exercised significantly greater discretion in its use of the rulemaking discretion afforded by Dodd-Frank and focused instead on employing a robust core principles framework designed to promote market confidence, customer protection and the reduction of systemic risk in a manner that facilitates efficiency, innovation and competition.

§ 38.4 – Procedures for listing products and implementing designated contract market rules.
The Commission indicates in its proposed rulemaking that the proposed amendments to § 38.4 are largely intended to conform the instant rule to the changes previously proposed by the Commission to §§ 40.3 (Voluntary submission of new products for Commission review and approval) and 40.5(b) (Voluntary submission of rules for Commission review and approval). CME Group filed a comment letter with

respect to that proposal on January 3, 2011, in which it argued that the proposed rules would very significantly and unnecessarily increase the burdens associated with new product submissions and rule changes. The proposed rules create substantial new and costly bureaucratic inefficiencies, competitive disadvantages in the global marketplace, and impediments to innovation, despite there having been no showing that the current streamlined process has proved in any way to be defective or to undermine market integrity. On the contrary, the current model has facilitated growth and innovation in exchanges' risk management offerings, leading to enhanced transparency and the reduction of systemic risk. CME Group reasserts the arguments outlined in its January 3, 2011 comment letter and reiterates its strong view that these new requirements are neither necessary nor related to the issues that Dodd-Frank intended to address and therefore should be reconsidered by the Commission.

§ 38.5 – Information relating to contract market compliance.

Proposed Regulation 38.5(c), Equity Interest Transfers, would require a DCM to file notice of an equity interest transfer of 10% or more to the Commission no later than the business day after the DCM enters into a firm obligation to transfer the equity interest, and also to notify the Commission of the consummation of the transaction on the day on which it occurs. While CME Group does not object to this general notification requirement, the submissions that are required to be simultaneously filed with the initial notification again may not lend themselves to preparation within the prescribed 24-hour time frame, nor is it clear why that level of immediacy is required. For example, the requirement that the initial notification include submission of any associated changes to relevant corporate documents fails to appreciate that such changes are unlikely to be finalized until nearer the transfer date. Additionally, CME Group is uncertain as to the purpose served by requiring the initial notification to include a representation that the DCM meets all the requirements of Section 5(d) of the Act and Commission regulations adopted thereunder; that notification is more properly required upon consummation of the equity interest transfer.

§ 38.7 – Prohibited use of data collected for regulatory purposes.

CME Group publishes both its Exchange Privacy Policy and its Confidentiality Policy for the Market Regulation and Audit Departments on its website. The latter policy specifically defines confidential regulatory information as data collected via the reporting of large trader positions, clearing member position data, financial records and source documents used in the production of financial reports or to demonstrate compliance with exchange rules, detailed transaction data at the account level that includes information from which market positions or profit and loss might be derived, and investigative materials. Such information is treated as highly sensitive confidential information and may be used only by authorized personnel in fulfillment of CME Group's self-regulatory responsibilities.

As proposed, however, § 38.7 precludes a DCM from using *any* proprietary data or personal information that it collects or receives for the purpose of fulfilling its regulatory obligations for business or marketing purposes. This is too broad a restriction as it does not account for data and information that a DCM collects for both regulatory and non-regulatory purposes. For example, the rules of the CME Group exchanges require the submission of numerous audit trail elements on each transaction record. We also require registration of Globex User ID and account identification information from market participants who voluntarily enter into membership agreements or into fee-related or other contractual arrangements with the Company. CME Group of course has policies and procedures in place to appropriately protect such

confidential information, but this type of information is necessary for and may be used for both business purposes and for regulatory purposes.

The proposed rule should distinguish between proprietary and personal information that is provided to a DCM exclusively for regulatory purposes and information that is provided to a DCM for both regulatory and non-regulatory purposes. A DCM should be permitted to use the latter for business or marketing purposes provided that the DCM has transparent rules and/or policies which disclose what data and information collected by the DCM is to be used exclusively in furtherance of its self-regulatory obligations and how such other confidential information may be used by the exchange and is protected. Additionally, a DCM should not be precluded from using proprietary or personal information that is provided for regulatory purposes for business and marketing purposes where the market participant has specifically agreed in writing to such use.

§ 38.9 – Boards of trade operating both a designated contract market and a swap execution facility.

Proposed § 38.9(b) requires that a board of trade which operates both a DCM and a SEF and which uses the same electronic platform for executing and trading instruments on the SEF and the DCM clearly identify to market participants for each swap whether the execution or trading of the swap is taking place on the SEF or the DCM. The rules of the DCM and SEF would make such distinction clear, and the Commission should clarify whether this regulation intends to create any more substantive obligation on the part of DCMs and SEFs given that market participants typically interface with electronic platforms through proprietary or third party front end systems that are not controlled by the DCM.

§ 38.10 – Reporting of swaps traded on a designated contract market.

CME Group provided substantive comments to the Commission on February 7, 2011, with respect to its proposed rulemakings under Part 43 (Real-Time Public Reporting of Swap Transaction Data) and Part 45 (Swap Data Recordkeeping and Reporting Requirements) and refers the Commission to its comments therein.

Subpart B – Designation as Contract Market

§ 38.100 – Core Principle 1.

Amended Core Principle 1 provides that unless otherwise determined by the Commission by rule or regulation, a DCM will have reasonable discretion in establishing the manner in which it complies with the core principles. The origin of this amended language is the Dodd-Frank Act, and it is clear that the statute established the Commission's authority, *not its obligation*, to promulgate regulations regarding compliance with core principles. In fact, Congress explicitly determined to maintain a fundamentally principles-based approach to regulation of the futures industry and, further, to adopt that same approach as the foundation for the new regulatory structure of the swaps market because it understood the substantial benefits of that model in terms of efficiency, innovation and regulatory effectiveness.
The Commission argues in its release that promulgation of clear-cut and definite requirements or practices in those areas where a standard industry practice has developed will provide greater legal certainty to the industry in demonstrating compliance with the CEA. The Commission, however, through this rulemaking and others, not only goes well beyond Dodd-Frank's mandates and standard industry practices with its prescriptive rules in many cases, but also fails to recognize that even if it were the case

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

that certain standard practices are now being codified, those practices evolved through continuous improvement and innovation that was allowed to flourish because DCMs were focused on achieving desired outcomes rather than on complying with the letter of government-mandated prescriptive regulations.

It simply is not necessary to choose between core principles and legal certainty where the Commission provides appropriate application guidance and acceptable practices for core principles, while simultaneously allowing DCMs the flexibility to choose or design a more efficient or more effective path to compliance. Core principles do not in any way obviate a DCM's accountability, but they do promote innovation and continuous improvement while mitigating the creation of inefficient, bureaucratic processes and procedures that sap resources from more productive uses. The results in our industry over the past decade speak volumes, as does our industry's performance throughout the financial crisis, and it should be no surprise that Congress looked to the futures industry as the model for the new regulatory structure for the over-the-counter market. The Commission should embrace its thoughtful foresight and success in this regard rather than reverse course at this important juncture in the evolution of U.S. financial markets.

CME Group strongly urges that the Commission reconsider its approach and implement the robust core principles framework endorsed by Congress that has proved to be successful rather than return to a bureaucratic, prescriptive approach that was previously jettisoned because of its ineffectiveness and inefficiencies. While CME Group acknowledges that there may be limited circumstances in which a specific regulation is warranted to address compliance with a core principle, the Commission should exercise significant restraint and give very careful consideration to the cost/benefit equation and the potential unintended consequences of choosing a prescriptive path.

Subpart C – Compliance With Rules

§ 38.150 – Core Principle 2.
Proposed § 38.150(c) requires that DCMs establish rules that provide the board of trade with the "capacity to carry out such international information-sharing agreements, as the Commission may require." CME Group Exchanges' Rule 415 ("Cooperation With Other Exchanges and Clearing Organizations") authorizes the sharing of information with another exchange or clearing organization with which CME Group has an information sharing agreement, in accordance with the terms and conditions of the agreement. CME Group has, for example, long been a member of the Intermarket Surveillance Group, an information-sharing network of self-regulatory organizations from around the world. However, a DCM cannot be expected to carry out international or other information-sharing agreements to which it is not a party and should not be unequivocally compelled by CFTC regulation to enter into agreements, the terms of which are determined by other parties, and which conceivably could include terms or conditions that a particular DCM is not agreeable to or capable of abiding by.

§ 38.151 – Access requirements.
(a) Jurisdiction. Proposed § 38.151 requires a DCM, prior to granting any member or market participant access to its markets, to require the member or market participant to consent to its jurisdiction and participate in its investigative and disciplinary processes. The Commission contemplates that DCMs will

adopt rules to implement this requirement, and acknowledges that implementation would require DCMs to require their clearing firms to amend all of their existing customer agreements and secure their customers' consent to submit to the jurisdiction of each DCM on which they seek to trade. In suggesting this approach, the Commission does not address the fact that certain customer accounts may not be disclosed on the books of the clearing member.

Clearly, requiring clearing firms to obtain every customer's consent to the regulatory jurisdiction of each DCM will be costly and the Commission suggests that DCMs allow their clearing members up to 180 days to secure the necessary modifications to all of their existing customer agreements. More importantly, however, even if such consent were to be obtained, CME Group believes the regulation will be entirely ineffective in achieving the Commission's desired outcome.

Under CME Group rules, clearing members are required to assist CME Group in any investigation into potential rule violations which occur with respect to a Globex connection guaranteed by the clearing member. By rule, such assistance must be timely and may include requiring any non-member customer to produce documents, to answer questions from the Exchange, and/or to appear in connection with an investigation. CME Group's rules allow it to deny access to any non-member who has violated its rules or who refuses to cooperate in an investigation, and clearing members must suspend or terminate a non-member's access if the Exchange determines that the actions of the non-member threaten the integrity or liquidity of any contract, violate any Exchange rule or the Act, or if the non-member customer fails to cooperate in an investigation (*see* CME Group Exchanges' Rule 574, Globex Access Restrictions, and Rule 402.D., Actions Against Non-Members).

Non-member participants who desire not to be permanently barred from trading in CME Group's markets are therefore strongly incentivized to consent to the Exchange's jurisdiction upon its request and to participate in its investigative and disciplinary processes. This occurs routinely at CME Group and, in such circumstances, the relevant Exchange disciplinary panel which hears the matter can, if appropriate, take disciplinary action, including imposing a fine, suspension or other action, against the non-member.

The fact that a non-member has consented to the DCM's jurisdiction in a customer agreement form, however, does not make it more likely that the non-member will in fact participate in the investigative or disciplinary process if requested to do so. If a non-member who had consented to the Exchange's jurisdiction under this proposed new rule committed a rule violation and subsequently elected not to cooperate in the investigation or disciplinary process, the Exchange's only recourse would be to deny the non-member's access and, if appropriate, refer the matter to the CFTC. DCMs simply do not have subpoena power or criminal authority and therefore cannot compel a non-member's participation in the investigative or disciplinary processes, irrespective of whether or not they have previously consented to the DCM's jurisdiction. The leverage a DCM has in this regard is control over access to its markets.

Consequently, the DCM's enforcement options and the regulatory outcomes do not change based on whether or not there is a record of the non-member consenting to jurisdiction, but rather on whether the non-member chooses to participate in the DCM's investigative and disciplinary processes; and there is no reason that this cannot occur on an as-requested basis. A regulation such as the one proposed here that requires every customer to affirmatively submit to DCM jurisdiction prior to accessing the DCM's

markets would impose significant costs and burdens on clearing member firms without offering any perceptible regulatory value.

In the event CME Group's ability to deny access to its markets is ineffectual in securing the non-member's participation in the investigative and disciplinary processes, and the DCM's resulting trading ban is an inadequate sanction given the conduct, the Commission is in the best position to prosecute the matter. As a government agency, the Commission has the legal and regulatory relationships, both domestic and foreign, subpoena power and access to the courts that better position it to compel non-member market participants to participate in an investigation. It also has the ability to enforce any penalty that results from a corresponding disciplinary action. Therefore, instead of seeking to impose an ineffectual and costly additional burden on DCMs and their clearing members, the Commission should reallocate scarce resources that are currently duplicating the efforts of the self-regulatory organizations, in matters the self-regulatory organizations are equipped to handle, to the investigation and prosecution of those matters which the Commission is uniquely empowered to address. This would be a more productive use of the industry's collective regulatory resources and enhance the industry's overall regulatory effectiveness. CME Group therefore urges the Commission withdraw part (a) of this regulation and, if deemed necessary, propose a new regulation that is cognizant of the reach of the DCM's investigative and disciplinary authority.

(b) Impartial access by members, market participants and independent software vendors.

We refer the Commission to our comments in Section I (b) above.

§ 38.152 – Abusive trading practices prohibited.

Proposed § 38.152 requires that a DCM prohibit abusive practices on its markets by members and market participants and also enumerates a number of specific trading practices that DCMs must prohibit, although it does not specifically define those practices or the scope of the intended prohibition with respect to each enumerated practice. Further, the proposed regulation requires that the DCM prohibit any other manipulative or disruptive trading practices prohibited by the CEA or by Commission regulation.

As an initial point, this regulation appears superfluous as Core Principle 12 already requires a DCM to establish and enforce rules to protect markets and market participants from abusive practices. Consistent with a core principles approach, DCMs should have reasonable discretion to establish rules appropriate to their markets that are consistent with the CEA and that satisfy the core principle, and be appropriately accountable for doing so. The Commission might offer guidance in terms of acceptable practices in this regard, but there appears to be no value in promulgating a regulation prescriptively enumerating specific practices in this way. DCMs do establish rules to protect their markets and market participants and are incentivized to maintain regulatory infrastructures that promote fair and efficient markets. Core principles allow their rule sets and interpretations to continually evolve in response to the changing dynamics of markets and market practices.

Additionally, there is a danger in promulgating regulations that are simultaneously both prescriptive and ambiguous. For example, the prescriptive rule requires, without qualification, that pre-arranged trading be prohibited, but DCMs may have rules that allow for block trading, for exchange for related position

transactions, and for pre-execution communications subject to specified conditions. Similar types of arguments could be made with respect to several of the other enumerated trading practices.

DCMs are required to certify with the Commission that their rules and any associated interpretative advisories comply with the Act and are also required to comply with the core principle that they establish and enforce rules that protect markets and market participants from abusive practices. Simply put, DCMs are in the best position to define the appropriate rules and practices for their markets that are not otherwise specifically prohibited by the Act or Commission regulation. In the latter regard, CME Group refers the Commission to its January 3, 2011 response to the Commission's Advance Notice of Proposed Rulemaking on Disruptive Trade Practices and reasserts its overarching comment that the Commission, to the extent it must, by statute, promulgate certain prescriptive rules in this area, must also ensure that it provides appropriate clarity to market participants regarding the conduct that is prohibited; further, it must do so in a manner that does not impair legitimate market behavior that contributes to liquidity and serves the price discovery and risk management functions of the market.

§ 38.153 – Capacity to detect and investigate rule violations.

Proposed § 38.153 requires a DCM to have the authority to collect information and documents and to examine the books and records kept by the DCM's members and by market participants. Under its existing rules, CME Group compels its members and those customers with direct market access to the Exchange to meet specific recordkeeping requirements and to produce relevant books, records and information necessary to enforce its rules upon request. Additionally, clearing members must require any non-member customer to produce documents or answer questions from the Exchange if requested to do so. The failure of a non-member to cooperate fully in an investigation may result in the denial of the non-member's access to CME Group markets. Modifying this model in accordance with the Commission's proposed prescriptive regulation will not, as described in the response to proposed § 38.151(a) above, enhance the effectiveness of the DCM's investigative and enforcement regime.

Although proposed § 38.153 does not detail which books, records and information the DCM must be able to obtain from non-member market participants, it appears to imply that the entire class of non-member, non-registered market participants will be subject to the panoply of recordkeeping requirements heretofore applicable only to members or registrants, and, in CME Group's case, direct access clients of the DCM. Given that there has been no showing that that such a requirement will further the DCM's ability to effectively carry out its self-regulatory responsibilities, it appears imprudent to impose these onerous burdens and costs on market participants.

§ 38.154 – Regulatory services provided by a third party.

The CEA allows a DCM to comply with applicable core principles by delegating relevant functions to a registered futures association or another registered entity, but the DCM remains responsible for the performance of any regulatory services received and for compliance with the DCM's obligations under the CEA and Commission regulations.

The proposed regulation, however, imposes a new requirement that the DCM conduct periodic reviews of the adequacy and effectiveness of the services provided and that such reviews "must be documented carefully" and made available to the Commission upon request. Further, the Commission not only finds it

necessary to prescribe by regulation that the DCM and the service provider hold regular meetings, but also to establish required agenda topics for such meetings. It is difficult to imagine that this is what Congress had in mind when granting the Commission rulemaking discretion where necessary to buttress the core principles framework. While it may well be that it is constructive for the DCM to hold regular meetings with its service provider and "discuss market participants," the core principle should stand on its own and the DCM should have the flexibility to determine how best to demonstrate compliance with the core principle. Again, CME Group does not object to the use of application guidance and appropriate acceptable practices by the Commission provided they are treated as such and not deemed to be the exclusive means for demonstrating compliance with the principle.

Proposed § 38.154(c) requires that the decision to open an investigation must always reside *exclusively* with the regulatory service provider rather than the DCM. While the regulatory service provider should have the independence to open an investigation at its discretion, CME Group sees no reason why the DCM cannot also direct the regulatory service provider to open an investigation, particularly given that it is the party responsible for compliance with the DCM's obligations under the CEA. It appears counterintuitive to make the DCM responsible but not give it the authority to direct that an investigation be undertaken. No conflict exists here and the DCM should always have the discretion to direct its service provider to open an investigation.

Proposed § 38.154(c) also requires that all decisions concerning the cancellation of trades remain as the exclusive authority of the DCM. In other words, the regulatory service provider cannot make such decisions subject to delegated authority. This proposal runs counter to current practices in the marketplace and the reality of the critical need for prompt decision making in such circumstances. CME Group, for example, currently hosts other exchanges on its electronic trading platform and the Globex Control Center ("GCC") provides related services to those DCMs. The DCM, of course, has the flexibility to establish its trade cancellation rules as it deems appropriate and to take ownership of trade cancellation decisions if it chooses, but there is no rational reason why the DCM should not also have the flexibility to determine that it is in the best interest of the market, market participants and the DCM to delegate that authority if it concludes that the GCC has the resources, expertise and technology that puts it in the best position to make those decisions and to do so expediently in order to mitigate potential market exposures.

The DCM is ultimately responsible for the decision of the GCC notwithstanding its delegation of decision making authority to the GCC, and it is unclear why the Commission would desire to mandate that the DCM satisfy the core principle in a manner that the DCM deemed to be less efficient and less effective. This again points to the reason why a core principle framework that provides for appropriate flexibility in determining how best to achieve desired objectives leads to superior outcomes. CME Group urges the Commission to retract this provision.

§ 38.156 – Automated trade surveillance.

Proposed § 38.156 states that a DCM must maintain an automated trade surveillance system capable of "detecting *and investigating* potential trade practice violations." Although CME Group has been proudly at the forefront of developing trade surveillance capabilities in our industry, we unfortunately have not yet

been able to design a system that automates the actual investigation of potential trade practice violations and we do not anticipate being able to do so within 60 days of the final rules becoming effective.

The proposed regulation further states that the system must be able to "maintain all data reflecting the details of each order entered into the trading system, including all order modifications and cancellations and maintain all data reflecting transactions executed on the designated contract market." CME Group maintains such capabilities in the context of its Globex platform, databasing in excess of 4 billion order and market data messages a month, but we in fact maintain several different databases and applications that make up our suite of surveillance systems, each of which have particular datasets and distinct analytical capabilities. Although it is not clear from the language in the regulation, we presume that with respect to order information, the regulation refers only to the electronic trading venue as CME Group does not capture order details, modifications or cancellations in an automated manner in the open outcry venue, unless such orders are transmitted to the floor via the exchange's order routing system, or with respect to privately-negotiated transactions.

The regulation further specifies a litany of capabilities the automated trade surveillance system must have including the capability to detect and flag specific trade execution patterns and trade anomalies, compute, retain and compare trading statistics; compute trade gains, losses and futures-equivalent positions; reconstruct the sequence of market activity; perform market analyses; and support system users to perform in-depth analyses and ad hoc queries of trade-related data. To the extent that we presume to fully understand the breadth of what is intended to be required by this regulation, CME Group has these capabilities, but it is inappropriate to use such broad and ambiguous terms to describe capabilities that a DCM's automated trade surveillance system is prescriptively required to have, and which it must unequivocally certify to the Commission that it does have, in order to maintain its designation status. We are confident the Commission has an appreciation for this point based on its own efforts to build its automated surveillance systems, and we would urge the Commission to reconsider the requirements of this regulation and again consider employing a more flexible core principles approach. As the Commission is well aware, the cutting edge regulatory infrastructure and applications that CME Group has developed and its continuing innovations in this area all occurred under a core principles regime, and it would be unfortunate if our continuing efforts in this regard now had to be recalibrated to focus on meeting prescriptive requirements dictated by the Commission rather than exercising our own business judgment about regulatory priorities and risks in our markets and how best to employ technology to continue to advance our regulatory effectiveness.

§ 38.157 – Real-time market monitoring.

Proposed § 38.157 obligates the DCM to conduct real-time market monitoring "of *all* trading activity on its electronic trading platform(s) to *ensure* orderly trading and identify *any* market or system anomalies." Such all-encompassing and absolute language in a prescriptive regulation that a DCM must certify to the Commission that it is in full compliance with is problematic. Although CME Group has what it believes to be is a market-leading framework for monitoring trading activity that includes real-time access to all electronic order and trading activity and market data, tools to query and analyze the data, various forms of live alerting capabilities and a multi-functional approach which incorporates staff in Market Regulation, the Globex Control Center and Clearing House Risk Management, it is not clear that we or any exchange could reasonably comply with the standard as set forth in this regulation. We again urge the Commission

to reconsider the utility and effectiveness of establishing prescriptive regulations such as these, and particularly so in areas of technology development that continue to rapidly evolve. We recommend that the Commission focus instead on providing reasonable application guidance within the framework of the core principles in a manner that is designed to promote continued innovation and advance regulatory effectiveness.

§ 38.158 – Investigations and investigation reports.
(a) *Procedures*. The proposed regulation requires that a DCM "must" commence an investigation upon a referral from the Commission or upon the discovery or receipt of information that, in the judgment of the DCM's compliance staff, indicates "a possible basis" for finding that a violation has occurred or will occur. Although perhaps not intended as such, this regulation as proposed effectively eviscerates any discretion the DCM has in determining which matters warrant a formal investigation because at the time of discovery or upon receipt of information, and before any review has occurred, there will always be "a possible basis" that a violation has occurred or will occur.

Formal written referrals from the Commission, law enforcement authorities, other regulatory agencies or other self-regulatory organizations should result in a formal investigation in every instance. However, a DCM should have reasonable discretion to determine how it responds to complaints, leads and other types of referrals. A DCM should be required to follow up on these referrals, but it should also have discretion in determining what level of review is required, how its resources are most effectively utilized to mitigate risks to market integrity, and at what point there is a sufficient basis to open a formal investigation.

For example, a DCM should have the discretion to follow up with a less formal "inquiry" or "research-based" review to determine whether a simple analysis of trading activity or perhaps trading floor video corroborates a complaint of illicit activity in a particular market during a specific time period. If that review clearly reveals that the alleged illicit activity did not occur, there is no need to conduct a formal investigation. If the review indicates that there is a possible basis for finding a rule violation, a formal investigation would be opened. This may be the intention of the "in the judgment of the DCM's compliance staff" language in the proposed regulation, but it is not framed in such a way that appears to allow for this initial review and consideration before opening a formal investigation.

(b) *Timeliness*. CME Group generally has no objection to this proposed subsection, however it recommends that the list of possible mitigating factors include the domicile of the subjects and the degree of DCM control over the progression of the investigation. Investigations involving market participants who live abroad, particularly when they do not speak English, almost always take greater time and resource to complete than they do when the investigation involves an English speaking person within the United States. Additionally, with respect to cooperative enforcement matters, the Commission should recognize that the DCM may not have independent control over the pace of the investigation.

The Commission has also previously distinguished between the time period of completion for the investigative phase of a matter and the time period of completion for the enforcement phase of a matter. This proposed subsection references only the investigation review period, and the Commission should

make clear that the time period necessary to prosecute an investigation once it is referred for enforcement action is independent of the 12-month period referenced in the regulation.

(c) *Investigation reports when a reasonable basis exists for finding a violation*. This subsection requires DCM staff to submit an investigation report "*for disciplinary action in every instance*" in which compliance staff determines from surveillance or from an investigation that a reasonable basis exists for finding a rule violation. As the Commission is well aware, rule violations can range from very minor to egregious and clearly not every instance of a rule violation merits formal disciplinary action. Minor transgressions may be effectively addressed by the issuance of a warning letter issued by CME Group's regulatory staff. To the extent that a prescriptive regulation is necessary in this context, the Commission should amend the language accordingly. However, this again points to the danger of a prescriptive, one-size-fits-all approach to regulation. DCMs should have flexibility to develop rules and procedures that best serve the objectives of the core principle, and accountability for demonstrating their compliance. CME Group has made many changes to its disciplinary rules and procedures over the past three years in the interest of continually enhancing its disciplinary processes and programs; mandating prescriptive approaches only serves to impede further such improvements.

This subsection also requires the DCM to include a respondent's disciplinary history in the investigative report that is submitted to the Review Panel. CME Group strongly opposes this requirement and its opposition is discussed further in response to NOPR § 38.703.

(d) *Investigation reports when a reasonable basis exists for finding a violation*. CME Group's Market Regulation Department currently has the authority to administratively issue letters of warning in cases where it determines that there is not a reasonable basis for making a referral to a disciplinary committee. Staff does not need a disciplinary committee's approval in order to issue a Letter of Warning, but can seek such approval if it chooses. As such, this subsection should be modified to account for a DCM's ability to close a case administratively and still issue a letter of warning without disciplinary committee approval.

(e) *Warning letters*. This proposed subsection states that no individual or entity may be issued a letter of warning by a DCM "for the same potential violation" during a rolling 12-month period. This is unduly prescriptive and fails to take into consideration important factors that are relevant to a DCM when evaluating potential sanctions in a given disciplinary matter. Generally speaking, sanctioning in disciplinary matters does not fit well within a prescriptive set of requirements such as this and there is no basis for the Commission to substitute its judgment, absent any facts, for the reasoned judgment of the DCM regulatory staff or disciplinary panel reviewing the facts of the matter. Each matter, and the putative sanctions resulting therefrom, must be evaluated and considered with a mind to the totality of the circumstances, and the DCM should have discretion as to the appropriate sanction in all circumstances.

Consider, for example, a firm with hundreds of traders around the world that receives a letter of warning related to a single employee who used another person's user ID to access an electronic trading platform. This is a violation of the DCM's rule that requires each person to utilize his own unique user ID when entering orders into the electronic trading platform. (*e.g.*, CME Rule 576). The DCM consequently issues a letter of warning to the firm which reiterates the importance of complying with the unique user ID

requirement. Twelve months minus one day later, a different trader – who has no knowledge of the previous letter of warning because he has only been working at the company for two months; works in a different office; has a different manager; and trades different products – enters an order using someone else's user ID. The DCM notices this and brings it to the attention of the firm. The firm promptly addresses the issue with the trader. There are no other instances of improper user IDs by the firm's employees.

Under this proposed provision, the DCM is not permitted to issue a second letter of warning to the firm in the above referenced scenario despite the fact that the only overlapping nexus between the two instances is that the firm is the same. The Commission's proposed regulation would have the DCM allocate its regulatory resources to conduct a full-scope investigation, prepare the prosecution of the case, convene a Probable Cause Committee, issue charges, resolve the matter via settlement or contested hearing before the Business Conduct Committee and prepare a decision in the matter. Clearly, this would be a grossly ineffective and inefficient use of regulatory resources given the alleged misconduct. Not allowing the DCM to take the circumstances of a matter into consideration and to exercise its informed judgment in its handling of investigations would be unduly burdensome and unfair to market participants.

§ 38.159 – Ability to obtain information.
See comments with respect to § 38.150.

Subpart D – Contracts Not Readily Susceptible to Manipulation

§ 38.200 – Core Principle 3.
See comments with respect to Appendix C.

Subpart E – Prevention of Market Disruption

§ 38.250 – Core Principle 4.
Dodd-Frank changed the title of Core Principle 4 from "Monitoring of Trading" to "Prevention of Market Disruptions," and the Commission notes that the corresponding amendments are intended to emphasize that DCMs must take an active role, not only in monitoring trading activities within their markets, but in preventing market disruptions. Under the revised core principle, the DCM "shall have the capacity and responsibility to prevent price manipulation, price distortion and disruptions of the delivery or cash-settlement process through market surveillance, compliance, and enforcement practices and procedures, including: (1) methods for conducting real-time monitoring of trading; and (2) comprehensive and accurate trade reconstructions."

As detailed in its comment letter regarding the Commission's advance notice of proposed rulemaking on Disruptive Trading Practices, CME Group employs significant human and technological resources and capabilities throughout the company to identify and mitigate the risk of market disruptions and also provides an array of tools designed to assist customers in effectively managing and mitigating these risks. These capabilities have been constantly evolving and improving over time as we have developed innovative solutions to regulatory and risk management challenges arising from the dynamic changes in our industry.

Despite the fact that this growth and innovation in capabilities has flourished under a core principles regime and in the absence of prescriptive government mandates, the Commission has elected to propose a number of new regulations to "clarify and strengthen" DCMs' responsibilities under the core principle.

§ 38.251 – General requirements.
The proposed rule establishes a number of mandates for DCMs. One of those mandates, for example, requires that the DCM have the capacity to conduct real-time monitoring of trading, adding that, "the monitoring of intraday trading must include the capacity to detect abnormal price movements, unusual trading volumes, impairments to market liquidity and position-limit violations."

As an initial matter, the regulation does not appear to distinguish in any way between trading conducted on an electronic venue and trading conducted in an open outcry venue. As the Commission is aware, the operational infrastructure of open outcry trading is substantially different from that of electronic trading and is not amenable to capturing trading data in real time. CME Group does, however, employ operations staff who monitor trading in the pits in order to report prices, specialized trading floor investigators who monitor activity throughout the day on the trading floor, and comprehensive video surveillance. That said, the Commission should, in any prescriptive regulation, be clear to appreciate the unique aspects of different types of trading venues and distinguish where requirements are different.

The Commission's requirements are also overly broad, and it is unclear what specific capabilities a DCM must have in order to certify that is compliant with the regulation within 60 days of publication of the final rule. CME Group trades tens of thousands of unique instruments and spread relationships, and requiring real-time monitoring capabilities across every instrument for such vague terms as "abnormal price movements," "unusual trading volumes," and "impairments to market liquidity" does not provide DCMs with sufficient clarity with respect to what specific capabilities satisfy the standard. CME Group has developed numerous technological capabilities, including a number of real-time monitoring capabilities, which have been iteratively evolving as we experiment with new regulatory and monitoring methods and technologies and respond to dynamic changes in our industry; we have also patented new ideas such as stop logic functionality to help address potential disruptions caused by the election of cascading stop orders during a transitory liquidity gap. But absent an understanding of what, for example, the Commission considers an "impairment to market liquidity" and the obligations of a DCM having identified such an "impairment," this type of vague rulemaking is not helpful.

This provision also requires that the DCM have the real-time capacity to detect position limit violations on an intra-day basis. The Commission is well aware of the challenges in this regard given the fact that the identical contract frequently trades in multiple competitive venues as well as through privately negotiated means and the fact that option deltas are changing throughout the day. These types of factors add complexity to the regulatory analysis conducted after the fact, and certainly do not allow for effective real-time monitoring given that the data from all of the venues is not available in real-time.

The Commission also invited comments on whether DCMs should be required to monitor the extent of high frequency trading and whether automated trading systems should include the ability to detect and flag high frequency trading anomalies. As an initial point, there is no formal or uniform definition of high

frequency trading and there are many different strategies that can be characterized as high frequency trading. There are also forms of automated trading that may generate high messaging traffic but only over discrete periods of time, and manual or grey box trading that may exhibit very high frequency messaging. DCMs should be expected to monitor activity on their markets, but it is unclear why the Commission should mandate DCMs to specifically monitor the extent of high frequency trading, whatever definition is ultimately ascribed to that term. The Commission has not articulated what the purpose would be for doing so, but the suggestion appears to have a pejorative undertone when, in fact, empirical studies have consistently demonstrated that high frequency trading fosters tighter markets, greater liquidity and enhanced market efficiency. As a practical matter, however, CME Group, and we imagine other DCMs, certainly have the capability to monitor the messaging frequency of participants in their markets and can quickly and easily identify which participants generate high messaging traffic. CME Group also requires registered users who predominantly enter orders via an automated trading system to be identified as automated traders and their orders are identified in the audit trail as originating from automated systems.

With respect to whether a DCM's "automated trading systems," (which we presume to mean "automated surveillance systems,") should include the ability to "detect and flag" high frequency trading anomalies, it again is unclear what specific types of anomalies the Commission has in mind that would be uniquely of concern in the context of a high frequency trader as opposed to any other type of trader. Automated surveillance systems are designed to identify anomalies or transaction patterns that potentially violate exchange rules or that may be indicative of some other type of risk to the orderly functioning of the market, and as the markets have evolved so too have these systems; we believe they will continue to do most effectively if the DCMs have the freedom to pursue those initiatives which best serve the interests of protecting the integrity of their markets rather than allocating resources to fulfill mandates for which the utility has not been demonstrated.

§ 38.252 – Additional requirements for physical delivery contracts.
Proposed §38.252 embodies long-standing practices of CME Group's DCMs. While we think that it is sound business practice as a DCM to, among other things, monitor a contract's terms and conditions as to whether there is convergence between the contract price and the price of the underlying commodity and to monitor deliverable supply to make sure it is adequate, as previously discussed, we oppose the Commission's eradication of principles-based regulation through prescriptive rules such as these. In substance, proposed §38.252 can be found in the current acceptable practices and we think that they should remain acceptable practices moving forward. We think this is equally applicable to proposed §38.253.

§ 38.253 – Additional requirements for cash-settled markets.
If a contract listed on a DCM is settled by reference to the price of a contract or commodity traded in another venue, this proposed regulation would obligate a DCM to require that all traders, including non-member traders, on the DCM provide the DCM with "their positions in the reference markets as the traders' contracts approach settlement," or, in the alternative, to have an information sharing agreement with the other venue or DCM.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

One of the areas in which the Commission is uniquely situated to add regulatory value to the industry is in the context of reviewing for potential cross-venue rule violations as it is the central repository for position information delivered to it on a daily basis in a common format across all venues. In the interest of efficient and effective industry regulation that minimizes the costs of redundant efforts, CME Group believes this is an appropriate area in which the Commission should allocate resources. The proposed alternative is for the Commission to impose onerous burdens on DCMs and their customers by requiring the reporting of information the Commission is already privy to; however, this would clearly be the more inefficient option, may impair liquidity because participants do not desire to take on the burden of reporting or the regulatory risk of failing to do so, and is also less effective because the trader may not report the positions to DCM as timely or as accurately as the clearing firm will report to the Commission via its routine reporting. The regulation also provides that instead of requiring the duplicative reporting, the DCM could instead enter into an information-sharing agreement with the other venue, but this too has additional costs to both entities and it may not be practical or prudent for a DCM to enter into such an agreement with the other venue.

CME Group rules already allow it to request such information on an as-needed basis from market participants and it is also a party to various information sharing agreements with other entities. When a market position is of concern to CME Group's regulators, they have the ability to request such information in one of these ways. The benefit of mandating duplicative reporting by all participants, even where there is no identified basis for concern, is burdensome and a poor use of regulatory resources.

§ 38.254 – Ability to obtain information.

Proposed rule § 38.254 requires DCMs to have rules in place that require traders to keep records of their trading, including records of their activity in the underlying commodity and related derivatives markets. The Commission provides no guidance as to the types records DCMs must require to be kept under this rule. We recommend that the Commission provide guidance to DCMs in the form of acceptable practices on the types of records that DCMs should require traders to keep under this rule.

§ 38.255 – Risk controls for trading.

Although CME Group broadly concurs that risk control mechanisms such as price limits, circuit breakers or halts in linked or substitute contracts should be coordinated "to the extent practicable," DCMs must retain the flexibility to determine and to implement risk controls that it believes are necessary to protect the integrity of its markets given that it is the DCM that is responsible for reducing the risk of potential disruptions in its markets. Further, CME Group is not aware that the national securities exchanges currently have a similar obligation to coordinate these types of risk controls with DCMs. For the foregoing reasons, CME Group does not believe that the Commission should mandate coordination by regulation. Instead, the Commission should work constructively with registered entitities to facilitate coordination, where appropriate, and also exercise leadership in facilitating dialogue with the SEC to accomplish this objective with respect to linkages among the various forms of equity securities and derivatives. The latter point, in particular, is a critical undertaking, and CME Group has previously expressed its strong support for elevating the level of collaboration and coordination in this area.

The Commission notes further in the rulemaking that it is considering mandating that DCMs employ other specific types of pre-trade risk controls in electronic trading environments that are appropriate and/or

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

necessary to reduce the risk of market disruptions and invited comment on which risk controls should be mandated and how. As outlined in its comment letter to the Commission's advance notice of proposed rulemaking on Disruptive Trading Practices, CME Group incorporates a broad array of risk and volatility mitigation tools, provides numerous risk management services and capabilities to its customers, and establishes and enforces rules and policies designed to mitigate the risk of disruptions to its markets.

CME Group believes that the marketplace would benefit from some level of standardization with respect to the types of pre-trade risk controls employed by DCMs, as well as by other trading venues, and is supportive of the Commission including as part of an acceptable practices framework, pre-trade quantity limits, price banding and messaging throttles; however, CME Group also believes that the determination of the specific parameters for these types of functionality should remain with the DCM which is in the best position to assess the parameters appropriate for its markets. It is, of course, equally important that clearing firms and trading firms with direct access have similar responsibilities to implement appropriate pre-trade risk controls; clearly, redundant risk mitigation checks that are appropriately calibrated at the various levels of the electronic trading supply chain will offer the most robust protection to markets and market participants. CME Group strongly encourages the Commission to continue its dialogue with the industry in formulating its approach in this area.

§ 38.256 – Trade reconstruction.
This proposed regulation would obligate the DCM to make all audit trail data and reconstructions available to the Commission in a form, manner and time as determined by the Commission, in its sole discretion. As the Commission is aware, audit trail information from electronic trading venues is extremely detailed and voluminous, and the DCM needs adequate time to prepare the data in the form the Commission requests and to ensure that the data it provides, particularly when requested to be produced in other than its native form, is accurate and complete. Although the Commission staff is typically reasonably flexible in regard to the timing of its requests, the volume of requests has increased substantially as the Commission staff has grown and various new initiatives have been undertaken. We therefore recommend that the Commission modify the language to "such reasonable time as determined by the Commission."

Subpart F – Position Limitations or Accountability

§ 38.300 – Core Principle 5.
§ 38.301 – Position limitations and accountability
The Commission has proposed a new and far more expansive and prescriptive position limit regime in a separate rulemaking without either having made a proper finding that its proposed rules are necessary or appropriate to achieving the mandates of the Dodd-Frank Act or having the information regarding the OTC market that would be necessary to calibrate appropriate limits should there be a finding that limits were justified. CME Group requests that the Commission give careful consideration to the comments CME Group will file in connection with that proposed rulemaking and carefully evaluate the ramifications of its proposed approach to price discovery, the efficiency of risk transfer and the vitality of U.S. markets.

Additionally, to the extent that Proposed Appendix C addresses issues that overlap with the proposal on Part 151, the Commission should ensure that the two rulemakings are consistent to avoid confusion to market participants.

Subpart G – Emergency Authority

§ 38.350 – Core Principle 6.
CME Group DCMs currently have rules in place that provide for the exercise of emergency authority and which are consistent with the types of emergencies contemplated in Core Principle 6. However, the Commission's proposed amended guidance and acceptable practices reflect a new emphasis on cross-market coordination of emergency actions, on the ability to address emergencies in real-time should the need arise, and on more significant involvement of the Commission with respect to exchange emergency actions. The Commission has only very generically articulated the basis for these proposed amendments and it is not clear that the Commission has fully considered the real-world implications of its guidance. There are a wide variety of possible types of emergencies, and a DCM must have the flexibility to respond to an emergency in the manner and time frame that it believes is necessary to protect the integrity of its markets. Certain types of emergencies might appropriately lend themselves to coordination, consultation and a comprehensive evaluation of the possible effects of the DCM's actions on all underlying, linked or similar markets, but clearly that is not universally, much less usually, the case, and doing so in fact may hinder the prompt implementation of the necessary action – creating rather than mitigating risk. Additionally, depending on the nature of the emergency, there may also be issues a DCM must consider with respect to sharing confidential and potentially market impacting information in advance of taking an emergency action.

The Commission's guidance also states that where a swap is traded on more than one platform, emergency action to liquidate or transfer open interest must be as directed, or agreed to, by the Commission or the Commission's staff. It is not clear from the guidance whether the Commission is referencing in this context all of the DCM's open interest in a particular swap or the swap positions of a particular participant; in the latter case, it is not clear why prior Commission approval is necessary or appropriate as requiring such prior approval will unequivocally impair the DCM's ability to take prompt action.

For these reasons, CME Group believes that the Commission should re-craft its guidance to make clear that DCMs have the flexibility and independence necessary to address market emergencies. The objective should be to ensure that DCMs have the rules, procedures and capabilities to respond to emergencies in an effective and timely manner consistent with the nature of the emergency and that all such actions taken by the DCM be made in good faith to protect the integrity of the market.

Subpart H – Availability of General Information

§ 38.400 – Core Principle 7.
Proposed regulation 38.401(c) would require DCMs to post regulatory submissions filed with the Secretary of the Commission simultaneously on its website where such filings concern new product listings, new rules, rule amendments or other changes to previously-disclosed information. This

requirement is duplicative given that the Commission already maintains an area on its website for all such filings for the express purpose of providing transparency and a centralized repository of such information to the marketplace. Further, CME Group, for example, already has in place vehicles such as its Special Executive Reports, Market Regulation and Clearing Advisories and Globex Bulletins, among others, that are posted on our website to clearly and timely communicate information regarding these matters to the public, and we also provide a service that allows the public to subscribe from our website to receive any such notifications via email.

Notwithstanding the foregoing, to the extent that the Commission elects to prescriptively mandate that a DCM make such filings available on its website, the DCM should have a minimum of one business day to post such filings rather than having to post "simultaneously" with the Commission filing. CME Group notes that even this one-day standard would be a significantly higher standard than the Commission holds itself to with respect to posting the filings it receives from DCMs today.

Subpart I – Daily Publication of Trading Information

§ 38.450 – Core Principle 8.
§ 38.451 – Reporting of trade information.
The Commission is proposing certain changes to § 16.01 that will require DCMs to report the total of volume of block trades that are included in the volume of trading of each contract. Although CME Group does not object to reporting this information to the Commission, the compilation of new mandates such as these throughout this rulemaking will require assessment once the final rules are published to ascertain what systems changes will be necessary and how long such changes will take to implement.
The Commission also seeks comment in its rulemaking on the appropriate end-of-day price reporting of swaps. CME Group believes that this topic is better addressed by the Commission as a separate initiative given the state of change with respect to how this market is expected to evolve in the context of the regulatory reform initiatives being undertaken and the broad diversity of swap products.

Subpart J – Execution of Transactions

§ 38.500 – Core Principle 9.
§ 38.502 – Minimum centralized market trading requirement
As described in greater detail at the outset of this letter, CME Group strongly believes that the statutory language of Dodd-Frank with respect to Core Principle 9 did not suggest in any way that Congress intended for the Commission to establish a prescriptive and arbitrary percentage of volume threshold that a particular contract must trade in the centralized market in order to be permitted to trade on a DCM. Further, the Commission has not demonstrated how establishing this arbitrary minimum threshold and potentially forcing contracts off of DCMs provides any public or regulatory benefit or serves the broader marketplace with respect to the fundamental price discovery and risk management objectives these markets serve. There can be little question that block trades, for example, contribute to price discovery and serve the risk management needs of market participants, just as it is clear that exchange of futures for related position transactions have flexibly served the risk management needs of end-users for more than a century.

In this proposed rulemaking, the Commission seeks to impose a single prescriptive standard across an incredible diversity of products that serve particular risk management needs for varying customer segments, and without any consideration for the unique characteristics of different products, their place in the product maturity cycle or the substantial costs to market participants of its proposed approach. The proposed regulation does, however, impose onerous burdens with respect to constantly evaluating compliance with thresholds, transferring open interest, liquidating contracts and endless paperwork related to reporting and exemption petitions – all for hypothetical benefits that have yet to be articulated or empirically supported.

CME Group strongly urges the Commission reconsider its prescriptive approach to this core principle.

§ 38.503 – Block trades on futures contracts.
Among other provisions, this proposed rule provides that a DCM's rules must limit block trades to "large transactions, and impose minimum size requirements on such transactions that are appropriate for each listed contract subject to a block trading provision." As discussed in Section I (a) above, and in response to proposed § 38.505, Core Principle 9 places no size limitation on off-exchange transactions executed pursuant to contract market rules. Specifically, subsection (b)(iii) states that the rules of DCMs may permit "a futures commission merchant, acting as principle or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if that contract is reported, recorded, or cleared in accordance with the rules of the contract market or [DCO]." Subsection (b)(iii) grants DCMs discretion in setting block thresholds so long as such thresholds do not undermine price discovery that may be occurring in the centralized market. Thus, to the extent that the "large transactions" language in proposed § 38.503 is intended to impose a size requirement on block transactions executed pursuant to DCM rules, such language should be omitted from a final rule as it is inconsistent with the plain language of subsection (b)(iii) of Core Principle 9 and inconsistent with the proposed requirement that DCMs set block levels that "are appropriate for each listed contract."

This new regulation also mandates that in all cases block trades must be reported to the contract market within five minutes of its execution, again applying a one-size-fits-all approach to regulation. DCMs should retain the flexibility to determine appropriate reporting periods based on appropriate factors, for example, the liquidity profile of the contract and the size of the block. One of the principal reasons for allowing block trades is that transactions that are large in size relative to a contract's liquidity have the potential to be disruptive if entered directly into the centralized market. In some circumstances, allowing only 5 minutes for the party facilitating the block to hedge that position may not be sufficient to mitigate potentially disruptive effects. Provided that the DCM can reasonably justify its minimum reporting period, it should have the flexibility to establish a period that in its judgment best serves the needs of the marketplace.

The regulation further requires that a DCM publish the details of each block trade "immediately" upon receipt. DCMs should instead be held to an "as soon as is practicable" standard given that DCM staff must first review the report for accuracy given its potential market impact and then execute the operational procedures necessary to publish the block report. Additionally, the regulation calls for separately identifying block trade volume in DCM's daily volume reports. CME Group does not fundamentally object to this additional mandate, but it will require changes to current systems and a

retooling of daily publications which will require time to implement that, again, will be longer than the proposed 60-day period that DCMs are proposed to have to certify compliance with all of the amended core principles and Commission regulations.

With respect to block trades between affiliated parties, the Commission proposes a more stringent pricing standard that requires the price of the block trade to either fall within the contemporaneous bid/ask spread on the centralized market or be based on a contemporaneous market price in a related cash market. It remains unclear, as it did when this requirement was initially proposed by the Commission in 2008, why affiliated parties should be held to a different standard in this regard than other market participants and be denied the ability to enter into valid transactions that are available to other market participants who are not affiliates. The regulation requires that each party have a separate and independent legal, bona fide business purpose for engaging in the trades and each party's decision to enter into the trade must be made by a separate and independent decision maker. Consequently, there is no reason that such affiliated parties should not be held to the same "fair and reasonable" pricing standard that applies to other market participants.

§ 38.505 – Exchange of derivatives for related position ("EDRP").

Proposed § 38.505 requires that the price differential between the futures leg and the cash or derivatives leg of an EDRP "should reflect commercial realities and at least one leg of the transaction should be priced at the prevailing market price." Current industry practice is to require EDRPs to be executed at commercially reasonable prices that are mutually agreed upon by the parties to the transaction and do not require that one leg be priced at the prevailing market price as proposed by the Commission. The Commission has not articulated any defect with this practice and we do not believe that the Commission should impose such a requirement.

The effective price of an EDRP is the price differential between the component legs of the transaction rather than the specific prices of each component leg and neither component price is reported. Parties to such transactions may have commercially appropriate reasons for pricing the legs of an EDRP at other than the prevailing market price at the time of the transaction, just as there are with futures spread transactions for which the component legs are routinely priced away from the prevailing market. The proposed regulation already requires that the EDRP be bona fide, and in the absence of any compelling basis to limit pricing flexibility in this regard, the Commission should modify this provision of the regulation to conform to current standards.

The Commission further notes that "given the continuous changes and advancements in electronic trading over the years," it believes EDRP trades should be reported within 5 minutes of consummation, the same time period as is proposed for block trades. The advancements in electronic trading have no bearing with respect to the reporting of EDRPs. These are privately-negotiated transactions, often between end-users, but unlike blocks do not inform price discovery and consequently do not require the same degree of reporting urgency. Block trade reports are currently typically called into the exchange to facilitate price reporting, but they are not required to be submitted for clearing within the time that they are required to be price reported. EDRPs are not price-reported and therefore are not called into the exchange, but rather are reported to the customers' clearing firms who subsequently input the exchange-leg into the clearing system. Thus, not only is it grossly impractical for EDRPs to be submitted for

clearing within five minutes of consummation, it is unnecessary. DCMs should continue to have the flexibility to establish clearing submission standards that are appropriate to supporting their business needs and the needs of market participants. It is also worth noting that blocks and EDRPs may be executed during time periods when the centralized market is closed and the prescriptive regulations proposed by the Commission do not contemplate this.

These are additional examples of why the Commission should be focused on implementing an appropriate core principles framework that allows a DCM flexibility in determining rules appropriate for its markets that are certified to the Commission and comply with core principles. The Commission simply is not in a position to appreciate all of the idiosyncrasies of the panoply of products traded on each DCM's market, the needs of the DCM's customers and the operations of the DCM in the same way that the DCM is able to. Further, every time there is an innovation that might create value for market participants that does not comply with the prescriptive standards established by the Commission, but which otherwise complies with the core principles, the DCM will have to petition the Commission for a rule change that will require Commission staff to examine the issue, publish a proposed rule change in a federal register release, review comments and publish a final rule. This is not the type of flexible regime that Congress contemplated and would represent a significant step backward for the industry.

Proposed § 38.505 also prohibits all "contingent" EDRP transactions. Specifically, subsection (c) of Proposed § 38.505 provides that "[a]n exchange of derivatives for a related position transaction must be bona fide such that the exchange of derivatives for the related position is not contingent upon an offsetting transaction." The Release does not identify any perceived regulatory or public concerns created by such transactions in markets where there is no established liquidity in a centralized market. On the contrary, in their dissent Commissioners Sommers and O'Malia note that, for the past decade, such transactions have provided significant regulatory and public benefit in the energy space:

> Over the past decade, a long list of non-standardized, illiquid contracts in the energy sphere have been executed off-exchange and cleared on-exchange through the exchange of futures for swaps (EFS) mechanism. The availability of clearing for these contracts added a level of safety, soundness and transparency to the marketplace that did not exist before. If the Commission had not permitted these contracts to be listed for clearing through the EFS process it is highly doubtful that the level of clearing that exists today for these contracts would have been achieved, and highly likely that this activity would have remained opaque to market participants and regulators.

75 FR 80636. There is nothing in Core Principle 9 or any other provision of DFA that requires the elimination of such transactions. We agree with Commissioners Sommers and O'Malia that "Congress was aware of this specialized marketplace when it amended Core Principle 9" and if it had "intended to outlaw this activity it could have done so by explicitly requiring all DCM contracts to trade in the centralized market." Id.

To the extent that there is an unstated philosophical issue with the continued use of such EDRP transactions, we submit that DCMs may allow market participants to achieve the same result by adopting rules pursuant to subsection (b)(iii) of Core Principle 9, which states that the rules of DCMs may permit "a futures commission merchant, acting as principle or agent, to enter into or confirm the execution of a

contract for the purchase or sale of a commodity for future delivery if that contract is reported, recorded, or cleared in accordance with the rules of the contract market or [DCO].” Subsection (b)(iii) grants DCMs discretion in setting block thresholds so long as such thresholds do not undermine any price discovery that may be occurring in the centralized market. The validity of such off-exchange transactions is underscored by CEA § 4(a), which expressly prohibits any person to execute or even offer to enter into a futures contract unless such transaction is “conducted on or subject to the rules of a board of trade which has been designated or registered by the Commission as a contract market.” 7 U.S.C. § 4(a) (emphasis added). Congress certainly was aware of this language in Section 4(a) the CEA when it passed DFA and chose not to eliminate it from the Act.

Subpart K – Trade Information

§ 38.552 – Elements of an acceptable audit trail program.
Proposed § 38.552 requires that a DCM's audit trail program include an electronic transaction history database that, among other things, includes “a history of all orders and trades.” CME Group maintains such a database in the context of electronic trading; however, the open outcry venue does not support an electronic transaction history database that captures *the history of all orders*, including orders that may be cancelled prior to execution. In those circumstances that open outcry orders are entered to the trading floor via an electronic order routing system, such information is captured and retained by CME Group. However, the majority of such orders are not entered in such manner and the Commission should ensure that any prescriptive regulations it chooses to promulgate in this area reflect the distinctions in the operations of different trading venues.

§ 38.553 – Enforcement of audit trail requirements.
The Commission's proposed § 38.553 requires that a DCM enforce its audit trail and recordkeeping requirements through at least annual reviews of “all members and market participants” to verify their compliance with all applicable audit trail requirements. In light of the manner in which the Commission has characterized the term market participant in other parts of this rulemaking and, incorrectly we believe, sought to require all market participants to be subject to all DCM rules in the identical manner as are members, the all-encompassing language of this regulation would suggest that DCMs have an obligation to conduct annual audit trail reviews of every participant who enters an order into the DCM's electronic trading system. This would be exceptionally onerous, costly and unproductive and we do not believe that this is what the Commission intended; however, given that this is a prescriptive regulation with which a DCM must certify compliance to maintain its designation status, we urge the Commission to clarify the language such that the required electronic audit trail reviews apply at the clearing firm level rather than the market participant level.

As the Commission notes, audit trail programs in the area of electronic trading have been evolving well ahead of any rulemaking by the Commission as DCMs have taken the initiative to develop new programs that are designed to support their regulatory objectives. CME Group again urges that the Commission recognize the value of a core principles regime in this context and allow DCMs the flexibility to design and execute audit trail programs that best serve the objectives of the core principle and provide the greatest regulatory benefit rather than focusing their efforts on fulfilling prescriptive mandates. For example, given that CME Group reviews front-end audit trail capabilities at the time a participant connects to Globex, the

allocation of resources to reviewing such capabilities in an audit relative to other factors that are more impactful to our regulatory capabilities may not be the best use of those resources from a regulatory risk point of view. As we have consistently seen, principles based regulation allows DCMs to determine the most efficient and effective way to achieve the desired outcomes, and they are accountable if they do not satisfy the relevant core principle.

Subpart L – Financial Integrity of Transactions

§ 38.600 – Core Principle 11.

§ 38.601 – Mandatory Clearing.

The mandatory clearing requirement should not apply to swaps traded on a DCM. As the Commission knows, not all swap contracts will be required to be cleared. Specifically, foreign exchange swaps may be exempt from the clearing mandate and end users may exercise their right not to clear swaps that may otherwise be subject to the clearing mandate. By requiring all contracts executed on a DCM – including swaps – to be cleared by a DCO, the Commission is putting DCMs at a competitive disadvantage to SEFs without justification in law or otherwise. Accordingly, the Commission should revise proposed § 38.601 to exclude swaps from its coverage.

§ 38.607 – Direct access.

Proposed § 38.607 requires that DCMs which permit direct electronic access by customers (defined as allowing customers of futures commission merchants to enter orders directly into a DCM's trade matching system for execution) have in place effective systems and controls reasonably designed to enable the FCM's management of financial risk, such as automated pre-trade controls that enable member futures commission merchants to implement appropriate financial risk limits. The regulation also requires that the DCM implement and enforce rules requiring the member futures commission merchants to use the provided systems and controls.

CME Group has established numerous systems, controls and services to assist its clearing members in managing financial risk associated with clearing direct access business as well as other business submitted through its systems. We support the Commission's objective and its approach of providing DCMs with reasonable discretion over the control model for access to a particular marketplace and for appropriate flexibility in determining the specific types of pre-trade controls to be implemented in this context.

The Commission requested comment on what specific direct access controls and procedures DCMs should implement to permit futures commission merchants to manage their risks and whether such controls should be mandatory. As noted previously, CME Group believes that the marketplace would benefit from some level of standardization with respect to the types of pre-trade risk controls employed by DCMs in the context of an acceptable practices framework and we encourage the Commission to continue its dialogue with the industry in formulating a holistic approach that incorporates appropriate risk controls at the DCM and DCO levels, as well as at the clearing firm and direct access client level.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

Subpart N – Disciplinary Procedures

§ 38.700 – Core Principle 13.
§ 38.702 – Disciplinary panels.
The Commission's regulations mandate a disciplinary structure that includes Review Panels, which are responsible for determining whether a reasonable basis exists for finding a violation of contract market rules and authorizing the issuance of notices of charges, and Hearing Panels, which are responsible for adjudicating disciplinary cases pursuant to a notice of charges authorized by a Review Panel. CME Group again believes the Commission should rely on a core principles rather than prescriptive approach in this context as DCMs may have established structures or develop new structures that clearly satisfy the objectives of the core principle, but may not precisely comply with the language of the prescriptive regulation. CME Group rules, for example, authorize its Market Regulation staff to determine whether certain non-egregious rule violations merit referral to a Review Panel and to issue warning letters on an administrative basis or to take certain summary actions when appropriate; the Hearing Panel may also adjudicate a disciplinary case prior to the issuance of charges pursuant to a supported settlement offer. Although this type of flexibility appears to be contemplated by other regulations under this core principle, the prescriptive language of this regulation appears to mandate a different approach.

§ 38.703 – Review of investigation report.
Section 38.158 proposes that all investigation reports be required to include the disciplinary history, if any, of the market participant against whom the DCM's compliance staff seeks charges. This proposed § 38.703 states that a "Review Panel" should review that investigation report when contemplating whether to issue formal charges. CME Group agrees that the investigation report should include the disciplinary history so that compliance and enforcement staff can sufficiently evaluate whether to seek charges from the Review Panel. However, it disagrees that the disciplinary history should be included in the version of the investigation report sent to the Review Panel. Nor should it be considered by the Review Panel when determining whether to issue formal charges. Whether a market participant has a disciplinary history is not relevant to the consideration of whether that person or entity, in the new matter, has committed a further violation(s) of the DCM's rules. An exception would be where the prior disciplinary offense is an element of proof for the rule violations that compliance staff is asking the Review Panel to issue charges, such as violation of a previously issued cease and desist order or broker ban. Prior disciplinary history is relevant to the sanctioning phase of a disciplinary hearing and should appropriately be addressed at that juncture in the disciplinary process.

§ 38.705 – Right to representation.
The proposed provision states that a market participant should be able to be represented by counsel "or any other representative of its choosing in all succeeding stages of the disciplinary process." Similar language appears in § 38.716. Consistent with current CME Group rules and in order to avoid conflicts, this should be limited to legal counsel or anyone other than a member of the DCM's disciplinary committees, a member of the DCM's Board of Directors, an employee of the DCM or a person substantially related to the underlying investigation, such as material witnesses or respondents.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

§ 38.710 – Hearings.
Section (a)(2) of this regulation states that the respondent "must be entitled" to review all evidence and documents to be relied upon by compliance staff at a contested hearing or that is "relevant" to the issued charges. To the extent the Commission believes it is necessary to promulgate regulations rather than rely on core principles, this should be revised to exclude protected attorney work product, attorney-client communications, and investigative work product, including, but not limited to, the investigation report and any exception reports.

§ 38.715 – Summary fines for violations of rules regarding timely submission of records, decorum, or other similar activities.
CME Group makes the same objection to the proposed requirement that no more than one letter of warning issue to a market participant in a 12-month rolling period as it did for proposed § 38.158(e).

§ 38.850 – Conflicts of Interest.
The Commission has published two separate NOPRs containing proposed rules that would govern DCMs obligations to comply with Core Principle 16. CME Group's comments on the Commission's proposed rules governing conflicts of interest issues at DCMs are contained in the letters submitted or to be submitted in response to those NOPRs[10].

§ 38.1050 – Core Principle 20.
§ 38.1051 – General requirements.
CME Group believes that it follows generally accepted standards and best practices with respect to the development, operation, reliability, security, and capacity of its automated systems. We also concur that disruptions to markets should be minimized, and that market providers must have strong BC-DR plans and processes. However, in setting standards for recovery time objectives ("RTO"), CME Group believes that it is imperative that impacts on all market participants and independent technology services providers be considered in each catastrophic situation in the context of determining the proper RTO. As a "critical financial market" CME Group would be subject to more stringent business continuity requirements and it previously commented on the Commission's proposed rule on this topic under Section 40.9.

Proposed regulation § 38.1051 mandates that DCMs notify Commission staff promptly of all electronic trading halts and systems malfunctions. CME Group widely publishes notices of electronic trading halts and agrees that this is necessary. However, the requirement for notice of all systems malfunctions is overly broad and would require onerous reporting of mundane and trivial incidents. CME Group's system architecture is highly redundant and scalable, and most minor incidents are corrected without disruption or cause for concern and do not merit reporting. Further, some market-related automated functionality such as stop logic may pause markets pursuant to published parameters, and these types of normal market events should not be subject to routine reporting. The Commission should therefore limit required reporting to any material system failures.

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[10] These NOPRs also contain the proposed rules relating to Core Principle 15 (Governance Fitness Standards) and Core Principle 22 (Diversity of Board of Directors). As such, CME Group's comments on these issues also will be addressed in these other comment letters.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

Proposed regulation § 38.1051 also mandates that DCMs provide the Commission with timely advance notice of *all* planned changes to automated systems that *may* impact the reliability, security, or adequate scalable capacity of such systems. Here again, the Commission has gone too far with its reporting requirements, creating an extremely onerous burden for DCMs and adding significant costs that are not at all commensurate with any value created. Any change to a system, if implemented incorrectly, could conceivably impact the operation of the system and it would be grossly inefficient and unproductive to report every planned change to the company's automated systems. The Commission should be focused on requiring DCMs to have proper change control processes and procedures, not on requiring advance reporting of the details of each and every system change.

The Commission further requires that DCMs provide timely advance notice of *all* planned changes to the DCM's program of risk analysis and oversight. As with the aforementioned mandates, this is an extraordinarily broad requirement that speaks more to excessive and stifling regulation rather than prudent oversight. It is neither necessary nor productive for the relationship between the Commission and DCMs to be defined in this way and we urge the Commission to consider a far more measured and practical approach that appropriately considers context and relative risks.

Disaster recovery tests generally involve the clearing community, member firms, and major liquidity providers connected in the Globex environment. However, while CME Group obtains representations that its major vendors have disaster recovery plans, CME Group does not control, or generally have access to, the details of the proprietary plans of these entities.

Subpart V – Financial Resources.

§ 38.1101 General requirements.
Proposed § 38.1101 seeks to implement Core Principle 21, which states that DCMs shall have adequate financial, operational, and managerial resources to discharge each responsibility of the DCM. Core Principle 21 further states that the financial resources of the DCM "shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the contract market to cover the operating costs of the contract market for a 1-year period, as calculated on a rolling basis." 7 U.S.C. §7(d)(21). Though the statute does not define "financial resources" we believe Congress intended the term to be construed broadly to include anything of value that the DCM has at its disposal, including operating revenues. Indeed, had Congress wanted to exclude operating revenues from financial resources available to the DCM for purposes of satisfying its obligations under Core Principle 21, it could have incorporated an equity concept. Moreover, unlike subsection (e) of proposed § 38.1101, which appears to be concerned with DCMs having adequate resources to wind-down the business, subsection (a) appears to be addressing the going concern of the business, which would naturally include estimated operating revenues.

With respect to subsection (e), we believe that the measurement of liquidity of financial resources is relevant only in the context of winding-down of operations. In that context, we believe a more accurate assessment of how long it would take for a DCM to wind-down is 3 months, rather than 6 months. Therefore, we recommend that the Commission revise subsection (e) accordingly.

Moreover, we believe that it is not feasible for DCMs to comply with the reporting requirement imposed under this rule within 17 business days after the end of the DCM's fiscal quarter, as proposed by the Commission. We strongly urge the Commission to revise this aspect of its proposed rule and grant DCMs 40 calendar days after the end of the DCM's fiscal quarter, and 60 calendar days after the end of the fiscal year, to comply with its filing obligations. This suggested time period is consistent with the SEC's reporting requirements.

Finally, CME Group recommends that the Commission clarify that all filings made pursuant to § 38.1101 be kept confidential by the Commission.[11] The data the Commission is requesting under this rule contains sensitive commercial information that the DCM is otherwise under no obligation to publicly disclose. We see no value in making this information publicly available. If the Commission were to make this information publicly available, we would object to the substantive filing requirements as well.

§ 38.1200 – Core Principle 23.
The proposed section states that the DCM must keep any records relating to swaps defined in § 1a(47)(A)(v) of the Act open for inspection for the SEC. The Commission's proposed rule does not provide any guidance as to what records will need to be retained nor how long such records must be retained in order to satisfy its obligations under Core Principle 23. Thus, DCMs will have no way of knowing whether it is in compliance with this core principle without further guidance from the Commission.

Appendix C, § (b)(i)(C)
This proposed rule provides that "…an appropriate estimate of deliverable supply excludes supplies that are committed to some commercial use." The Commission's proposal in this regard is overly restrictive and inconsistent with long-standing practice in the industry. Specifically, since the adoption of the 25% formula for the grain and livestock markets in the 1980s, DCMs have estimated deliverable supplies by including in their calculations all supplies that are stored in the delivery territory or that move through the delivery territory. The Release identifies no problems with using this methodology in these markets, and in fact, there are none. If this standard is adopted, it will impose additional costs on exchanges and market participants with no defined benefit, including requiring exchanges to survey market participants annually.[12]

Appendix C, §§ (c)(3)(ii) & (g)(ii).
Both proposed rules provide "The cash-settlement survey should include a minimum of four independent entities if such sources do not take positions in the commodity (e.g., if the survey list is comprised exclusively of brokers) or at least eight independent entities if such sources trade for their own accounts (e.g., if the survey list is comprised of dealers or merchants)." For many commodities, including certain parts of the livestock/meat/dairy sector, there may not be eight independent entities in the entire industry. Therefore, we believe that these rules should be modified to provide that where there are less than eight

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[11] CME Group recommends that the Commission also clarify that consolidated financial statements covering multiple DCMs, and DCOs where relevant, comply with § 38.1101.

[12] Since this concept is related to the Commission's proposal under Part 151 regarding position limits, the Commission should ensure that the definition of deliverable supply is the same in the final rules under both Parts.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

independent entities, that the cash-settlement survey should include transactions representing at least 51% of total production for the commodity in question.

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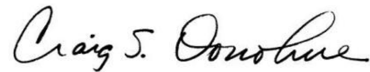
CME Group thanks the Commission for the opportunity to comment on this matter. We would be happy to discuss any of these issues with Commission staff. If you have any comments or questions, please feel free to contact me at (312) 930-8275 or via email at Craig.Donohue@cmegroup.com, or Christal Lint, Director, Associate General Counsel, at (312) 930-4527 or Christal.Lint@cmegroup.com.

Sincerely,



Craig S. Donohue

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia

Exhibit B

CME Group

Craig S. Donohue
Chief Executive Officer

February 7, 2011

David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre, 1155 21st Street, NW
Washington, DC 20581

Re: General Regulations and Derivatives Clearing Organizations 75 Fed. Reg. 77576 (Dec. 13, 2010), RIN 3038-AC98

Dear Mr. Stawick:

CME Group Inc. ("CME Group") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or the "Commission") notice of proposed rulemaking ("NPR") regarding requirements for the chief compliance officer of a derivatives clearing organization ("DCO"), as set forth in proposed Regulation 39.10, and the establishment of regulatory standards for compliance with certain DCO Core Principles.[1] CME Group is the parent of Chicago Mercantile Exchange Inc. ("CME"). CME's clearing house division ("CME Clearing") offers clearing and settlement services for exchange-traded futures contracts, and for over-the-counter ("OTC") derivatives transactions through CME ClearPort. CME is registered with the CFTC as a DCO, and is one of the largest central counterparty clearing services in the world.

A. DCO Chief Compliance Officer

1. Overview

Among the many new requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank" or "DFA") is the mandate in Section 725(b) (as codified in new Section 5b(i) of the Commodity Exchange Act, or CEA) that each DCO designate an individual to serve as its chief compliance officer. CME Group is committed to promoting and maintaining a strong culture of compliance throughout our organization. In furtherance of that commitment, we devote substantial time and resources to developing compliance policies and procedures and providing compliance education and training to our personnel. These efforts involve officers and employees in various departments throughout CME Group and its subsidiaries, including but not limited to CME and CME Clearing. CME Group supports creating a culture of compliance at CFTC registrants, including DCOs, and concurs with the regulatory policy underlying the requirement for every DCO to have a chief compliance officer ("CCO").

In preparing this letter, we have had the benefit of reviewing comment letters submitted by other market participants in response to the CFTC's separate rulemaking proposal implementing Sections 731(k) and

[1] The NPR also addresses (i) procedures for DCO applications and for the transfer of a DCO registration, (ii) requirements for approval of DCO rules establishing a portfolio margining program for customer accounts carried by a futures commission merchant that is also registered as a securities broker-dealer, and (iii) certain new or revised definitions.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

732(d) of Dodd-Frank, which require every swap dealer, major swap participant and futures commission merchant ("FCM") to appoint a CCO.[2] We have found particularly insightful the comment letters submitted by the Futures Industry Association ("FIA") and the Securities Industry Financial Markets Association (the "FIA/SIFMA Letter"),[3] the National Futures Association (the "NFA Letter"),[4] the National Society of Compliance Professionals (the "NSCP Letter"),[5] and Newedge USA, LLC (the "Newedge Letter").[6] Many of the issues discussed in those letters are also germane to the CFTC's proposal regarding the DCO CCO role. In particular, as we discuss below, while certain aspects of proposed Regulation 39.10 are appropriate, other provisions in the Regulation stray too far afield from Dodd-Frank's mandate and established compliance practices in the financial services industry with respect to the appropriate scope of CCO responsibilities.

2. <u>CCO Reporting Structure</u>

Dodd-Frank provides that the CCO "shall report directly to the board or senior officer" of the DCO.[7] Proposed Regulation 39.10(c)(ii) likewise requires the CCO to report to the DCO's board of directors or senior officer. The CFTC seeks comment as to "(i) [w]hether it would be more appropriate for a CCO to report to the senior officer or the board of directors; (ii) whether the senior officer or board of directors generally is a stronger advocate of compliance matters within an organization; and (iii) whether the proposed rules allow for sufficient flexibility with regard to a DCO's business structure."[8]

CME Group believes that Regulation 39.10 provides a DCO with appropriate flexibility to determine whether its CCO should report to its board or senior officer, and to select which reporting structure works best considering its corporate organization, size and business needs. Of course, a key function of the CCO will be to advise DCO senior management on compliance with applicable laws and regulations, and to keep them informed of developments in these areas. The CCO will also assist senior management in educating DCO staff on compliance issues, and serve as a point of contact within the DCO for compliance questions. Given the CCO's day-to-day responsibilities, it would be logical for a CCO to report to DCO senior management, who are responsible for establishing and communicating a compliance policy and for ensuring that it is observed. Generally speaking, the board of directors (or a board committee) should oversee implementation of compliance policy, and ensure that compliance issues are resolved effectively and expeditiously by senior management with the assistance of the CCO.[9]

With respect to accommodating various DCO business structures, we note that CME Clearing is not a stand-alone entity but operates as a division of a larger corporation (CME). The senior officer of the DCO division is familiar with the day-to-day operations of the DCO and its personnel and is therefore generally

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[2] 75 Fed. Reg. 70881 (Nov. 19, 2010).

[3] Letter from FIA and SIFMA (John M. Damgard, FIA President, and Kenneth E. Bentsen, Jr., SIFMA Executive Vice President, Public Policy and Advocacy) to the CFTC (Jan. 18, 2011).

[4] Letter from NSCP (Joan Hinchman, Executive Director, President and CEO) to the CFTC (Jan. 18, 2011).

[5] Letter from NFA (Thomas W. Sexton III, Senior Vice President and General Counsel) to the CFTC (Jan. 18, 2011).

[6] Letter from Newedge (Gary DeWaal, Senior Managing Director and Group General Counsel) to the CFTC (Jan. 7, 2011).

[7] DFA § 725(b), CEA § 5b(i)(2)(A).

[8] 75 Fed. Reg. 77576, 77581 (Dec. 13, 2010).

[9] *Compliance and the Compliance Function in Banks*, Basel Committee on Banking Supervision, at 9-10 (April 2005).

best positioned to ensure that the DCO division is compliant with the CEA and CFTC Regulations. Accordingly, a DCO may determine that its CCO should report to the senior officer of the DCO division rather than reporting to the senior officer of the larger corporation.[10] In order to provide for a divisional or business-unit approach, we ask the CFTC to clarify that the term "senior officer" of the DCO (as used throughout Regulation 39.10) may apply to the senior officer of a division that is engaged in DCO activities.

3. Potential for CCOs with Other Duties

Proposed Regulation 39.10(c)(i) requires the CCO to "have the background and skills appropriate for fulfilling the responsibilities of the position" and prohibits anyone who would be disqualified from registration under Sections 8(a)(2) or (a)(3) of the CEA from serving as CCO. The CFTC requests comment on whether additional limitations should be placed on the person who may be designated as the CCO. In particular, the CFTC asks whether it should restrict the CCO position from being held by an attorney who represents the DCO or its board of directors, such as in-house counsel. The rationale for such a restriction would be based on concerns that the interests of acting as defense counsel "would be in conflict with the duties of the CCO."[11]

CME Group recognizes that it may be preferable for a CCO to only perform compliance activities, and that compliance staff, and in particular the CCO, should not be placed in a position where possible conflicts of interest may arise between their compliance responsibilities and other duties they perform at the DCO. Nevertheless, it is commonplace for CCOs to have certain other job responsibilities, most typically in related "control areas" such as the Legal Department or Internal Audit.[12] At a minimum, the CCO inevitably will share some functions with Legal and Internal Audit, and will engage in ongoing coordination and information sharing with those departments in order for each to carry out its role efficiently and effectively. We believe the CFTC should not add further restrictions to the CCO role but should retain an approach that gives DCOs flexibility to determine whether their CCOs may perform certain tasks that are not strictly compliance-related.[13]

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[10] Similar "division" issues were raised in at least one comment letter regarding CCO requirements for swap dealers, major swap participants and FCMs. Letter from Cargill Inc. (David Robertson, Assistant Vice President & Assistant General Counsel) to the CFTC (Jan. 14, 2011).

[11] 75 Fed. Reg. at 77581-82.

[12] Recent surveys indicate that about 35 to 40 percent of companies polled have a CCO that does not have other job responsibilities, and that where the CCO job is shared with another title, it is most commonly someone from the Legal department (at around 20 percent of survey participants), or Internal Audit (at around 10 percent of survey participants). Melissa Klein Aguilar, *Chief Compliance Officer Now a Full-Time Job*, Compliance Week (Dec. 15, 2009).

[13] Having a CCO also act as in-house counsel may present certain challenges with respect to defining and maintaining appropriate roles. For example, in order to preserve the attorney-client privilege (which generally does not apply to CCO communications, even if the CCO is an attorney), "[l]awyers who also perform compliance functions should make clear to other employees when they are acting as legal counsel and providing legal advice." Securities Industry Association, Compliance & Legal Division, *White Paper on the Role of Compliance*, at 3 (October 2005) ("SIA White Paper"). However, issues such as this do not necessitate a blanket prohibition against CCOs also serving as in-house counsel.

4. Overbreadth of Proposed CCO Responsibilities

a. *"Ensuring" Compliance*

As proposed, Regulation 39.10(c)(2)(iv) purports to require CCOs to "ensur[e] compliance with" the CEA and CFTC regulations "relating to agreements, contracts, or transactions, and with [CFTC] regulations prescribed under section 5b of" the CEA (which addresses DCO Core Principles). Although this mirrors language in Dodd-Frank requiring CCOs to "ensure compliance", we do not believe that Congress intended the CFTC to promulgate regulations that burden CCOs with such an insurmountable task.

As stated in the NFA Letter, "[t]he CCO should not…be held to the impracticable standard that must 'ensure' a firm's compliance as contemplated in the Commission's proposal."[14] The appropriate standard – and one that is actually achievable – is to require CCOs to put in place measures *reasonably designed to* ensure compliance with the CEA and CFTC regulations. This is consistent with FINRA Rule 3130 (Annual Certification of Compliance and Supervisory Processes), which requires the CCO of broker-dealer members to establish written policies and procedures "reasonably designed to achieve compliance with applicable" rules, regulations and laws.

The Financial Stability Oversight Council ("FSOC") utilized this same standard in a recent study recommending that boards of directors and CEOs of banks be made "responsible for developing and maintaining a program *reasonably designed to achieve compliance* with the Volcker Rule."[15] Furthermore, as explained in the NSCP Letter:

> …the Gramm Leach Bliley Act required, in Section 501, that financial institutions adopt safeguards to "ensure the security and confidentiality of personal information." During the rulemaking by the banking regulators, FTC and SEC, the regulators recognized that this standard needed to be modified, and required that financial institutions be required by the regulations to adopt safeguards "designed to ensure the security and confidentiality of personal information." That standard remains in the regulations to this day, has worked well, and has never been objected to by Congress as inconsistent with its instructions. This example suggests that the CFTC can adopt regulations that are consistent with the spirit of Dodd-Frank and will work well, without adopting verbatim the "ensuring" compliance standard for CCOs.[16]

The CFTC appears to acknowledge the impracticality of an "ensuring compliance" standard elsewhere in the proposed Regulation. Most notably, Regulation 39.10(c)(2)(viii) requires the CCO to establish "a compliance manual *designed to promote* compliance", and a "code of ethics *designed to prevent* ethical violations and to *promote* ethical conduct." CME Group urges the CFTC to amend the language throughout Regulation 39.10 to require CCOs to establish measures *reasonably designed to* ensure compliance with the pertinent sections of the CEA and CFTC regulations.

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[14] NFA Letter at 6.

[15] Financial Stability Oversight Council, *Study & Recommendations on Proprietary Trading & Certain Relationships with Hedge Funds & Private Equity Funds*, at 35 (Jan. 2011) (the "FSOC Study").

[16] NSCP Letter at 3.

b. "*Enforcing" Compliance Policies and Procedures*

Proposed Regulation 39.10(c) would require each DCO to provide its CCO "with the full responsibility to develop and enforce, in consultation with the board of directors or the senior officer, appropriate compliance policies and procedures", as that term is defined in proposed Regulation 39.1(b). This provision raises several serious concerns.

First, the CFTC proposes to define "compliance policies and procedures" to encompass "all policies, procedures, codes, including a code of ethics, safeguards, rules, programs, and internal controls that are required to be adopted or established by a DCO pursuant to the Act, Commission regulations, or orders, or that otherwise facilitate compliance with the Act and Commission regulations." Literally construed, this definition would burden CME Clearing's CCO with "full responsibility to develop and enforce", among other things, the CME Rule Book and CME's financial and accounting policies, procedures and internal controls. In order to avoid such profoundly negative and obviously unintended consequences, the CFTC should narrow the definition of "compliance policies and procedures" to encompass only "those policies, procedures and codes, including a code of ethics, that are required to be adopted or established by a DCO pursuant to the Act, Commission regulations or orders." We further suggest that, for the sake of consistency, the CFTC should harmonize the terminology and definitions of "compliance policies and procedures" for DCOs and "compliance policies" for FCMs, swap dealers and major swap participants.[17]

Second, the text of Dodd-Frank does not require a CCO to "enforce" compliance policies and procedures, and neither should Regulation 39.10. The importance of separating a CCO's functions of monitoring and advising on compliance issues from senior management's functions of enforcing and supervising compliance policies is well-established in the financial services industry. This critical division of responsibilities is described in the Security Industry's Association's *White Paper on the Role of Compliance*:

> The role of the Compliance Department is to advise businesses on how to comply with applicable laws and regulations, and to monitor business activity and employee conduct to identify violations (or potential violations) of rules, regulations, policies, procedures and industry standards. Even with the evolving, and in many cases increased, emphasis being imposed on the Compliance Department function, there is a huge difference between the role of the Compliance Department and its personnel, and the overall broad firm responsibility "to comply" with applicable rules and regulations. The Compliance Department plays an integral support function for firm compliance programs, but only senior management and business line supervisors ultimately are responsible for ensuring firm compliance with laws and regulations. Since these different roles are often confused, it is critical to understand and maintain these distinctions.[18]

The NSCP Letter similarly emphasizes that the CCO "guides, tests, monitors and reports on the status of a registrant's activities for compliance with the law but does not actually engage in the business of the firm. It is the business unit within the registrants that either obeys the law or violates it. All that the CCO

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[17] The CFTC has proposed to require CCOs of FCMs, swap dealers and major swap participants to establish "compliance policies", a term the CFTC has proposed to define as "all policies, procedures, codes, safeguards, rules, programs, and internal controls required to be established by a registrant pursuant to the Act and Commission regulations, including a code of ethics."

[18] SIA White Paper at 10 (footnotes omitted).

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

can do is guide, monitor, and report on these business activities."[19] The NFA also disagrees with the CFTC's proposal "to the extent that it seeks to expand the CCO's oversight role of a firm's compliance function to one of a line supervisor who is ultimately responsible for the execution of compliance policies."[20]

To give effect to the well-established and critical distinction between a CCO's monitoring and advisory role and senior management's enforcement and supervisory role, we urge the CFTC to revise the language of proposed Regulation 39.10(c) to require DCOs to provide their CCOs "with responsibility to develop, in consultation with the board of directors or the senior officer, appropriate compliance policies and procedures...." For similar reasons, we urge the CFTC to revise proposed Regulation 39.10(c)(2)(vi) to require the CCO to "[e]stablish[] appropriate procedures [for] the handling, management response, remediation, retesting, and closing of noncompliance issues", and to eliminate the requirements that the CCO "follow[]" such procedures (which is a function of senior management).

c. *Resolving Conflicts of Interest*

Proposed Regulation 39.10(c)(2)(ii) would require the CCO, "in consultation with the board of directors or the senior officer," to "resolv[e] conflicts of interest that may arise."[21] This mirrors language in Dodd-Frank. Nevertheless, as the FIA/SIFMA Letter observes, when Congress stated in Dodd-Frank that the CCO should "resolve" conflicts of interest:

> …it did not intend to mean "resolve" in the executive or managerial sense such that the CCO alone would examine the facts and determine and effect the course of action. We believe Congress intended to mean identify, advise [and] escalate as appropriate and assist senior management in resolving conflicts, and to require putting in place reasonable procedures for the resolution of conflicts. Again, the authority to actually resolve conflicts, like the power to enforce compliance, is a duty that should remain with the firm's senior executives and supervisors.[22]

We agree with this analysis and urge the CFTC to revise Regulation 39.10(c)(2)(ii) to require the CCO, in consultation with the board of directors or the senior officer, to establish policies and procedures reasonably designed to resolve any conflicts of interest that may arise.

[19] NSCP Letter at 3.

[20] NFA Letter at 6-7.

[21] The NPR states that such conflicts of interest would include: "Conflicts between business considerations and compliance requirements; conflicts between the consideration to restrict clearing membership to certain types of clearing members and the requirement that a DCO provide fair and open access; conflicts between and among different categories of clearing members of the DCO; conflicts between a DCO's clearing members and its management; and conflicts between a DCO's management and members of the board of directors." 75 Fed. Reg. at 77581.

[22] FIA/SIFMA Letter at 3.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

5. Annual Compliance Report

a. *Content*

Dodd-Frank requires the CCO to "annually prepare and sign a report that contains a description of (i) the compliance of the [DCO] with respect to" the CEA and CFTC regulations, "and (ii) each policy and procedure of the [DCO] (including the code of ethics and conflict of interest policies of the [DCO])."[23] These requirements are reflected in Regulation 39.10(c)(3)(i). As proposed, the Regulation would further require the annual compliance report to contain the following information:

- For each DCO Core Principle: (A) a list of the compliance policies and procedures that "ensure compliance"; (B) an assessment as to the effectiveness of such policies and procedures; and (C) a discussion of areas for improvement and recommendations for potential or prospective changes or improvements to the DCO's compliance program and resources allocated to compliance.

- A list of any material changes to the DCO's compliance policies and procedures since the last annual report.

- A description of the financial, managerial and operational resources set aside for compliance with the CEA and CFTC regulations.

- A description of "any material compliance matters," including incidents of noncompliance, since the last annual report, and of the corresponding action taken.

- A delineation of the roles and responsibilities of the DCO's board of directors, relevant board committees and staff in addressing any conflict of interest, including any necessary coordination with, or notification of, other entities, including regulators.

We reiterate our concerns regarding language in the proposed Regulation requiring the CCO to "ensure" compliance, and the overbreadth of the proposed definition of "compliance policies and procedures." In addition, CME Group supports the recommendation in the FIA/SIFMA Letter that the CFTC specify key areas that should be discussed in the annual report, rather than requiring the report to describe in detail the registrant's compliance with respect to each of the numerous components of the CEA and CFTC regulations.[24] The CFTC may have intended to accomplish this result by referring specifically to compliance with the DCO Core Principles in proposed Regulation 39.10(c)(3)(ii). However, we believe the CFTC should revise subparts (i) and (ii) of the DCO annual report provisions to require the report to: (i) contain a description of the DCO's compliance with respect to the DCO Core Principle provisions in the CEA and CFTC regulations, and the DCO's compliance policies and procedures (as we suggest that term be defined); and (ii) with respect to each of the Core Principles, provide the information currently listed in proposed Regulation 39.10(c)(3)(ii)(A)-(C).

In addition, rather than requiring the annual report to describe all material compliance matters and actions taken in response thereto, a better approach would be to require the report to identify *any material non-compliance issues that were not properly addressed*. This approach is also recommended in the NSCP Letter, which observes that "the key issue is not whether compliance issues happened at a firm, but

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[23] DFA § 725(b), CEA § 5b(i)(3)(A)(i)-(ii).

[24] FIA/SIFMA Letter at 18.

whether a firm's governance and supervisory procedures are operating reasonably, and whether material issues were escalated and remediated by the firm."[25] We agree with the NSCP that broad reporting requirements with respect to compliance issues may create a chilling effect on open and continuous communication with the CCO and would be seriously counterproductive to good public policy.

b. *Certification Requirement*

Dodd-Frank provides that the annual report "shall…include a certification, that under penalty of law, the compliance report is accurate and complete."[26] Dodd-Frank is silent as to the person who shall make the required certification. The CFTC proposes to add that task to the CCO's list of responsibilities. We urge the CFTC to reconsider that approach, and to instead require the senior officer of the DCO (or, in the case of a DCO that is a division of a larger corporation, the senior officer of the DCO division) to make the required certification.

As explained in the comment letters submitted by FIA/SIFMA, NFA and Newedge regarding CCO requirements for FCMs, swap dealer and major swap participants:

- The best way to achieve the goal of a robust effective compliance program, and to close the loop on creating a culture of compliance, is to require the registrant's senior officer – and not the CCO – to complete the required certification.[27]

- A certification by the registrant's senior officer would be consistent with FINRA Rule 3130, which requires the firm's CEO (or equivalent officer) to execute the annual compliance certification, after consulting with the CCO and such others, to the extent appropriate, in order to attest to the statements in the certification.[28]

Furthermore, the FSOC has recommended that banks' senior officers certify compliance with the Volcker Rule. More specifically, the FSOC urged agencies to "strongly consider requiring the CEO to attest publicly to the ongoing effectiveness of the internal compliance regime. This will ensure the highest level of compliance for the satisfaction of these expectations."[29] CME Group similarly urges the CFTC to strongly consider requiring the DCO's senior officer, and not its CCO, to make the necessary certification in the annual compliance report.

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[25] NSCP Letter at 4.

[26] DFA § 725(b), CEA § 5b(i)(3)(B).

[27] FIA/SIFMA Letter at 16; NFA Letter at 8.

[28] FIA/SIFMA Letter at 16; Newedge Letter at 7.

[29] FSOC Study at 36.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com

c. *Confidentiality*

CME Group concurs with the observation in the FIA/SIFMA Letter that CFTC regulations governing annual compliance reports should "expressly state that Annual Reports shall be confidential documents that are not subject to public disclosure by listing such Annual Reports as a specifically exempt item in Regulation 145.5."[30] We urge the CFTC to revise the provisions in proposed Regulation 39.10 regarding DCO annual compliance reports accordingly.

6. Insulating CCOs from Undue Pressure or Coercion

The CFTC seeks comment on whether it should adopt a regulation that requires DCOs to "insulate a CCO from undue pressure and coercion."[31] Absent such a regulation, the CFTC asks how potential conflicts "between and among compliance interests, commercial interests, and ownership interests of a DCO" can be addressed.[32] Regulation 39.10, as proposed, provides several important mechanisms designed to minimize the likelihood that a CCO will fail to adequately perform her function as a result of inappropriate pressure from other parts of the business. In particular, Regulation 39.10(c)(i) requires the CCO to have "the background and skills appropriate for fulfilling the responsibilities of the position." Regulation 39.10(c) mandates that the CCO be given authority to develop appropriate compliance policies and procedures for the DCO. Moreover, pursuant to Regulation 39.10(c)(iv), a DCO must report to the CFTC whenever there is a change in the designation of the person serving as its CCO. Additionally, our recommendation to require the senior officer of the DCO to certify the annual compliance report should greatly reduce any incentive DCO senior management may have to discourage the CCO from fulfilling her job responsibilities.

Beyond these measures, CME Group believes that each DCO should be given flexibility to take additional steps (based on the DCO's particular corporate structure, size and complexity) designed to ensure an appropriate level of independence for its CCO. Such steps might include, for example: (a) in those cases where the CCO reports to the senior officer, giving the CCO a right of direct access to the board of directors (or a board committee), bypassing normal reporting lines, should the CCO determine that such a course of action is necessary; (b) having Internal Audit review the activities of the DCO compliance function; (c) requiring that the board of directors be informed when the CCO leaves that position, and the reasons for the departure; and (d) where the DCO is part of a larger organization, not tying CCO remuneration to the DCO's financial performance.[33] We urge the CFTC to provide DCOs with flexibility in designing such additional arrangements, and to refrain from prescribing detailed CCO-independence measures that would force all DCOs into "one size fits all" standards.

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[30] FIA/SIFMA Letter at 20-21.

[31] 75 Fed. Reg. at 77582.

[32] *Id.*

[33] Where the DCO is part of a larger corporate organization, CCO remuneration related to the financial performance of the larger organization as a whole should generally be acceptable.

7. Implementation Period

The CFTC requests comment on an appropriate effective date for Regulation 39.10. As noted above, the CCO role and related compliance requirements are new for DCOs under Dodd-Frank. "Generally, for a registrant that does not currently have a CCO or compliance program, approximately eighteen months would be required to recruit and hire a CCO and implement a compliance program."[34] That time period is particularly appropriate here because of the challenges associated with locating and retaining an individual with the relatively unique background and skills necessary and appropriate for fulfilling the responsibilities of a DCO CCO. Given that Dodd-Frank and forthcoming CFTC regulations will require several categories of registrants to employ CCOs, many companies will be undertaking a CCO job search simultaneously which will likely make the task of retaining a qualified CCO even more competitive and time consuming than in normal conditions.

Furthermore, once employed, the CCO's responsibilities will entail more than simply becoming familiar with the CFTC's regulatory requirements (including the myriad new regulatory requirements under Dodd-Frank) and preparing a compliance manual and code of ethics. The CCO will also be expected to comprehensively monitor the DCO's business activities, which will require building an effective compliance framework and surveillance systems tailored for DCO compliance monitoring needs, and commensurate with the particular DCO's compliance risk profile. The CCO (and outside consultants and/or compliance personnel the DCO may retain to assist with these tasks) will need to consider data collection, analytical requirements and reporting needs in order to build and apply solution frameworks that integrate data and deliver it in a way that enables the CCO and the DCO's business supervisors to monitor, surveil and supervise in accordance with the DCO's compliance policies and procedures, and to comply with new CFTC DCO reporting requirements.[35] We believe that, in order to accomplish all of these tasks, DCOs will require an implementation period of not less than 18 months after Regulation 39.10 is issued in final form.

B. DCO Core Principles

1. Core Principle N (Antitrust Considerations)

Proposed Regulation 39.23 provides, "Unless necessary or appropriate to achieve the purposes of the Act, a [DCO] shall not adopt any rule or take any action that results in any unreasonable restraint of trade, or impose any material anticompetitive burden." The CFTC requests comment on "whether there are additional standards or requirements that should be imposed to more effectively implement the purposes of DCO Core Principle N." We believe that the Regulation is adequate as proposed.

2. Core Principle R (Legal Risk)

Proposed Regulation 39.27 addresses new DCO Core Principle R regarding Legal Risk. Subpart (a) of the Regulation requires DCOs to have all necessary legal authorizations in place. Subpart (b) requires DCOs to have a "well-founded, transparent, and enforceable legal framework" that provides for significant aspects of the DCO's operations, risk management procedures and related requirements. For DCOs that provide clearing services outside of the U.S., subpart (c) requires the DCO to, among other things, "identify and address *any* conflict of law issues." We believe this requirement is unduly overbroad, and we

[34] NSCP Letter at 8.

[35] *See generally* 75 Fed. Reg. 78185 (Dec. 15, 2010), Information Management Requirements for DCOs.

urge the CFTC to revise Regulation 39.27(c) to require DCOs to "identify and address any *material* conflict of law issues."

CME Group thanks the CFTC for the opportunity to comment on this matter. We would be happy to discuss any of these issues with the Commission and its staff. If you have any comments or questions, please feel free to contact me at (312) 930-8275 or Craig.Donohue@cmegroup.com; or Lisa Dunsky, Director and Associate General Counsel, at (312) 338-2483 or Lisa.Dunsky@cmegroup.com.

Sincerely,

Craig S. Donohue

CSD/110211 CFTC Comment Ltr

cc: Chairman Gary Gensler (via e-mail)
Commissioner Michael Dunn (via e-mail)
Commissioner Bart Chilton (via e-mail)
Commissioner Jill Sommers (via e-mail)
Commissioner Scott O'Malia (via e-mail)
Ananda Radakrishnan (via e-mail)
Phyllis Dietz (via e-mail)
Jonathan Lave (via e-mail)

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.8275 F 312 930.3209 craig.s.donohue@cmegroup.com cmegroup.com