CME Group

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Chief Executive Officer

VIA ON-LINE SUBMISSION

April 11, 2011

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

Re: Requirements for Processing, Clearing and Transfer of Customer Positions – 76 Fed. Reg. 13101 (Mar. 10, 2011), 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 regulations to further implement compliance with derivatives clearing organization ("DCO") Core Principle F (Treatment of Funds) by requiring a DCO, upon request, to promptly transfer customer positions and related funds; regulations to further implement compliance with DCO Core Principle C (Participant and Product Eligibility) in connection with standards for cleared products and accepting and processing transactions submitted for clearing; regulations requiring swap execution facilities ("SEFs") and designated contract markets ("DCMs") to coordinate with DCOs in developing rules and procedures to facilitate clearing; and the time frame for swap dealers ("SDs") and major swap participants ("MSPs") to submit transactions to DCOs for clearing.

CME Group is the parent of four DCMs: the 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"). These DCMs 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'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 Core Principle F (Treatment of Funds)

The CFTC proposes to amend proposed Regulation 39.15 by adding new subpart (d), which would require each DCO to "have rules providing that, upon the request of a customer and subject to the consent of the receiving clearing member, the [DCO] will promptly transfer all or a portion of such customer's portfolio of positions and related funds from the carrying clearing member of the [DCO] to another clearing member of the [DCO], without requiring the close-out and re-booking of the positions

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prior to the requested transfer." The NPR states that this provision would "formalize and apply to swaps clearing, the futures clearinghouse practice of transferring customer positions and related funds without close-out and re-booking of the positions."[1]

In light of the importance of portability of customer positions and related collateral, CME Group fully supports the concept of applying the same standards to transfer of customer cleared swaps as have historically been applied to transfer of customer futures. We note, however, that a customer request to transfer its account is made not to a DCO but to the FCM that carries the customer's account. The transfer of customer accounts by FCMs is governed by rules of the National Futures Association ("NFA"). In particular, NFA Rule 2-27 (Transfer of Customer Accounts) provides as follows:

> (a) Upon receipt of a signed instruction from a customer to transfer an account from one Member to another, and provided that such instruction contains the customer's name, address and account number (and, if the transfer is not of the entire account, a description of which portions are to be transferred) and the name and address of the receiving Member, the carrying Member shall confirm to the receiving Member all balances in the account, whether money, securities or other property, and all open positions, within two business days or within such further time as may be necessary in the exercise of due diligence. Within three business days of the day such confirmation is due, or within such further time as may be necessary in the exercise of due diligence, and provided that the receiving Member agrees to accept the account, the carrying Member shall effect the transfer of the balances and positions to the receiving Member.
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> (b) This rule shall apply only to transfers made at the request of a customer.
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> (c) This rule shall not prohibit transfers based upon oral requests.

Given the existence of NFA Rule 2-27 (which applies to all FCM members of NFA, not just those that are clearing members of one or more DCOs), we do not believe the CFTC should require DCOs to adopt rules that would require their clearing members to facilitate prompt transfer of customer accounts. Furthermore, in order to ensure consistency between NFA Rule 2-27 and any DCO rules regarding the transfer of customer accounts, we suggest that the CFTC revise proposed Regulation 39.15(d) to require each DCO to "have rules providing that, upon the request of a *carrying clearing member* and subject to the consent of the receiving clearing member, the [DCO] will promptly transfer all or a portion of *a* customer's portfolio of positions and related funds from the carrying clearing member of the [DCO] to another clearing member of the [DCO], without requiring the close-out and re-booking of the positions prior to the requested transfer."

The CFTC requests comment on whether the term "promptly", as used in the proposed Regulation, provides adequate guidance or whether another descriptive term should be used. We believe the term "promptly" is adequate, provided that it (or any other term the CFTC may use in its stead) cannot be read to conflict with the timing set forth in NFA Rule 2-27(a).

[1] 76 Fed. Reg. 13101, 13103 (Mar. 10, 2011).

B. DCO Core Principle C (Participant and Product Eligibility)

1. Templates

The CFTC proposes various amendments to subpart (b) (Product Eligibility) of proposed Regulation 39.12. The CFTC states that it is proposing to revise 39.12(b)(2) "to clarify that a DCO must adopt rules to establish templates for the terms and conditions of the swaps it will clear."[2] As re-proposed, the new provision would state as follows, with the newly proposed language underscored:

> A [DCO] shall adopt rules providing that all swaps with the same terms and conditions, as defined by templates established under [DCO] rules, submitted to the [DCO] for clearing are economically equivalent within the [DCO] and may be offset with each other within the [DCO].

As proposed, 39.12(b)(6)(iii) similarly would require that "[a]ll terms of the cleared swaps must conform to templates established under" DCO rules. Rather than clarifying the proposed Regulation, the references to "templates" – a term that is not defined or further explained in the NPR or the proposed Regulation – injects confusion. Swap dealers generally maintain standard templates for documenting their trading relationships, and their counterparties frequently negotiate changes to those templates. A DCO does not define the templates used by OTC participants, nor do DCO rules function as templates from which counterparties may negotiate. Rather, a DCO sets forth in its rule books the product specifications of each contract it accepts for clearing, including swaps. Once a transaction in a particular product is accepted for clearing, the product specifications in the DCO's rule book will govern the cleared transaction.

References to "templates" in proposed Regulation 39.12 are unnecessary and should be removed. We suggest that the CFTC amend 39.12(b)(2) to state as follows:

> A [DCO] shall adopt rules providing that all swaps with the same terms and conditions, as defined by product specifications established under [DCO] rules, submitted to the [DCO] for clearing are economically equivalent within the [DCO] and may be offset with each other within the [DCO].

We further suggest that the CFTC amend 39.12(b)(6)(iii) to state: "All terms of the cleared swaps must conform to product specifications established under [DCO] rules."[3]

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[2] *Id.* at 13104.

[3] With respect to renumbered proposed Regulation 39.12(b)(6)(ii), we reiterate the point made in our comment letter of March 21, 2011 that the proposed language requiring a DCO to adopt rules providing that, upon acceptance of a swap by the DCO for clearing, "the original swap is replaced by equal and opposite swaps between clearing members and the DCO" appears to presume the use of a "principal" model for all cleared swaps, including those that an FCM clears on behalf of its customers. However, an FCM clearing customer business acts as an agent for undisclosed principals (*i.e.*, the FCM's customers) vis a vis CME Clearing and guarantees its customers' performance to CME Clearing. Use of the FCM-customer agency model is critical because it facilitates portability of customer positions, as well as customer segregation protections and favorable capital treatment for FCMs. It also facilitates operational simplicity and efficiency by avoiding the necessity of an FCM booking a string of back-to-back transactions between the FCM and the DCO, and the FCM and its customers. The agency model also improves systemic risk protection by providing bankruptcy protections and certainty to the DCO in the event of an FCM clearing member default. In order to preserve the agency model for customer cleared swaps, CME Group urges the CFTC to Regulation 39.12(b)(6)(ii) to provide that, upon acceptance of a swap for clearing, "the original swap is replaced by equal and opposite swaps with the DCO."

2. Executing Parties

Newly proposed Regulation 39.12(b)(4) would prohibit a DCO from requiring "that one of the original executing parties must be a clearing member in order for a contract agreement, or transaction to be accepted for clearing." As the NPR explains:

> Some clearinghouses have indicated that they intend to require that, for a transaction to be eligible for clearing, one of the executing parties must be a clearing member. This has the effect of preventing trades between two parties who are not clearing members from being cleared. Such a restriction of open access serves no apparent risk management purpose and operates to keep certain trades out of the clearing process and to constrain liquidity for cleared trades. Moreover, such restrictions also may raise competitive issues under Core Principle N (Antitrust Considerations).[4]

CME Group concurs with the CFTC's analysis and fully supports proposed Regulation 39.12(b)(4).

3. Time Frame for Clearing

a. Coordination Between DCOs, SEFs and DCMs

The CFTC proposes to add new subpart (b)(7) ("Time frame for clearing") to Regulation 39.12. Regulation 39.12(b)(7)(i) would require a DCO to coordinate with each SEF and DCM that lists for trading a product that is cleared by the DCO, in developing rules and procedures to facilitate prompt and efficient processing of all transactions submitted to the DCO for clearing. The CFTC proposes separate regulations that would impose parallel requirements on SEFs and DCMs.

The CFTC inquires whether there are "systemic or legal obstacles to DCO, SEF, and DCM coordination required under the proposed regulation."[5] CME Group is not aware of any such obstacles. The CFTC also seeks comment "on how best to facilitate the development of infrastructure, systems, and procedures to address" issues relating to connectivity between and among trading platforms and DCOs.[6] We believe such issues generally are best left to DCOs, SEFs and DCMs to address in the contracts that govern their relationships.

b. Accepting Transactions for Clearing

Proposed Regulation 39.12(b)(ii) and (iii) would require a DCO to:

> (ii) … have rules that provide that the [DCO] will accept for clearing, immediately upon execution, all contracts, agreements, and transactions that are listed for clearing by the DCO and (A) That are entered into on or subject to the rules of a [SEF] or [DCM]; (B) For which the executing parties have clearing arrangements in place with clearing members of the [DCO]; and (C) For which the executing parties identify the [DCO] as the intended clearinghouse.

[4] 76 Fed. Reg. at 13105 (footnote omitted).

[5] *Id.* at 13106.

[6] *Id.* at 13105.

> [and]
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> (iii) … have rules that provide that the [DCO] will accept for clearing, upon submission, all contracts, agreements, and transactions that are listed for clearing by the [DCO] and (A) That are not executed on or subject to the rules of a [SEF] or [DCM]; (B) That are subject to mandatory clearing pursuant to section 2(h) of the Act; (C) That are submitted by the parties to the [DCO], in accordance with § 23.506 of this chapter; (D) For which the executing parties have clearing arrangements in place with clearing members of the [DCO]; and (E) For which the executing parties identify the [DCO] as the intended clearinghouse.

CME Group is very concerned with the timing elements in the proposed Regulation (underscored above), which disregard key aspects of trade execution and submission and essential elements of DCO risk management. It would be imprudent, impractical and risk-additive to require a DCO to accept transactions for clearing "immediately upon execution" or "upon submission". Even for transactions that are competitively executed on a DCM, CME Clearing does not substitute itself as the seller to the buyer and the buyer to the seller until the successful matching of trade data submitted to and accepted by CME Clearing. This standard is codified in CME Rule 804 (Substitution). Furthermore, certain transactions listed for clearing by a DCO and subject to the rules of a DCM are not competitively executed and are not submitted to a DCO for clearing until some period of time *after* execution. Such transactions include, for example, block trades and exchange of futures for physicals (or EFPs).[7] Pursuant to Rule 804, CME Clearing does not become the central counterparty to these transactions until "the time payment of the first settlement variation and performance bond for such trades pursuant to Rule 814 is confirmed by the appropriate settlement bank for both [clearing] members."[8]

For cleared swaps, CME Clearing contemplates promulgating rules whereby, following execution (regardless of venue), a swap must be submitted for clearing and then be subjected to credit-control procedures before CME Clearing becomes the central counterparty. It is essential that a DCO be afforded sufficient opportunity to conduct necessary credit checks to determine whether acceptance of a transaction for clearing would violate any credit limits on the relevant customer accounts and/or clearing firms. In addition, a DCO must retain the ability to reject transactions for clearing in certain limited or unusual circumstances, in accordance with prudent risk-management standards. Such circumstances may include, for example, transactions that are executed or submitted for clearing in error or as the result of a technical breakdown (*e.g.*, a malfunction in a matching algorithm). Forcing DCOs to accept transactions for clearing "immediately upon execution" or "upon submission" would strip DCOs of these essential risk-management tools and inject a high degree of systemic risk into CFTC-regulated cleared markets.

We therefore urge the CFTC to amend proposed Regulation 39.12(b)(ii) and (iii) so that a DCO is required to:

[7] A block trade is a privately negotiated transaction that is executed apart from the public auction market and that is permitted in designated contracts subject to specified conditions. An EFP is a privately negotiated and simultaneous exchange of an Exchange futures position for a corresponding cash position.

[8] Similar to CME Rule 804, CME Rule 8F005 provides that certain OTC derivatives submitted for clearing "shall be guaranteed by the Clearing House at the time of payment of initial settlement of mark to market, performance bond and any other applicable initial OTC cash flows …, in accordance with the procedures set forth in Rule 814, is confirmed by the appropriate settlement bank for both OTC Clearing Members."

> (ii) … have rules that provide that the [DCO] will promptly accept for clearing all contracts, agreements, and transactions that are listed for clearing by the DCO and (A) That are entered into on or subject to the rules of a [SEF] or [DCM]; (B) For which the executing parties have clearing arrangements in place with clearing members of the [DCO]; (C) For which the executing parties identify the [DCO] as the intended clearinghouse; (D) That are submitted in accordance with the procedures established by the [DCO]; and (E) That satisfy the [DCO's] criteria for acceptance, including but not limited to credit controls and other risk-management mechanisms.
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> [and]
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> (iii) … have rules that provide that the [DCO] will promptly accept for clearing all contracts, agreements, and transactions that are listed for clearing by the [DCO] and (A) That are not executed on or subject to the rules of a [SEF] or [DCM]; (B) That are subject to mandatory clearing pursuant to section 2(h) of the Act; (C) That are submitted by the parties to the [DCO], in accordance with § 23.506 of this chapter; (D) For which the executing parties have clearing arrangements in place with clearing members of the [DCO]; (E) For which the executing parties identify the [DCO] as the intended clearinghouse; (D) That are submitted in accordance with the procedures established by the [DCO]; and (E) That satisfy the [DCO's] criteria for acceptance, including but not limited to credit controls and other risk-management mechanisms.

c. Processing Swaps for Clearing

Proposed Regulation 39.12(b)(iv) would require a DCO to:

> (iv) … have rules that provide that the [DCO] will process for clearing, no later than the close of business on the day of submission to the [DCO], all swaps that are listed for clearing by the DCO and (A) That are not executed on a [SEF] or a [DCM]; (B) That are not subject to mandatory clearing pursuant to section 2(h) of the Act; (C) That are submitted by the parties to the [DCO] in accordance with § 23.506 of this chapter; (D) For which the executing parties have clearing arrangements in place with clearing members of the [DCO]; and (E) For which the executing parties identify the [DCO] as the intended clearinghouse.

The timing elements in this regulation raise similar concerns as those described above: a DCO should not be required to accept *or process* for clearing any transaction that (i) has not been submitted in accordance with the procedures established by the DCO, or (i) fails to satisfy the DCO's criteria for acceptance, including but not limited to credit controls and other risk-management mechanisms. Additionally, while same-day clearing of bilateral swaps that are not subject to the clearing mandate is operationally feasible, it requires that the swap be submitted and accepted for clearing in accordance with the deadlines established by each DCO.

For these reasons, we urge the CFTC to amend proposed Regulation 39.12(b)(iv) so that a DCO is required to:

> (iv) … have rules that provide that the [DCO] will process for clearing, on the same business day as the swap is submitted and accepted for clearing by the [DCO] (provided that the swap is submitted and accepted for clearing prior to the [DCO's] deadline for same-day processing), all swaps that are listed for clearing by the DCO and (A) That are not executed on a [SEF] or a [DCM]; (B) That are not subject to mandatory clearing pursuant to section 2(h) of the Act; (C) That are submitted by the parties to the [DCO] in accordance with § 23.506 of this chapter; (D) For which the

> executing parties have clearing arrangements in place with clearing members of the [DCO]; and (E) For which the executing parties identify the [DCO] as the intended clearinghouse.

d. Allocation of Block Trades in Swaps

The CFTC requests comment on whether it is operationally feasible to subject swaps executed by asset managers as block trades to the type of regulatory regime that exists under current rules and regulations which permit certain "bunched" customer orders for futures contracts to be accepted for clearing and subsequently allocated by the asset manager to its customers' accounts throughout the day. The CFTC also asks how much time may be necessary for asset managers to allocate block trades in swaps to the individual entities on whose behalf they manage money, prior to such allocated trades being sent to clearing.

CME Group believes that the "futures model" for treatment of bunched orders is not a suitable model for swaps, particularly with respect to block trades. After a bunched trade in the futures market is accepted for clearing, an FCM generally holds the positions in a suspense account (basically holding the risk) while awaiting allocation instructions from the asset manager. An FCM holding one or more large block trades in swaps in a suspense account, while waiting for allocation instructions, may be exposed to substantially greater risk considering larger transaction sizes and the different risk profile of cleared swaps as compared to futures. We therefore believe that block trades in swaps should not be subject to the same type of regulatory regime as bunched orders in futures contracts. It is our understanding that a time frame of two hours should allow sufficient time for asset managers to allocate block trades in swaps to their individual customers' accounts.

e. Confirmations

As proposed, Regulation 39.12(b)(7)(v) would require a DCO to "provide the *counterparties* to a cleared swap with a *definitive written record* of the terms of their agreement, which will serve as a confirmation of the swap." CME Clearing generally provides its clearing members (and other parties each clearing member may designate) with an electronic message (in the appropriate XML vocabulary, either FpML or FIXML) which confirms the transaction that has been accepted for clearing. Once per business day, each clearing member receives from CME Clearing a Trade Register report, which includes trade-confirmation information in human-readable and printable form. In the case of a transaction cleared on behalf of a customer, the clearing member provides a written confirmation of the transaction to its customer, in accordance with CFTC regulations. In order to accurately reflect the facts with respect to trade confirmations, the CFTC should amend the proposed Regulation to require a DCO to "provide *each clearing member carrying* a cleared swap with *a definitive record* of the terms of the agreement, which will serve as a confirmation of the swap."

C. Submission of Swaps by SDs and MSPs for Clearing

The CFTC proposes to adopt certain provisions in Regulation 23.506 that would: (a) require SDs and MSPs to have the ability to route to a DCO for clearing, in a manner acceptable to the DCO, any swaps not executed on a SEF or a DCM; and (b) set forth timing requirements for SDs and MSPs to submit OTC transactions to DCOs for clearing. For swaps subject to mandatory clearing but not executed on a SEF or a DCM, MSPs and SDs would be required to submit the swap to a DCO "as soon as technologically practicable", but no later than the close of business on the day of execution. For swaps not subject to mandatory clearing but where the parties voluntarily elect clearing, MSPs and SDs would be required to submit the swap to a DCO no later than the next business day after execution or the agreement to clear, if later than execution.

The CFTC asks for comment on whether its regulations should "specify how an SD or MSP must ensure it has the capacity to route swaps to a DCO."[9] CME Group does not believe that CFTC regulations should specify any particular system or methodology that SDs or MSPs must utilize for submitting swaps to DCOs. The better approach is to give each DCO flexibility to work with SDs and MSPs to implement various systems and methodologies for swap submission, which may be subject to change over time as cleared OTC markets continue to develop and grow.

The CFTC also requests comment on use of the phrase "as soon as technologically practicable" in the proposed regulations. The technology for SDs and MSPs to route swaps to a DCO may be as simple as entering the necessary data in a web page. Accordingly, a more apt phrase for purposes of this regulation may be "as soon as operationally feasible". CME Group believes that the proposed time frames for submission of swaps are appropriate and operationally feasible, and we are aware of no systemic obstacles to the coordination between DCOs, MSPs and SDs required under the proposed regulation.

CME Group thanks the CFTC for the opportunity to comment on this matter. We would be happy to discuss any of these issues with CFTC 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

Craig S. Donohue

cc: Chairman Gary Gensler (via e-mail)
Commissioner Michael Dunn (via e-mail)
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[9] 76 Fed. Reg. at 13104.