CME Group

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August 8, 2011

VIA ON-LINE SUBMISSION

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Adaptation of Regulations to Incorporate Swaps – 76 Fed. Reg. 33066 (Jun. 7, 2011), RIN 3038-AD53

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 June 7, 2011. In the Release, the Commission seeks comment on proposed amendments to existing Commission rules and regulations. While most of the proposed amendments are technical in nature, there are a few proposals that would operate to change the substantive obligations of registered entities, registrants and/or market participants. We provide our preliminary comments on some of those substantive changes below; because some of the changes proposed in the Release would alter market participants' substantive obligations under several other rulemakings, further analysis is needed to assess the impact of this rulemaking on those other pending rulemakings and we expect to provide further comment in the coming weeks.[1] We also address a few technical amendments that we believe are inaccurate or otherwise could be enhanced by clarifying language.

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

[1] For example, the Release proposes to amend Commission regulation 1.31 to require, among other things, that records be maintained in "native file format." As an initial matter (and as discussed in more detail below) it is not clear what the Commission means by "native file format." More importantly, however, is that the proposed rulemakings governing, among other things, the core principle obligations of DCMs, DCOs and SEFs, as well as the swap recordkeeping rulemaking, all reference Commission regulation 1.31 and propose to require that registrants and registered entities comply with this regulation on a going-forward basis. At the time that the formal comment period was pending for these other rulemakings, the public had no idea that the Commission intended to propose a substantive modification to regulation 1.31; indeed, none of the forgoing releases references the obligation to maintain records in "native file format." We submit that the Commission should re-propose all pending rulemakings that are substantively altered as a result of the Release, particularly in light of the fact that members of the public impacted by the Release may not have reviewed it for possible comment because the Release has been presented as simply making "technical" amendments to the Commission's regulations to conform the language of those regulations to the language of the Dodd-Frank Act. The Release is much broader in scope.

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provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter derivatives transactions through CME ClearPort®.[2]

A. <u>The New Recordkeeping Requirements for Members of Designated Contract Markets ("DCMs") and Swap Execution Facilities ("SEFs") Are Unduly Burdensome, Unclear, and Not Supported by an Adequate Cost-Benefit Analysis.</u>

The CFTC proposes to adopt new substantive recordkeeping requirements for futures commission merchants ("FCMs"), retail foreign exchange dealers ("RFEDs"), introducing brokers ("IBs") and members of a DCM or SEF ("members" and, together with FCMs, RFEDs and IBs, "covered intermediaries"). Specifically, the proposed amendments to Rule 1.35 would require covered intermediaries to maintain records of all oral and written communications provided or received concerning quotes, solicitations, bids, offers, instructions, trading, and prices, that lead to the execution of transactions in a commodity interest or cash commodity. Proposed amendments to Rule 1.31 would require each record to be maintained as a separate electronic file in native file format, identifiable by transaction and counterparty, for five years; records of swap transactions would need to be maintained for the duration of the swap and five years thereafter.

1. The proposed oral recordkeeping requirements would be unduly burdensome to covered intermediaries and have not been shown to be necessary.

The proposed oral recordkeeping requirements, if adopted, would impose substantial costs on covered intermediaries. For example, to maintain and produce records as required, covered intermediaries would first need to establish recording systems and develop mechanisms to find relevant recordings when asked by the CFTC or other regulators, or when subpoenaed in a private lawsuit. This proposed rule and its attendant burdens would apply to all classes of DCM members, including corporate and clearing members, and may deter market participants from seeking DCM membership.

Moreover, the proposed recordkeeping requirements for oral communications are premature. These requirements are not mandated by, or even related to, the Dodd-Frank Act and the Commission lacks data to know whether such requirements will be necessary once all Dodd-Frank Act regulations take effect. The Commission should wait until SEFs are registered and the clearing, exchange-trading, recordkeeping and reporting requirements of the Dodd-Frank Act take effect. At that time, the Commission can evaluate whether the proposed requirements are necessary in light of the Dodd-Frank Act's reform of derivatives regulation.

2. If the Commission chooses to proceed, it should clarify several aspects of the proposed oral recordkeeping requirements.

The scope of the proposed oral recordkeeping requirements is unclear in many respects. For example, the proposed requirements, on their face, would apply to all communications that "lead to the execution" of a transaction in a commodity interest or cash commodity, but the CFTC has not provided any guidance

[2] As a pioneer in the globalization of the futures markets, CME Group 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 Kuala Lumpur and Mexico City reduce our customers' connectivity costs, increase accessibility, and deliver faster, more efficient trading. Additionally, CME Group has established international offices in London, Singapore, Tokyo, Hong Kong, São Paolo and Calgary. CME Group believes that its significant global expertise and experience will provide the Commission with a unique and valuable perspective on the matters discussed herein.

for identifying which conversations "lead to the execution" of such a transaction. If the proposed recordkeeping requirements are read broadly, covered entities may be compelled to record and identify all conversations that take place during the negotiations for a transaction, which frequently span several days. Linking these conversations to transactions will prove extremely difficult, if not impossible, given that recording technology presently has limited search functionality. Often audio discovery software is incapable of capturing inflections and tends to result in inaccurate search results. To promote the workability of the proposed requirements under such circumstances, the CFTC should clarify that a covered intermediary is only required to record and identify conversations immediately preceding an order.

The Commission also should clarify the means of communication covered by its proposed recordkeeping requirements. The proposed rules, by their terms, would apply broadly to oral or written communications "whether communicated by telephone, voicemail, facsimile, instant messaging, chat rooms, electronic mail, mobile device or other digital or electronic media." Thus, covered intermediaries would be required to record conversations that occur on business telephone lines, personal and firm-issued mobile phones, or in person, among other means of communication. This requirement has broader reach than recording requirements for mobile phones imposed by foreign regulators, which only apply to firm-provided phones. The Commission should similarly narrow the scope of its proposed rule by specifying that the references to "telephone" and "mobile device" apply only to firm-provided phones.

Even with respect to firm-provided phones, however, there is a need for further clarification in light of technology issues. Specifically, the recording technology for mobile phones – including any firm-provided mobile phones – is still in the developmental stages and, at least in the United States, may not be sufficiently robust to handle the potential scope of conversations that would need to be recorded. Indeed, most providers of mobile voice recording services are new business start ups with little or no track record of being able to physically deliver the technology solutions they are selling. Because recording mobile phone conversations as required may be virtually impossible, covered intermediaries face a risk of non-compliance with the proposed recording requirement. Accordingly, the CFTC should clarify that a covered intermediary may comply where it does not have any mobile phone communications to record – that is, where a covered intermediary prohibits the use of cell phones to solicit or accept orders for covered transactions.

Along with making clarifications to narrow the proposed rule's covered communications and means of communicating, the CFTC should adopt a "reasonableness" standard to ensure that covered intermediaries that make a good faith effort to comply do not face sanctions if compliance proves impossible. Such a standard has been adopted by other regulators, including the United Kingdom's Financial Services Agency and the Financial Industry Regulatory Authority. A reasonableness standard is appropriate in light of the uncertain availability of recording technology and the lack of a reliable search mechanism to assist with indexing verbal communications. The CFTC gives no indication that it has considered this less restrictive standard and provides no evidence that such a standard would be less effective in accomplishing the Commission's goals.

With respect to the time frames for record retention, market participants will face unnecessary financial and operational burdens if required to maintain records for the length of the transaction plus five years as proposed. Swap transactions frequently have a duration of several years and many extend for ten years or more. Put differently, the CFTC's proposal could require covered intermediaries to maintain recordings of oral communications for more than a decade. Given these long periods of time, technology is likely to change several times over the life of a transaction and, at some point, it may be difficult to retrieve conversations recorded on older technology or prohibitively expensive to convert such conversations to a new format. We believe that requiring covered intermediaries to retain records of conversations for six months after execution of a transaction would balance appropriately the costs of the oral recordkeeping requirements on covered intermediaries and the CFTC's desire to improve its enforcement capabilities.

Unless the Commission addresses the issues discussed above and provides necessary guidance to covered intermediaries, the proposed recordkeeping requirements may prove unworkable and compliance may be impossible.

3. The proposed amendments to rule 1.31(a) also need clarification.

CME Group objects to the proposed amendment to Rule 1.31, as drafted, to the extent it creates ambiguity and potentially causes unintended consequences as applied to DCMs and DCOs that operate electronic trading or clearing systems and that are potentially obligated to comply with the new rules-based recordkeeping provisions of Core Principles 10 (Trade Information), 18 (Recordkeeping), and K (General Swap Recordkeeping). CME Group's comments below relate solely to proposed technical changes to Rule 1.31. Nothing in this letter should be read to endorse the substantive rules-based recordkeeping provisions proposed under Core Principles 10, 18 or K.

One proposed amendment to Rule 1.31(a) provides that "[a]ll books and records required to be kept by the Act or by these regulations shall be kept in their original form (for paper records) or native file format (for electronic records)." A similar proposed change to Rule 1.31(b) requires electronic records to be preserved on media in "the native file format of the electronic records as required by paragraph (a)(1) of this section." The Commission does not define "native file format," but the Release suggests that the concept comes in part from the requirements of the Federal Rules of Civil Procedure, which provide that electronically stored information is to be produced "in a form or forms in which it is ordinarily maintained or in a reasonably usable form or forms." However, reference to "native file format" instead of "a format in which the data is ordinary maintained" is potentially ambiguous and suggests something different than what is required under the Federal Rules of Civil Procedure. The "native file format" concept may be appropriate and feasible in some instances for certain types of business records such as emails, word processing files, and financial spreadsheets. However, the "native file format" concept does not easily translate to the retention of data generated by an electronic trading or clearing system in which large volumes of raw packets of data are in constant flow, with various proprietary systems extracting, reformatting, and storing that data at different points in the process. Thus, to the extent "native file format" could be read to cover the raw data packets in an electronic trading or clearing system, as opposed to the formatted files that are regularly used by a DCM or DCO in the normal course of business, such as the trade confirmations or order messages, CME Group strongly urges the Commission to clarify the scope and definition of "native file format" in order to exclude raw, unprocessed data generated or transmitted by an electronic trading or clearing system.

CME Group's recommendation is not intended to alter the type or format of data that its DCO and DCMs currently capture and store for both business and regulatory purposes. Rather, the recommendation is meant to clarify that the "native file format" provision does not impose some new or additional recordkeeping requirement upon DCOs and DCMs as it relates to their electronic trading or clearing systems.

Another proposed amendment to Rule 1.31 covers the retention of records related to swaps. Although the Commission's Release suggests that this provision applies only to SDs and MSPs, as addressed in proposed Section 23.203(b), the language in the proposed amendment to Rule 1.31 is ambiguous and could be read to apply to all entities. CME Group urges the Commission to clarify the scope of the swaps recordkeeping provisions in the proposed amendments to Rule 1.31.

Proposed Section 45.2 under Core Principle K governs the swaps recordkeeping requirements for DCOs and DCMs without reference to Rule 1.31. However, to the extent that the Commission intends for Rule 1.31 to apply to the swaps recordkeeping requirements for DCOs and DCMs, CME Group objects to proposed requirement to retain swaps records in their original or "native" file format for the entire period of time during which the swaps exist, as well as five years after such date. As the Commission has

recognized, a swap can continue to exist for a substantial period of time prior to its final termination or expiration – in some cases 30 to 50 years. Yet, the technology used to generate or store electronic records related to such swaps transactions certainly will become outdated or completely obsolete in a much shorter period of time. As a result, CME Group recommends that the Commission eliminate any proposed requirement to retain swaps records in their "native file format" for the entire period of time during which a swap exists. The Commission should recognize, in Rule 1.31 and in other similar provisions, that electronic files often must be migrated, upgraded, or converted in order to meet ever-evolving technology standards.

Finally, in light of the provisions of Rule 1.31(b), which permit the storage of paper records on "microfilm or microfiche or any similar medium," CME Group observes that the proposed requirement under 1.31(a) to keep paper records "in their original form" is both confusing and superfluous without further clarification as to what that provision requires.

4. The Commission's proposals lack an adequate cost-benefit analysis.

In addition, the Commission's cursory cost-benefit analysis of the proposed modifications to Rules 1.31 and 1.35 is inadequate because it fails to apprise Congress or market participants of the costs associated with implementing these proposals. Courts have overturned rulemakings of other agencies on the basis that the relevant agencies failed to properly perform a statutorily-required cost-benefit analysis. Most recently, in *Business Roundtable and Chamber of Commerce of the United States of America v. Securities and Exchange Commission*, the District of Columbia Circuit Court of Appeals vacated Securities and Exchange Commission ("SEC") Rule 14a-11 which related to access to proxy statements. In doing so, it found that the SEC acted "arbitrarily and capriciously" for having failed once again "adequately to assess the economic effects of a new rule."[3] The court further noted that the SEC, among other things "inconsistently and opportunistically framed the costs and benefits of the rule;…neglected to support its predictive judgments; [and] contradicted itself."[4] The cost-benefit analysis in the CFTC's Release is similarly flawed.

The Commission provides scant analysis of the costs of the proposed amendments to Rule 1.31 and never specifically addresses the costs associated with maintaining electronic records in native file format as would be required by proposed Rule 1.31(a)(1). In lieu of analysis, the CFTC states its conclusion that the "costs to institute recordkeeping systems to retain swap records for the life of the swap...and for five years after that date would be far outweighed by the benefits to the financial system as a whole."[5] The Commission notes that the proposed rule would not "impos[e] any costs that a prudent FCM, IB, CPO, CTA and DCM member would not already incur in maintaining records for swap transactions."[6] However, the CFTC's analysis fails to discuss how many FCMs, IBs, CPOs, CTAs or DCM members currently observe these recordkeeping standards. As the D.C. Circuit Court of Appeals noted in *Business Roundtable*, when an agency fails to address the marginal costs of its rules its reasoning is "illogical and, in an economic analysis, unacceptable."[7]

The Commission's analysis of costs for the proposed oral recordkeeping requirement is similarly deficient. The CFTC states that it expects that "any additional cost imposed by the recordkeeping requirements of

[3] *See* 2011 WL 29366808 *3 (D.C. Cir. July 22, 2011).

[4] *See id.*

[5] *See* 76 Fed. Reg. at 33080.

[6] *See id.*

[7] *See* 200 WL 2936808 at *6.

proposed amendments to regulation 1.35 would be minimal for the average large [covered intermediary] because the information and data required to be recorded is information and data a prudent [covered intermediary] would already maintain during the ordinary course of its business."[8] However, the Commission makes no attempt to evaluate how many covered intermediaries currently observe these data maintenance standards, and other portions of the proposal suggest that many do not.[9] Moreover, the cost-benefit analysis never estimates the actual cost to a covered intermediary of bringing its operations into compliance with the proposed rule or the costs associated with indexing and storing data subject to the oral recording requirement on an ongoing basis.[10] Under the *Business Roundtable* standard, this failure by the CFTC to "apprise itself – and hence the public and the Congress – of the economic consequences of a proposed regulation'" would make promulgation of the rule arbitrary and capricious and not in accordance with law.[11] Accordingly, in order to proceed with these proposals, the Commission must carefully and completely assess the costs and benefits of the proposals and prepares a thorough cost-benefit analysis, as required by the CEA.

B. The Proposed Amendments to "Open Contracts" Do Not Accurately Reflect Market Realities.

The Commission proposed to amend rule 1.3(t), which currently addresses the definition of "open contracts", to address the term "open positions." In proposing to make this change, the Commission also proposes to add language that would cover open positions in commodity options and swaps. We do not believe that the language proposed accurately reflects market conditions.

Specifically, with respect to commodity options, the Commission proposes adding language that provides open positions means "commodity option transactions that have not expired, been exercised, or offset." If the Commission intends this aspect of the provision to cover options on swaps, then the Commission should delete the word "commodity" from the referenced phrase. If, however, the Commission does not intend to cover options on swaps -- that is, because such instruments are understood to be "swaps", then we recommend that the Commission make clear that such instruments are covered by subsection (3), which addresses swaps. With respect to subsection (3), we do not believe that the proposed amendment accurately characterizes open positions in cleared swaps, and that the proposed amendment to subsection (1), which addresses contracts for the sale of a commodity for future delivery, more accurately characterizes cleared swaps since those contract may, like futures, be fulfilled by delivery or offset.

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[8] *See* 76 Fed. Reg. at 33081.

[9] *See* 76 Fed. Reg. at 33071 (noting that enforcement efforts have been hampered by the lack of audio recordings).

[10] In addition, the CFTC does not conduct any serious cost-benefit analysis with respect to small covered intermediaries. Rather, the CFTC states that compliance costs would be "minimal for the average small IB or member of a SEF who does not have digital telephone systems in place and may not have robust or up-to-date electronic data saving and storage capacity." *See* 76 Fed. Reg. at 33081. The Commission provides no indication that it has considered compliance costs for small covered intermediaries who are not IBs or SEF members.

[11] *See* Business Roundtable and Chamber of Commerce of the United States of America v. SEC, No. 10-1035, at 6 (DC Cir. Jul. 22, 2011).

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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,

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cc: Chairman Gary Gensler
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