January 14, 2013

The Honorable Gary Gensler
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Chicago Mercantile Exchange Inc. Amended Request to Adopt New Chapter 10 and New Rule 1001 of CME's Rulebook (12-391R)

Dear Chairman Gensler:

The Association of Institutional INVESTORS (the "Association")[1] submits this letter to the Commodity Futures Trading Commission ("CFTC" or "Commission") in response to its request for public comment on the Chicago Mercantile Exchange Inc.'s ("CME") Amended Submission #12-391R, dated December 6, 2012, which requests that the CFTC review and approve a new Chapter 10 and Rule 1001 of CME's derivatives clearing organization's ("DCO") Rulebook ("Proposed Rule 1001")[2] through the CFTC's formal approval process under CFTC Rule 40.5.[3] CME's Proposed Rule 1001 would require participants using CME's clearing services to allow data for trades cleared through CME's derivatives clearing organization ("DCO") to be reported to CME's own swap data repository ("SDR").

[1] The Association of Institutional INVESTORS is an association of some of the oldest, largest, and most trusted investment advisers in the United States. Our clients are primarily institutional investment entities that serve the interests of individual investors through public and private pension plans, foundations, and registered investment companies. Collectively, our member firms manage ERISA pension, 401(k), mutual fund, and personal investments on behalf of more than 100 million American workers and retirees. Our clients rely on us to prudently manage participants' retirements, savings, and investments. This reliance is built, in part, upon the fiduciary duty owed to these organizations and individuals. We recognize the significance of this role, and our comments are intended to reflect not just the concerns of the Association, but also the concerns of the companies, labor unions, municipalities, families, and individuals we ultimately serve.

[2] The Chicago Mercantile Exchange Inc. ("CME") submitted an amended request to its original submission dated November 9, 2012. The amended request is *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul120612cme001.pdf. CME also submitted a "corrected" Rule 1001 dated December 14, 2012, "to correct a typographical error per CFTC staff's request." The amended request is *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul121412cme001.pdf. CME's original submission is *available at* http://www.cftc.govistellent/groups/publici@rulesandproducts/documents/ifdocs/ru1110912cme005.pdf.

[3] *See* 17 C.F.R. § 40.5 (2012).

SDRs were established under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") to bring transparency to the entirety of the swaps market.[4] They play a central role in risk reduction, recording swap transaction data for both cleared and uncleared over-the-counter contracts and permitting fair and open access to the data. Going forward, SDRs will continue to play an important role for our members and their clients in developing more efficient credit risk, collateral, and margin processes, including collateral optimization, movement, and portability. However, SDRs can only effectively fulfill this role in an environment that promotes investor choice and segregation of duties among service providers, and that limits data fragmentation.

CFTC approval of Proposed Rule 1001 would allow CME to tie together DCO and SDR services directly against the fair and open access core principles set forth in the Dodd-Frank Act.[5] CME's Proposed Rule 1001 would eliminate the clear segregation of duties performed by DCOs and SDRs outlined in the Dodd-Frank Act framework, reducing transparency and undermining fundamental investor and market protections. Further, if approved, data will be fragmented, leaving investors unable to rely on the accuracy of the market data available. Proposed Rule 1001 would also set the precedent for potentially tying or bundling execution, clearing and other mandated regulatory services in a manner that further concentrates risk and hinders transparency. Therefore, the CFTC should reject CME's Proposed Rule 1001.

The Association's Concerns with CME's Proposed Rule 1001

A. Proposed Rule 1001 Limits Counterparty Choice and Runs Contrary to the Principles of Fair and Open Access

CME's Proposed Rule 1001 is not in the public's interest. It eliminates counterparty choice, requiring CME's clearing customers to use CME's captive SDR services as a condition precedent to the use of CME's clearing services, for the purposes of fulfilling the customer's mandated swap data reporting obligations.[6] This is contrary to the Dodd-Frank Act, where Congress recognized that market participants are best positioned to select the SDR for each

[4] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Pub. L. No. 111–203, 124 Stat. 1376 (2010); *see also* Swap Data Repositories: Registration Standards, Duties and Core Principles, 76 Fed. Reg. 54,538 (Sept. 1, 2011) (noting that the rule falls within the Dodd-Frank Act framework, which "was enacted to reduce risk, increase transparency and promote market integrity within the financial system").

[5] Commodity Exchange Act ("CEA") § 5b(c)(2)(C)(iii)(III), as amended by the Dodd-Frank Act. The DCO core principles set forth in the Dodd-Frank Act also specify that a DCO may not (i) "adopt any rule or take any action that results in any unreasonable restraint of trade;" or (ii) "impose any material anticompetitive burden on the trading, clearing, or reporting of transactions." *Id.* § 5b(c)(2)(N), as amended by the Dodd-Frank Act (emphasis added) (the SDR core principles contain similar language at CEA § 21(f)(1)).

[6] *See* CME Proposed Rule 1001, *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul110912cme005.pdf. "For all swaps cleared by the Clearing House, and resulting positions, creation and continuation data shall be reported to CME's swap data repository for purposes of complying with applicable CFTC rules governing the regulatory reporting of swaps."

transaction.[7] Further, the Commission implicitly endorsed a model for trade reporting that allows counterparty choice of the SDR by imposing a legal obligation on the swap dealer or major swap participant to report and retain data.[8] The Association believes that market participants, rather than DCOs (who have a vested commercial interest), are the appropriate entities to select the SDR.

Further, since 2010, the Association has advocated for open access to all information in the SDR, in order to ensure that barriers to entry are not erected in the marketplace.[9] To this end, the Association supports mandating fair and open access to clearing services.[10] We also support the prohibition on tying or bundling the offering of mandated regulatory services with other ancillary services that an SDR may provide to market participants, based on the principles of open access.[11]

Because of these open access principles and the final rules that were released almost a year ago, market participants have expended significant resources in preparing to report in compliance with such final rules. CME's Proposed Rule 1001 changes the underlying rules of the road. The mere potential that CME's Proposed Rule 1001 will be approved has caused market participants to ask for a delay in reporting certain required data. These requests were necessary because, if CME is allowed to require reporting to its captive SDR, market participants will have to restructure the operations and plans they have already developed for reporting. The CFTC has already had to grant some no-action relief to address these issues, delaying reporting of valuation

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[7] *See* CEA § 2(a)(13)(F), as amended by the Dodd-Frank Act (noting, "[p]arties to a swap (including agents of the parties to a swap) shall be responsible for reporting swap transaction information to the appropriate registered entity in a timely manner as may be prescribed by the Commission.").

[8] The Dodd-Frank Act includes several provisions that address swap dealer and major swap participants' recordkeeping and reporting requirements. Specifically, the statute requires that swap transactions must be reported to SDRs and records must be retained by the counterparties. *See* the Dodd-Frank Act § 729. The CFTC's Part 23 rules require swap dealers and major swap participants to comply with the CFTC's Part 43 and Part 45 rules, and to report required information and data electronically. *See* Swap Dealer and Major Swap Participant Recordkeeping, Reporting, and Duties Rules; Futures Commission Merchant and Introducing Broker Conflicts of Interest Rules; and Chief Compliance Officer Rules for Swap Dealers, Major Swap Participants, and Futures Commission Merchants, 77 Fed. Reg. 20,128, 20,204-05 (Apr. 3, 2012).

[9] During a CFTC public roundtable in September 2010, Mr. John Gidman stated that "market participants large and small, the public interest, and objectives of regulators, are well-served by very open access to all the information [that is] in [a] repository." CFTC, *Public Roundtable to Discuss Swap Data, Swap Data Repositories, and Real Time Reporting* (Sept. 14, 2010), transcript *available at* http://www.cftc.gov/ucm/groups/public/@swaps/documents/dfsubmission/dfsubmission18_091410.pdf, at 275-76.

[10] CEA § 5b(c)(2)(C)(iii)(III).

[11] *See* 17 C.F.R. § 49.27; *see also* CFTC, *Open Meeting to Discuss a Final Rule on Derivatives Clearing Organization General Provisions and Core Principles; a Final Rule on Position Limits for Futures and Swaps; and a Notice of Proposed Amendment to Effective Date for Swap Regulation* (Oct. 18, 2011) (colloquy between the Honorable Bart Chilton and Mr. Ananda Radhakrishnan). In response to an inquiry by Commissioner Bart Chilton, the Commission staff affirmed that "a registered SDR, consistent with the principles of open access, shall not tie or bundle the offering of mandated regulatory services with other ancillary services that an SDR may provide to market participants." Commissioner Chilton then noted that bundling is not permitted for DCO-SDRs because "it would be anti-competitive if it was allowed."

data through June 30, 2013.[12] By granting market participants this no-action relief, the prospect of undermining user choice has already imposed costs and reduced transparency.[13] CME's Proposed Rule 1001 will impose significant additional costs on market participants, who will be forced to duplicate the building and testing of reporting to CME's (and likely other DCOs') proprietary SDRs. Ultimately, these costs will be borne by our investors.

Additionally, the Association is skeptical about CME's assertion that the provision of a duplicative (but not official) record of the data to the SDR of the user's choice sufficiently addresses open access concerns without increasing costs for market participants. Making duplicative reports will likely be operationally difficult and expensive. Any costs associated with reporting to multiple SDRs will be passed on to the parties to the swap, such as swap dealers, who in turn will pass the costs on to asset managers and their investors.[14] Going forward, the costs of maintaining the data at two SDRs will also be passed on and paid for by investors.

Further, information sharing rules differ between SDRs. Many asset managers may wish to restrict their data to a single SDR in order to ensure that the asset manager and its clients understand and approve of the SDR's policies on issues like data sharing. By requiring market participants to share their data with CME's affiliated SDR, CME is effectively taking away market participants' right to ensure that their data is managed in accordance with the information sharing and dissemination policies of their choice. Privacy and confidentiality issues may prevent global market participants from allowing the data to be sent to the SDR of choice if CME is allowed to designate itself as the official SDR.

B. Proposed Rule 1001 Promotes Data Fragmentation

CME's Proposed Rule 1001 promotes data fragmentation. This undermines the goals of the Dodd-Frank Act by reducing the ability of regulators to view consolidated positions and patterns of abusive trading. It also undermines the ability of the buy-side to effectively manage risk through monitoring data reported to SDRs.

Even if CME reports the cleared transaction to their own SDR and then provides a duplicative copy to an SDR of the customer's choice, the reporting scheme is introducing additional points

[12] *See* CFTC No-Action Letter No. 12-55 (Dec. 17, 2012), *available at* http://www.cftc.gov/ucm/groups/public/@lrlettergeneral/documents/letter/12-55.pdf.

[13] *Id.*

[14] CME noted these increased costs in its Amended Request when requesting that neither swap dealers nor end users have reporting obligations for resulting swaps and related positions, stating, "imposing a duplicative reporting requirement would unduly increase costs for swap dealers, which could be passed on to other market participants in the form of higher fees." CME Amended Request, *supra* note 2, at n.5. (In CME's example, Party A is a swap dealer, and Party B is a commercial end user.) Despite CME's assurances that these services will be free of charge for now, there are no assurances that this will last forever.

of failure and other risks into an already complicated system.[15] Market participants will be forced to unnecessarily reconcile data across multiple SDRs, adding more unjustified costs and burdens on counterparties to trades. Many of our members do business with multiple futures commission merchants ("FCMs"); a single point of reconciliation at a single SDR ensures that the net position reported to regulators is correct. It also preserves the ability of asset managers to move between FCMs without disturbing the data collection, as the portability process develops. Further, as many of our clients, including pension funds and endowments, place portions of their overall funding with different asset managers, utilizing a single SDR potentially provides the customer with a holistic way to look across various asset managers, which would be impossible if data were housed in a fragmented manner.

The Association also supports the public dissemination of accurate market data, as it helps create robust markets for all investors. The creation of a complete audit trail will result in accurate liquidity reports. Proposed Rule 1001 fragments data, jeopardizing safety and soundness principles. The Association believes this is dangerous, leading to substantially overstated and understated information in the marketplace.[16] Sound systemic risk management will only occur when data is consolidated and aggregated, ensuring its accuracy and completeness.

C. CFTC Should Provide Additional Time to Comment on Proposed Rule 1001

The Association believes that the comment period the CFTC provided for CME's Proposed Rule 1001, which was originally scheduled to end on January 7, 2013 and was subsequently extended to January 14, 2013, does not provide sufficient time for market participants to adequately examine and articulate their concerns regarding the effects of CME's Proposed Rule 1001 on issues such as user choice, segregation of duties, and data fragmentation.

The majority of the original comment period the CFTC provided coincided with the December holidays, and even with the extension, ends two weeks after the December 31 start-up date for expanded reporting. This brief window has also been filled with CFTC no-action requests, no-action relief, and exemptive orders related to pressing "day one" issues.[17] As a result, market participants and the CFTC have been overwhelmed with the myriad of implementation issues facing the swaps market during this thirty-day window and unable to effectively focus on the Proposed Rule 1001.

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[15] The Commission recognized the opportunities for misreporting and misunderstanding the importance of reported information. For this reason, in Part 45, the Commission emphasized the need for a complete audit trail following all reported trades over their life-cycles, including when they are novated and replaced by new, economically equivalent trades. *See* Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2,136, 2,159 (Jan. 13, 2012). Failure to carefully follow this audit trail will lead not only to failure to detect potentially dangerous market manipulation, but will likewise very easily lead to double counting, as there will be difficulty in linking the novation of old trades with the creation of economically equivalent new trades.

[16] During the September 2010 CFTC public roundtable, Mr. Gidman also noted the "danger" of "misleading, substantially-overstated or understated information" as a result of "fragmentation of the market and the rush to provide-real-time information." *See supra* note 9, at 268-69.

[17] Since December 6, 2012, the CFTC has released 30 no-action relief letters and other staff guidance.

Additionally, CME submitted a "corrected" Rule 1001 dated December 14, 2012, "to correct a typographical error per CFTC staff's request."[18] The change does not appear to be a "typographical error," as it goes beyond correcting an errant comma or missing punctuation. If additional time were granted, organizations like the Association would have the ability to further analyze what effects, if any, would result from the change included in the "corrected" version.

Due to the complex and important issues raised by CME's Proposed Rule 1001, as well as the "corrected" version submitted in mid-December, the Association requests that the comment period on CME's Proposed Rule 1001 be further extended for at least sixty days from the date of publication on the CFTC website. This additional time will ensure that market participants, including the Association, have sufficient time to fully analyze the potential effects of CME's Proposed Rule 1001.

Conclusion

SDRs play a critical role for investors to safely invest in markets. Congress did not intend for the CFTC to dilute SDRs' systemic risk management role by allowing regulated service providers to limit market participant choice, undermine the protections provided by segregation of duties, and fragment data. The Association recognizes the difficult challenges the CFTC faces in determining how best to proceed in regulating entities, like DCOs and SDRs, in the marketplace. However, for the reasons detailed above, we urge the Commission to reject the adoption of CME's Proposed Rule 1001. Please feel free to contact me with any questions you may have on our comments at jgidman@loomissayles.com or (617) 748-1748.

On Behalf of the Association of Institutional INVESTORS,

John Gidman
President

[18] Submission #12-391R, *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul121412cme001.pdf. Of note, the December 14, 2012 submission does not appear to have been posted to the CFTC's Rule 1001 public comment page until December 28, 2012.