

COMMENT

CHICAGO MERCANTILE EXCHANGE INC.

James J. McNulty
President and Chief Executive Officer
312 / 930-3100
Fax: 312 / 648-3625
jmcnulty@cme.com

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OFFICE OF THE SECRETARIAT

Ms. Jean A. Webb
Office of the Secretariat
COMMODITY FUTURES TRADING COMMISSION
1155 21st Street, N.W.
Washington, D.C. 20581

RE: Part 39-Clearing Organizations

Dear Ms. Webb:

Chicago Mercantile Exchange Inc. ("CME" or "Exchange") is pleased to offer comments on the Commission's proposed rules relating to the regulation of clearing organizations ("DCO"). CME generally supports the Commission's concept of applying flexible core principles to entities seeking to clear contracts of sale of a commodity for future delivery, options on such contracts and options on a commodity. However, CME believes that some aspects of the Commission's proposed rulemaking should be modified. The comments below will focus on certain areas where the proposal could be improved.

The Commission is proposing a new Part 39 regulatory framework that would apply to clearing organizations. An entity can be approved by the Commission as a "derivatives clearing organization" ("DCO") by demonstrating that it satisfies 14 core principles. Existing DCOs "shall be deemed to be registered with the Commission to the extent that the DCO clears agreements, contracts or transactions for a board of trade that has been designated by the Commission as a contract market for such agreements, contracts or transactions prior to enactment of the CFMA." This formulation, which echoes section 5b(d) creates confusion and should be clarified. The CFMA was intended to grandfather existing futures clearinghouses without requiring a new registration process. A narrow reading of the Commission's formulation implies that the well established futures clearinghouses may only be grandfathered to the extent of the contracts that they cleared for designated contract markets prior to the date of the CFMA's enactment. The regulation should be clarified so that such clearinghouses are not required to prosecute a registration if they clear a "new" contract.

Section 39.7 applies to fraud in connection with the clearing of transactions on a derivative clearing organization but is drafted in a manner that appears to govern fraud in connection with any transaction that is cleared. The Commission's explanation states: "As is the case with the other provisions of part 39, the antifraud rule would apply specifically and only the activity of clearing." Nonetheless, CME is concerned that section 39.7 will be read as expanding

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the scope of CFTC jurisdiction to cover the execution of any transaction that is cleared by a DCO, even if the transactions otherwise would be outside of the CFTC's jurisdiction. CME's concern arises from the broad phrase, "in connection with the clearing." Most if not all frauds, with which we are familiar, have been in connection with the inducement to enter the transaction and not, in any real sense, in connection with clearing. If the Commission does not intend to regulate "execution fraud" in every case where a transaction happens to clear through a DCO, it should clearly express that intent in the explanation and change the wording of section 39.7.

It is reasonable for the Commission to regulate the risks to the clearinghouse associated with everything that flows through the clearinghouse, whether or not the transaction is otherwise regulated. It is not clear, however, why the Commission should be interested in fraud in the execution of excluded transactions that are eventually cleared in a DCO. If the relationship between the clearing members and the clearinghouse is properly documented, there should be no risks to the clearinghouse even if the original transaction was fraudulent and voidable.

CME's Clearing House currently clears transactions in unregulated spot markets for commodities such as butter and cheese. CME's Clearing House will offer clearing services for other unregulated spot markets on behalf of business-to-business exchanges. Transactions in such unregulated markets should not be subject to CFTC jurisdiction. Yet proposed Regulation 39.7 makes it unlawful for any person to cheat or defraud or attempt to cheat or defraud any other person in connection with "the clearing of transactions" cleared by a DCO. In other words, a transaction that otherwise would be outside of the CFTC's jurisdiction could become subject to the CFTC's anti-fraud rule simply because it is cleared by a DCO.

The participants in the OTC derivatives markets and the business-to-business markets have made it very clear that they do not wish to subject transactions in their markets to CFTC jurisdiction. Accordingly, if there were any possibility that transactions in such markets could become subject to jurisdiction if they are cleared by a DCO, the participants would arrange to have such transactions cleared by an entity that is not a DCO. This would make it impossible for DCOs to compete for this type of business against other clearing entities that are not DCOs. We therefore urge the Commission to revise Part 39 to make it clear that transactions that are outside of the CFTC's jurisdiction do not become subject to its jurisdiction simply because they are cleared by a DCO.

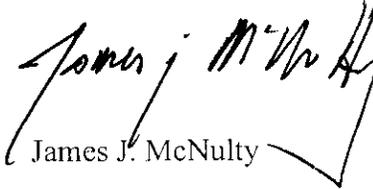
CME believes that Section 39.5(b) of the proposed regulations is too broad as currently drafted. That section provides that, upon request, a DCO must file with the Commission a written demonstration, containing supporting data, information and documents, in the form and manner and within such time as the Commission may specify that the DCO is in compliance with one or more of the core principles specified in the request.

Section 39.5(b) does not state that the Commission can only make such a request to a DCO if the Commission has a reasonable basis to believe the DCO is not in compliance with a core principle(s). In order to comply with such a CFTC request, it is likely that substantial staff

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time and effort will be expended gathering and reviewing data. As such, it is logical that the Commission first establish that the information is needed due to legitimate concerns regarding the DCO's compliance or ability to comply with one or more core principles.

Respectfully submitted,



James J. McNulty

cc: Honorable Barbara Pedersen Holum
Honorable David D. Spears
Honorable James E. Newsome
Honorable Thomas J. Erickson