CME Group

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VIA ELECTRONIC MAIL

Commissioner Scott D. O'Malia
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
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Re: Review of Swaps for Mandatory Clearing under Section 723 of the Dodd-Frank Act (the "Act")

Dear Commissioner O'Malia:

CME Group Inc. ("CME Group")[1], on behalf of its four designated contract markets ("Exchanges" or "DCMs") and its derivative clearing organization ("DCO"), appreciates the opportunity to provide further input on the Commodity Futures Trading Commission's (the "CFTC" or "Commission") review of swaps for mandatory clearing under Section 723 of the Act in response to your letter to the public dated July 28, 2011. CME Group commends your office for seeking additional comment on this very important topic. As your July 28 letter notes, the Commission's final rulemaking on the process for review of swaps for mandatory clearing focused on process and did not address, among other things, the manner in which the Commission will determine (i) which swaps would be subject to the clearing requirement and (ii) whether to issue a stay of a clearing requirement. To assist in the Commission's analysis of these issues, you pose several questions in your letter. Our responses to those questions are detailed below.

Section 2(h)(2)(D)(ii) of the Commodity Exchange Act ("CEA") states:

> In reviewing a swap, group of swaps, or class of swaps..., the Commission shall take into account the following factors:
> (I) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data.
> (II) The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded.
> (III) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract.
> (IV) The effect on competition, including appropriate fees and charges applied to clearing.

[1] CME Group, the world's largest and most diverse derivatives marketplace, consists of four Exchanges: 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 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 also 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®.

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(V) The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or 1 or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.

Congress did not provide any further guidance as to how the Commission should consider these factors. As previously noted, despite requests from the public to do so, the Commission thus far has not provided any guidance in its final rulemaking on the process for review of swaps for mandatory clearing or any other rulemaking as to how it will consider and weigh these factors in determining which swaps will be subject to the clearing mandate. Below please find our response to your specific questions as outlined in your July 28 letter.

1. ***How should the Commission consider the five factors?***

   What criteria should the Commission consider when evaluating whether the DCO has properly categorized "group, category, type, or class of swaps"?

   It is unclear whether "group, category, type or class of swaps" is intended as a list of synonyms or an ordered taxonomy. And, if an ordered taxonomy, whether the list proceeds from the most general to the least or from the least general to the most. Is it a list that descends from super family to species like the iconic "Kingdom, Phylum, Class, Order, Family, Genus, Species" of biology? There is no clue in the legislation and we doubt that the Commission's staff has a clue or has given a signal as to how the list is to be regarded.

   The important questions are: first whether a subset of swaps can be described in a clear enough fashion so that there will be no legitimate disputes about the boundaries and second whether the members of the subset are similar enough so that the Commission can be confident that its decision that mandatory clearing applies based on the examples presented will not have adverse, unintended consequences.

   Generally, we believe that, in determining whether a DCO has properly described a subset of swaps that it believes should be subject to the mandatory clearing requirement the Commission should consider whether the subset is adequately described and whether its members have the same general risk parameters. For example, the subset of fixed versus floating interest rate swaps based on the same measure of the floating rate, the same currency, and a reasonable span of duration should be treated as a subset entitled to the same treatment and should only require a single determination.

   Additional subsets would include:

   - Zero Coupon
   - Floating / Floating (basis swaps)
   - Forward Rate Agreements
   - Amortizing
   - Cross Currency
   - Caps
   - Floors
   - Swaptions

   subset.

   Further, different products would fall into different classifications based on pricing inputs/models, operational requirements, risk management profiles, and margin methodologies. The Bank of International Settlements (BIS) breaks out swap data by currency (available at http://www.bis.org/statistics/otcder/dt21a21b.pdf)]; we submit that the BIS framework should be

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one of the data points used by the Commission to assess this issue and implement the clearing mandate with respect to interest rate swaps.

With respect to credit default swaps, we believe that the logical subsets include the following:

- NA Indexes
    - IG and HY
        - All on the run indices should be deemed clearable upon issuance by Markit (Each Sept 20 and March 20)
    - HVOL
- NA Single Name Constituents (SNAC – Standard North American Contracts)
    - IG Index Constituents and HY Index Constituents
- NA Single Name non-Constituents (SNAC – Standard North American Contracts)

Should the Commission accord more weight to one or more of the factors than others? If so, why?

IRS /CDS

In our view, the most important factor for the Commission's consideration in determining whether a swap should be subject to the clearing mandate are the closely related concepts of adequate trading liquidity and pricing data, which is listed in subpart (I). Without adequate trading liquidity, there will not be adequate pricing data, and a clearing house cannot properly risk manage a product, including collateralizing the product and marking to market. We believe that the other factors listed in subpart (I) are important considerations in assessing whether a swap should be subject to the clearing mandate, but are not necessary for making such a finding.

We believe that the factors listed in subpart (II) should be given relatively little weight. Specifically, in order for a clearing house to be permitted to clear a swap, it will need to have demonstrated to the Commission that it will have the necessary rule framework in place; capacity, operational expertise and resources to clear the product; and the credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded. Additionally, we believe that a clearing house that is in compliance with its core principle obligations will already satisfy these criteria. Thus, the only relevant question with respect to subpart (II) is whether there is a DCO willing to clear the product.

We believe that subpart (III) is an important factor primarily because one of the overarching goals of DFA is the reduction of systemic risk; central counterparty clearing of derivatives contracts is a critical feature of the statute aimed at achieving Congress's intent. While we believe that "size of the market" – assuming size is notional value – may be relevant to assessing the effect of mitigation of systemic risk, we do not believe that this is the sole determining factor. Indeed, certain swap in instruments which have relatively little market size are riskier than, let's say, plain vanilla interest rate swaps, and arguably pose more systemic risk due to the contract features, rather than market size. With respect to "resources of the derivatives clearing organization available to clear the contract," like the factors listed in subpart (II), we believe the element will already be satisfied where a DCO is voluntarily clearing the swap.

With respect to subpart IV, we note that the Commission is required to perform a substantive cost benefit analysis in conjunction with any rulemaking and may not implement a rule if the costs are outweighed by its benefits and that such an analysis should be performed in conjunction with determining which products are subject to the clearing mandate. To that end, we believe that it may be appropriate to consider the costs incurred by customers, who are not entitled to an exemption, in cases where there is no showing that mandatory clearing is not necessary to avoid systemic risk. Beyond this consideration, we believe that subpart (IV) should be given relatively little weight

We do not believe that subpart (V) – "The existence of reasonable legal certainty in the event of the insolvency of the relevant derivatives clearing organization or 1 or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property" – is an issue. In particular, DFA amended the relevant provisions of the bankruptcy code to ensure that customer positions, funds and property receive the same treatment as customer positions, funds and property for futures contracts.

To the extent that the Commission decides to consider mandating for clearing a swap not voluntarily accepted by a clearing house for clearing, we think subparts (II) and (III) should be given more weight. However, DFA does prohibit the Commission from forcing the clearing house to accept for clearing any swap, group, category, type, or class of swaps if it would "threaten the financial integrity of the derivatives clearing organization." *See* §2(h)(3)(C). We believe that if a clearing house can risk manage a product, it will voluntarily accept such swap for clearing, and therefore we believe a situation should not arise where the Commission determines that a swap should be subject to the clearing mandate yet that swap is not already accepted for clearing by a DCO.

Should the Commission consider the factors differently depending on asset class (e.g., interest rate swaps, credit default swaps, and physical commodities)? If so, how should the Commission consider the factors for each asset class (or instruments therein)?

We cannot think of a reason why the Commission should consider the factors differently depending on asset class and recommend that the Commission take the same approach across all asset classes.

To what extent should the Commission take into account, in its consideration of the five factors, the connection between (i) mandatory clearing under Section 2(h)(1) through (4) of the CEA and (ii) the trade execution requirement under Section 2(h)(8) of the CEA?

DFA provides that a swap subject to the clearing mandate must be executed on or subject to the rules of a DCM or SEF. There is an exception to this trade execution requirement if no DCM or SEF "makes the swap available to trade." *See* §2(h)(8)(B). By its unambiguous terms, DFA does not contemplate a separate determination by the Commission as to the products subject to the "trade execution requirement" referenced in the question and in the Commission's release on SEFs. *Compare* §2(h)(8)(B) *with* §2(h)(1)-(3). Rather, the phrase "made available to trade" is tantamount to "listed," and we do not see a legal basis for the Commission to read this statutory language any differently.

As mentioned above, the Commission specifically sought comment on the "trade execution requirement" in its SEF rulemaking. Many commenters, including CME Group, expressed concern that if "made available to trade" meant "listed," then the market could experience a situation where a SEF, as defined by the Commission, lists a product that is unsuitable for trading on a Commission defined SEF. This will impair trading of the product and raise costs for any end user that is exempt from the mandatory clearing/trading requirement. This problem arises because of the Commission's impermissibly narrow reading of the statutory provisions related to SEF, and in particular, what types of trading platforms may qualify as a SEF. Specifically, the Commission's artificial construct of "required transactions" and "permitted transactions" in the SEF rulemaking is not supported by DFA and requires the Commission to contort different provisions of the statute in an unnatural manner to arrive at some semblance of a legal justification for these categories. In turn, this reading puts the Commission in the legally unsound position of making a determination of "made available to trade" when DFA does not grant the

Commission that authority. Simply put, voice brokers qualify as SEFs under the plain language of DFA and with this understanding, there is no reason to create categories such as "required transactions" and "permissible transactions." If the Commission reads the statute as written to allow voice brokered SEFs, then the concerns outlined in the comment letters discussed above regarding the "trade execution requirement" would be alleviated as no markets would be forced to trade on the screen. Thus, there would be no regulatory or other market concerns with "made available to trade" meaning listed, as was clearly Congress's intent.

Final regulation 39.5(b)(3) sets forth a list of documents that each DCO must submit in its request for a mandatory clearing determination. What, if any, additional information should the Commission routinely obtain to aid in its consideration of the five factors? Please indicate the specific factor (and element therein) that such information would help the Commission evaluate.

We believe that the information requested by the Commission in its final rulemaking on the process for review of swaps for mandatory clearing is more than adequate to allow the Commission to consider fully the five factors outlined above. In fact, as noted in our comment letters on the process for review of swaps for mandatory clearing, we believe that the Commission is seeking unnecessary information from clearing houses.

CME Group, however, strongly recommends that the Commission be mindful of what its foreign counterparts are doing on this front to ensure that the Commission's actions do not drive business overseas. In particular, Section 772(d)(ii) of DFA provides that the CEA provisions relating to swaps will apply to foreign activities if those activities "contravene such rules or regulations as the [CFTC] may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of [the CEA] that was enacted by [Title VII]." The Commission is proposing to implement this authority through Proposed Rule 1.6, which provides that foreign activities will be unlawful (and subject to the CEA provisions relating to swaps) if they willfully evade or attempt to evade any provision of the CEA (as enacted by DFA) or CFTC rules, regulations, orders thereunder.

The extraterritorial application of the CEA to "evasive" foreign conduct, as called for by DFA and Proposed Rule 1.6, is likely to raise complex jurisdictional issues and create regulatory conflicts – especially in light of the potentially broad scope of what constitutes "evasion." For instance, a conflict could arise where the Commission seeks to regulate "evasive" overseas swaps trading that is already subject to some form of regulation by a foreign regulator. The Commission's proposal is completely silent on how such regulatory conflicts should be addressed.

An insistence on applying the CEA extraterritorially without regard to otherwise applicable foreign regulatory schemes would prove problematic in several respects. For one, as pointed out in a recent association letter to the U.S. Department of Treasury and European Commission, "extra-territorial application of rules will lead to a more fragmented view of activity in financial markets, making it more difficult for regulators to monitor, much less prevent a build-up of systemic risk."[2] Moreover, a strict, uncompromising application of rules extraterritorially would be contrary to the spirit of DFA Section 752 ["International Harmonization"], which requires the Commission to consult and coordinate with foreign authorities on issues related to derivatives regulation.
CME Group urges the Commission to develop a mechanism and/or provide some guidance for addressing international jurisdictional issues and regulatory conflicts that will invariably arise in the context of the Commission's efforts to prevent evasion overseas. To this end, CME Group endorses the approaches to extraterritoriality issues offered in the association letter referred to

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[2] *See* International Swaps and Derivatives Association et al. Letter re "Extra-territorial Effects in EU and US regulation of derivatives," to Michel Barnier (Commissioner for the Internal Market and Services, European Commission) and Timothy Geithner (Secretary, Department of the Treasury) (July 5, 2011) at 3, available at http://www.gfma.org/pdf/JT-associations-letter-re-extra-territoriality-5july.pdf.

above, particularly the recommendation that: "regulators . . . work together towards a sensible and mutually acceptable solution that reflects the legitimate interest in regulatory oversight of entities active in a jurisdiction in a manner that gives due recognition to the rules that are applicable to an entity in its home jurisdiction."[3]

Moreover, we believe the Commission must make greater efforts to achieve parity with foreign regulators on the regulation of foreign boards of trade; otherwise, the Commission's apparent overreach in this regard will result in retaliatory conduct by foreign regulators against U.S. businesses or their affiliates operating abroad. Such duplicative regulation – both within the U.S. (e.g., amongst the Commission and the Securities Exchange Commission) and across borders – provides no regulatory or public benefit and instead imposes unnecessary increased costs on businesses and subjects them to conflicting regulatory regimes in many instances. As the Commissioner knows, the Commission is obligated under the CEA to do a cost benefit analysis in conjunction with its rulemakings to ensure that the costs of a rulemaking do not outweigh the benefits. And, although not bound by Executive Order 13563, "Improving Regulation and Regulatory Review" issued by the President earlier this year, the Commission has stated that it intends to voluntarily comply with the order in conjunction with its regulatory actions under DFA. The Executive Order requires certain agencies to, among other things, "propose or adopt a regulation only upon a reasoned determination that its benefits justify its costs (recognizing that some benefits and costs are difficult to quantify)," "tailor its regulations to impose the least burden on society, consistent with obtaining regulatory objectives, taking into account, among other things, and to the extent practicable, the costs of cumulative regulations," and "to the extent feasible, specify performance objectives, rather than specifying the behavior or manner of compliance that regulated entities must adopt." 76 Fed. Reg. at 3821. We do not believe that the Commission's rulemakings in this regard are consistent with its obligations under the CEA to perform an adequate cost benefit analysis before promulgating rules or the recent Executive Order.

3. ***Section 2(h)(3)(A) of the CEA states: "After making a determination..., the Commission, on application of a counterparty to a swap or on its own initiative, may stay the clearing requirement... until the Commission completes a review of the terms of the swap (or the group, category, type, or class of swaps) and the clearing arrangement."***

   What criteria should the Commission employ to determine whether staying the clearing requirement would be appropriate?

   By its terms, Section 2(h)(3)(A) of the CEA is applicable to swaps that the Commission determines to be subject to the clearing mandate after a DCO makes a submission to voluntarily clear the swap. In addition to being required to consider the statutory factors discussed above, the Commission has 90 days to make this determination, which period of time includes a 30-day notice and comment period. In order for the Commission to subject a swap to the clearing mandate, it will have had to engage in, at a minimum, an assessment of the applicable statutory factors, solicited public comment and considered those comments in making the determination. Thus, the only reason that may warrant a stay of the clearing mandate given these circumstances is a situation where a market participant can demonstrate that it would be unduly burdensome to require it to comply with the mandate within the timeframe required by the Commission. Otherwise, we believe that the substance and process associated with making this clearing mandate determination protects market participants from being unjustifiably forced to clear products.

[3] *Id.* at 2.

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

Craig S. Donohue

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers