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CME Group
A CME/Chicago Board of Trade Company

Craig S. Donohue
Chief Executive Officer

December 27, 2007

Acting Chairman Walter Lukken
Commissioner Michael Dunn
Commissioner Jill E. Sommers
Commissioner Bart Chilton
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Dear Commissioners:

In its October 9, 2007, letter commenting on the China Foreign Exchange Trading System and National Interbank Funding Center's (CFETS) petition for relief from futures commission merchant (FCM) registration, the Futures Industry Association (FIA) raised questions concerning the financial integrity of CFETS and its fitness to operate as a CME clearing member firm, as well as competitive concerns related to an alleged un-level playing field between CFETS and its members on the one hand and FIA's FCM members on the other hand.

In our letter dated December 18, 2007, we responded to the issues raised by the FIA in terms of CFETS' financial integrity and the manner in which CME Group would ensure adequate financial resources from, as well as prudential oversight of CFETS in terms of trading activity, credit controls, risk management and financial condition of CFETS' member firms. We believe we have adequately addressed these issues with a set of requirements that are equal to or greater than those than would apply to CME Group clearing member firms.

The purpose of this letter is to directly respond to the inaccurate and disingenuous claims of the FIA and its members that the proposed Order Routing and Super-Clearing Agreement between CME Group and CFETS (Agreement) would disadvantage U.S. firms seeking to access the Chinese market for agency brokerage or proprietary trading activity involving Chinese banks. A closer examination of the following business-related and competitive facts demonstrates that these claims are unfounded, that U.S. based investment banks are already actively involved in brokerage and trading activity involving Chinese banks in both the spot and OTC FX and interest rate markets, and that any CFTC decision preventing or limiting the implementation of the Agreement will only serve to retard growth and use of exchange-traded futures and options products by Chinese banks and financial institutions. Rather than protecting U.S. FCMs from an un-level playing field, any such decision would simply funnel more trading activity into exempt OTC markets, benefiting these same firms in their other lines of business and creating a more significant un-level playing field between OTC and exchange-traded futures and options markets.

Chinese Regulators Continue to Expand In-Bound Participation of U.S. Banks and Broker-Dealers in Chinese Financial Markets While Also Expanding Out-Bound Participation by Chinese Banks and Investors in Off-Shore Financial Markets

In its letter dated October 9, 2007, the FIA states that ". . .[a]llowing CFETS to become a clearing member without first being registered as an FCM would likely result in CFETS having a competitive advantage in soliciting Chinese banks and other institutional clients to trade on the CME and CBOT." The FIA does not explain why an exemption from registration for CFETS would confer such an advantage on it relative to U.S. FCMs. More importantly, FIA failed to point out the numerous regulatory reforms adopted in recent years and months that actually facilitate participation by U.S. investment banks and financial institutions in Chinese markets or with Chinese banks and financial institutions trading non-Chinese markets.

For example, starting in 2001, the CSRC and SAFE enacted regulations permitting Chinese corporations to trade foreign derivatives products to hedge corporate risks.[1] In 2005, the CSRC adopted regulations permitting foreign institutions to invest in or acquire up to a 49% interest in Chinese FCMs in order to permit off-shore intermediaries access to Chinese investors and customers.[2] While some FCMs have complained about the limitations on ownership of Chinese FCMs, it is worth noting that Chinese regulatory authorities have not adopted any such permission for foreign futures and options exchanges to invest in or acquire such a significant percentage of ownership in a Chinese exchange in order to expand business there. More recently, the China Securities Regulatory Commission (CSRC) adopted *The Trial Measures for the Administration of Overseas Securities Investment by Qualified Domestic Institution Investors (QDII)* which allows domestic brokerages and fund management firms to invest clients' funds in overseas fixed income, stocks and other financial derivatives. This expands the category of eligible investors from banks and insurance companies only to brokerages and fund management firms. These investor categories will now be able to raise funds to invest in overseas fixed-income and equity products along with forwards, swaps, warrants, options and futures in markets whose regulators have signed cooperative supervisory MOUs with the CSRC.[3] Finally, in 2007, the Chinese Banking Regulatory Commission (CBRC) adopted rules allowing Chinese commercial banks to engage in off-shore brokerage activity for their Chinese clients in investment grade products and in financial derivatives products.[4]

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[1] Domestic Corporation to Hedge in Foreign Markets Regulation, CSRC 2001-81.

[2] Foreign Investors Involved in Chinese FCMs, CSRC 2005-138.

[3] (Full texts in Chinese: http://www.csrc.gov.cn/n575458/n575667/n642011/3866131.html, http://www.csrc.gov.cn/n575458/n575667/n642011/3866223.html)

[4] Adjustment for Commercial Banks to Do Offshore Brokerage Business, CBRC 2007-114.

U.S. Investment Banks *Already Actively Participate* in OTC Foreign Exchange Transactions with Chinese Banks Through CFETS

The Chinese government has been actively fostering the development and expansion of the OTC foreign exchange market within China for several years, including the active participation of U.S. banks.[5] For example, on May 18, 2005, ABN-AMRO announced that it has signed an agreement with CFETS to become one of the first international market makers for China's inter-bank FX trading business.[6] On August 22, 2005, Standard Chartered announced it had received in-principal approval from CFETS, to participate on its multi-bank portal as a liquidity provider.[7]

In July, 2006, a master agreement for RMB cross-currency forwards and swaps drawn up by CFETS was approved by the State Administration of Foreign Exchange (SAFE). The press release announcing the implementation of this agreement noted that "SAFE released the master agreement after months of consultation with market players, including local and foreign banks [emphasis added]." This master agreement was modeled after the 1992/2002 ISDA Master Agreement. On April 9, 2007, CFETS launched trading in five currency pairs against the RMB, utilizing a new trading platform based on the Reuters Electronic Trading system customized to support RMB. Participants on the platform include the 300 CFETS member banks, as well as 20 liquidity providers. Six of the 20 liquidity providers are FIA members or affiliates of FIA members:.Bank of Montreal, Citigroup[8]; Deutsche Bank[9]; HSBC, RBS and UBS.[10]

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[5] In 2006, Moody's Investors Service noted that "[u]nder its World Trade Organization (WTO) accession commitment made in 2001, China will 'fully' open up its banking sector to foreign competition after December 11, 2006. Having gradually relaxed constraints over the past five years, China will allow foreign banks access to RMB retail business and lift all geographic and client constraints on their operations, eliminating any existing non-prudential measures restricting ownership, operations, internal branching and licenses." Moody's Investors Service, November 2006, "Special Comment: China's Banking Sector Opening Under WTO Commitments-Beneficial to Foreign and Domestic Banks alike, but a Gradual Process; No Near-Term Rating Impact," at page 1.

[6] Steven Metzler, Executive Director of Technology Alliances, FX & Futures, at ABN-AMRO said: "The launch of CFETS FX trading is conducive to the development of China's FX market as it provides broader access to global FX liquidity in China. " "China Foreign Exchange Trade System Goes Live with Reuters Electronic Trading," at page 1, Xinhua-PRNewswire (Shanghai, May 18, 2007)."

[7] Mike Bass, Global Head for Rates and FX at Standard Chartered Bank said: "Standard Chartered is pleased to have been accepted by CFETS as one of their liquidity providers. We are committed to developing our business in China and we believe that our participation on this portal will reinforce our position as a leader in Asia's largest emerging market. Our clients need quick time-to-market, ease of connectivity and local support, and this electronic trading solution is key to our ensuring we provide them with premium quality service. ." "Standard Chartered Grows its Foreign Exchange Capabilities in China with CFETS Membership," at pages 1-2, www.StandardChartered.com (press release, Shanghai, May 18, 2007)."

[8] Paulus Mok, Managing Director, Citibank China, head of fixed income, currencies and commodities and country treasurer said: "The newly launched CFETS portal, which combines G7 currencies and the Chinese Yuan in one centralized system, will generate significant benefits to all market players in China and have a profound impact on the future development of China's foreign exchange market. Citi is privileged to be a market-maker for both G7 and Yuan currency trading. With our strong global trading capacity and deep commitment to the Chinese market, we are confident that our partnership with CFETS will substantially increase the breadth and depth of the currency market in China. "CFETS Today Launches New Foreign Exchange Trading System to Trade RMB Using Reuters Technology," at pages 2-3 (Business Wire summary of Reuters and CFETS press release, Shanghai, April 9, 2007)."

As can be seen from the above, CFETS and its members already have broad access to the OTC FX market. More importantly, it is evident that U.S. investment banks are actively participating in spot, forward and swap transactions, on both an agency brokerage and proprietary trading basis, with Chinese banks through SAFE and CFETS sponsored mechanisms. CFTC approval of the Agreement will not create an un-level playing field for U.S. FCMs; rather, it will enhance the ability of FCMs to compete with other business lines or affiliates within the same investment banking organization. More germane to CME Group, CFTC approval of the agreement will eliminate an un-level playing field between exempt OTC FX markets and regulated exchange-traded futures and options markets in foreign exchange and interest rates.

It should be noted that CME Group is one of the largest FX platforms in the world, with a leadership position in both the listed FX products market as well as in the broader community of OTC FX participants. According to an Aite Group LLC report from May 2007 ("Institutional FX Trading Platforms: Old Habits Are Hard to Break"), CME Group ranks third among the largest FX platforms, and is the only exchange model among the balance of the field of bilateral models. CME Group's exchange model provides the CFTC with 100% regulatory market oversight, where the existing bi-lateral models operate in the opaque world of OTC and are therefore not similarly regulated. Excluding on-shore Chinese institutions from participating in CME's FX market via the proposed Order Routing and Super-Clearing Agreement would be to the detriment of the domestic Chinese market. This would create an inherently un-level playing field between the domestic Chinese market (without access to CME's exchange model) and the global FX market (where CME continues to grow). This would further disadvantage the global FX market by missing the opportunity to create regulatory oversight of FX business which will increasingly emanate from China and ripple out into the broader FX market. Please find below a ranking of the largest FX ECNs as reported by Aite Group LLC in May 2007. This provides the context for the petition to provide access to CME Group's exchange model, and clearly demonstrates the power of CME Group's value proposition of the transparency to the entire spectrum of global FX market participants relative to the existing bi-lateral models currently in the market.

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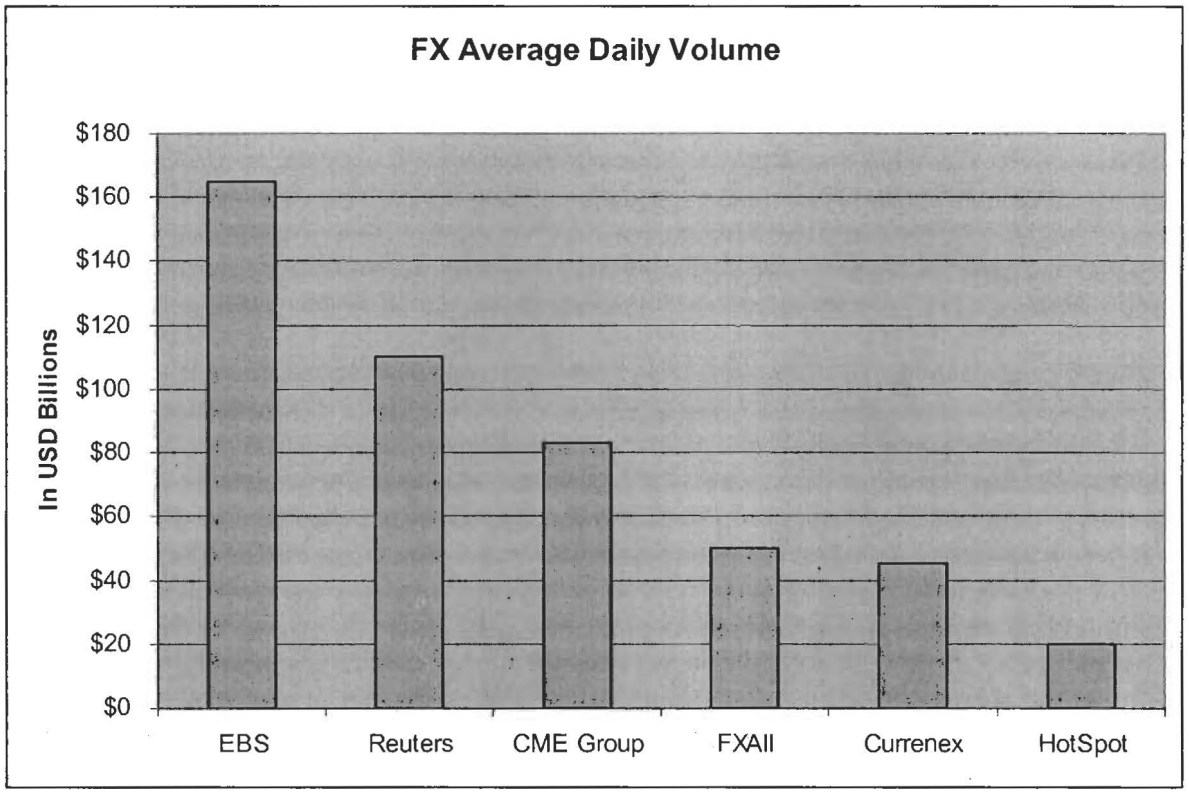
[9] Michele Wee, Vice President, Corporate & Investment Banking at Deutsche Bank, said: "The CFETS—FX platform allows liquidity providers such as Deutsche Bank to provide streaming FX prices with one-click trading, order module and RFQ functionality. This new platform will encourage development of China's FX market and provide opportunities for both Deutsche Bank and CFETS member banks "China Foreign Exchange Trade System Goes Live with Reuters Electronic Trading," at page 2, Xinhua-PRNewswire (Shanghai, May 18, 2007)."

[10] "Riding e-FX Wave in China", presentation by Zhu Rong (CFETS staff), Shanghai, November 14, 2007.



It should also be pointed out that the Agreement is not exclusive: Chinese banks, with the permission of CFETS, may execute transactions through approved foreign brokers rather than strictly through CFETS as a super clearing member firm of CME Group.[11] Finally, CME Group believes that the Agreement, if successful, will ultimately lead to broader hedging, trading and risk management activity on the part of Chinese banks in global futures and options markets.[12] As this growth and maturation occurs, it is not only likely, but probable, that Chinese banks will seek a broader range of services through professional financial intermediaries, including U.S. FCMs and investment banks.

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[11] In this regard, it should be noted that the Chinese government has a legitimate interest in carefully managing the evolution of hedging and risk management practices of Chinese banks in derivatives markets. While such permission may not yet exist on a wise scale basis, we believe that the Agreement can and will serve as an incubation laboratory for better developing these practices, ultimately paving the way for Chinese banks to access a broader range of global exchange markets through on-shore and off-shore intermediaries.

[12] The ability to engage in such hedging activity has been set forth in regulations issued by the State Council on March 16, 2007 and effective on April 15, 2007. See Reuters article entitled, "China relaxes gold, futures industry controls" (Beijing, March 16, 2007) which notes that "China will gradually relax controls over the import and export of gold and allow more foreign access to domestic futures markets, the central bank said on Friday in a lengthy announcement of new financial reforms....China will also allow more domestic firms to hedge in overseas futures markets...." This information is collaborated by a bulletin on "The Economic and Commercial Section of the Consulate General of the People's Republic of China in Vancouver," citing an April 17, Xin Hua News Agency article.

U.S. Investment Banks *Already Actively Participate* in OTC Fixed Income Transactions with Chinese Banks Through CFETS

Similar to the development of FX market activity by Chinese Banks, CFETS has announced or implemented arrangements that facilitate activity between Chinese banks and U.S. and European fixed income trading platforms. On February 14, 2006, MTS, the premier electronic market for fixed-income securities in Europe, announced the signing of a letter of intent with CFETS to develop a domestic fixed-income market in the People's Republic of China. On September 13, 2007, the Shanghai CFETS-ICAP International Money Broking Co. Ltd. (CFETS-ICAP) commenced voice broking operations. CFETS-ICAP is a 67/33 joint venture interdealer broker, providing voice broking services to the money, bond and derivative markets in both the RMB and international markets.[13]

Summary

The CFTC's approval of the request for exemptive relief will enable CFETS and its member banks access to, and the benefits of, deep, liquid, transparent exchange-traded and CFTC-regulated markets for financial futures and options. The Agreement is limited to foreign exchange and interest rate products only. The Chinese entities that will participate in the super-clearing arrangement are entities that would otherwise be unable to trade regulated foreign exchange and interest rate products in the United States.

Through our Agreement, member banks of CFETS will be exposed to, and gain experience in, trading U.S. exchange traded derivative products. This experience in trading and financial market operations will ultimately benefit the entire U.S. futures industry and all of its participants as the regulatory environment in China continues to evolve and become more open to U.S. businesses. As Chinese entities gain experience and expertise in trading the narrow group of derivative products that are included within the Agreement, they will likely seek assistance from other U.S. businesses in the future in order to trade additional exchange traded derivative products under more complex trading strategies. The Agreement and the relationship between CME and CFETS is an important step in that process.

In its comment letter, FIA states: "[w]e are pleased that the PBC has called upon the expertise of the CME to provide consulting and technical assistance to CFETS." FIA recognizes that the People's Bank of China, SAFE and CFETS will benefit from the unique and innovative linkage arrangement represented by our Agreement. The ability to access a liquid, transparent and regulated market in a carefully supervised manner under the auspices of CFETS, and with the educational and technical assistance desired by Chinese government authorities is a necessary first step in improving hedging and risk management practices within Chinese Banks, particularly where such practices are both embryonic within China and

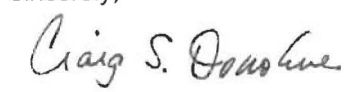
[13] Michael Spencer, ICAP Group Chief Executive, commented "China represents a significant opportunity for ICAP to take part, together with the CFETS, in the rapid development and growth of the interbank financial markets. This is an exciting prospect for ICAP, in the next few years the volume of transactions in Chinese wholesale financial products will rise rapidly and China will be recognized globally as one of the most important and liquid markets. "China Foreign Exchange Trade System and ICAP are approved to prepare to form joint venture in Shanghai," www.thisismoney.co.uk (ICAP PLC press release, London and Shanghai, July 26, 2006).

have been plagued by past failures within China when unaccompanied by such close supervision and oversight.

Based on the foregoing information and facts, we believe the Agreement meets the statutory standards for an exemption under section 4(c) of the Act. The Agreement and petition for exemption will promote economic and financial innovation by permitting Chinese banks to acquire hedging and risk management expertise in a closely supervised structure, accompanied by significant educational and technical risk management assistance provided by CME Group that would otherwise be unavailable to CFETS. The Agreement will also promote competition by facilitating Chinese bank access to liquid, transparent and regulated futures markets, in addition to their existing access to OTC markets, thereby expanding their range of choice in accomplishing their hedging and risk management needs. Second, the Agreement and petition for exemption is consistent with the public interest and the purposes of the Act in that the ability of Chinese banks to hedge interest rate and foreign currency exposures will better enable the Chinese government to further liberalize fluctuations in the RMB and more effectively move toward a free market economy approach to financial markets. Indeed, this objective has been of paramount interest to the U.S. government, as evidenced by the numerous comments of support for the Agreement for Treasury Department and Administration officials.[14] Finally, as already explained in our letters dated October 23 and December 18, 2007, the Agreement and the petition for exemption will not have a material adverse affect on the ability of the CFTC or CME Group to discharge their regulatory and self-regulatory duties under the Act.

We therefore request a timely approval of the petition for exemption and authorization to implement our Agreement in an expedited fashion.

Sincerely,



Craig S. Donohue

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cc: Ananda Radhakrishnan
Jacqueline Hamra Mesa

[14] Upon the execution of our Memorandum of Understanding with CFETS, the precursor to our Agreement, former Treasury Secretary John Snow stated that "this cooperative initiative is an outstanding example of the kinds of exchange-rate-related technical cooperation efforts Treasury has consistently advocated as part of our ongoing technical cooperation program with China's financial sector and financial regulators."