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CME Group
A CME/Chicago Board of Trade/NYMEX Company

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July 6, 2009

VIA ELECTRONIC MAIL

David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
secretary@cftc.gov

Re: Revised Adjusted Net Capital Requirements for Futures Commission Merchants and Introducing Brokers – 74 Fed. Reg. 21290 (May 7, 2009), RIN 3038-AC66

Dear Mr. Stawick:

CME Group Inc. ("CME Group"), on behalf of its four designated contracts markets ("DCMs") and derivatives clearing organization ("DCO"), appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "Commission") notice of proposed rulemaking ("NPR") with respect to revising the adjusted net capital ("ANC") requirements for futures commission merchants ("FCMs") and introducing brokers ("IBs") set forth in Commission Regulation 1.17.

CME Group was formed by the merger of Chicago Mercantile Exchange Holdings Inc. and CBOT Holdings Inc. in 2007, and subsequently merged with NYMEX Holdings, Inc. in 2008. CME Group is the parent of four DCMs: (1) the Chicago Mercantile Exchange ("CME"); (2) the Chicago Board of Trade ("CBOT"); (3) the New York Mercantile Exchange; and (4) the Commodity Exchange. CME's clearing house ("CME Clearing") is among the largest DCOs in the world. Collectively, these DCMs and CME Clearing serve the risk management needs of customers around the globe. As an international marketplace, the CME Group exchanges bring buyers and sellers together on the CME Globex electronic trading platform and on trading floors in Chicago and New York. 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, emissions, agricultural commodities, metals, and alternative investment products such as weather and real estate.

I. Background

Regulation 1.17 sets forth minimum financial requirements for FCMs and IBs that are registered with the Commission. Because FCMs hold customer funds, their ability to meet financial obligations is critical to the strength and vitality of U.S. futures markets. Regulation 1.17(a)(1)(i) requires FCMs to maintain

adjusted net capital "equal to or in excess of the greatest of", among other things: (a) a set minimum-dollar amount (currently $250,000); (b) the FCM's "risk-based capital requirement", which is calculated based on specified percentages of total risk margin requirements for positions in customer and noncustomer accounts carried by the FCM; and (c) for FCMs that are also securities broker-dealers ("FCM/BDs"), the amount of net capital required by Regulation 15c3–1 of the Securities and Exchange Commission ("SEC").[1] If an FCM falls below its minimum capital requirements, it must immediately notify the Commission and the FCM's designated self-regulatory organization.

The Commission has proposed various amendments to Regulation 1.17. Many of the amendments are designed to ensure that FCMs' capital requirements appropriately reflect cleared over-the-counter ("OTC") derivative instruments carried in customer, noncustomer and proprietary accounts. As further explained below, CME Group agrees that Regulation 1.17 should be amended as proposed to include cleared OTC derivative positions in the calculation of FCMs' capital requirements. Furthermore, we agree with the Commission's proposal to increase the minimum dollar-amount requirements for FCMs and IBs, and to amend FCM risk-based capital requirements so that the required percentage of risk-maintenance margin is the same for customer and noncustomer accounts. We believe these are appropriate measures to ensure that FCMs can continue to meet their financial obligations in light of recent developments in U.S. futures markets, including the growing demand for cleared OTC derivative instruments.

CME Group does not, however, support the Commission's proposal to increase FCM risk-based capital requirements for customer and noncustomer accounts to 10 percent. Current risk-based margin requirements for FCMs performed admirably during the recent financial crisis, when no FCM defaulted or fell below its regulatory capital requirements. Moreover, raising capital requirements to the proposed levels may have the undesirable effects of further concentrating customer accounts among fewer FCMs, decreasing competition and increasing customer costs.

II. Proposal to Increase the Required Minimum Dollar Amount of ANC

We support the Commission's proposal to amend Regulation 1.17(a) to increase the required minimum dollar amount of ANC for FCMs from $250,000 to $1 million, and for IBs from $30,000 to $45,000. This amendment will not impact FCMs that are clearing members of CME Clearing, who are subject to CME's significantly greater minimum capital requirements. Nevertheless, as noted in the NPR, the minimum dollar-amount requirements in Regulation 1.17 have been in place for more than 10 years. In 2006, the National Futures Association ("NFA") increased its minimum capital requirements for FCM members from $250,000 to $500,000, and for IB members from $30,000 to $45,000. The Commission's proposed amendment will only affect a small number of FCMs who utilize the minimum dollar amount (as opposed to another required method) for calculating ANC requirements, and it will harmonize Regulation 1.17(a) and NFA Rules with regard to capital requirements for IBs.

[1] 17 C.F.R. 240.15c3–1(a).

III. Proposals to Include in FCMs' Risk-Based Capital Calculations All Cleared OTC Positions Carried for Customers and Noncustomers and to Expand the Definition of "Risk Margin"

We also support the Commission's proposals to: (a) require FCMs to account for all cleared OTC derivative positions carried for customers and noncustomers in their risk-based capital calculations, regardless of whether such positions are in an account governed by Section 4d of the Commodity Exchange Act ("CEA") or another account type including a secured account governed by Commission Regulation 30.7; and (b) amend the definition of "risk margin" in Regulation 1.17(b) to include, "where margin or performance bond is required only for accounts at the clearing organization, for purposes of the FCM's risk-based capital calculations, applying the same margin or performance bond requirements to customer and noncustomer positions in accounts carried by the FCM." Risk exposure associated with cleared OTC derivative positions exists regardless of the account type in which the positions are held. Including all cleared OTC positions that an FCM carries for its customers and noncustomers in the FCM's risk-based capital calculation is necessary to accurately reflect the FCM's total risk exposure.

IV. Proposal to Require FCMs to Take Capital Deductions for Cleared OTC Proprietary Positions

The Commission has proposed to amend subpart (x) of the definition of "adjusted net capital" in Regulation 1.17(c)(5) to address the manner in which FCMs are required to take capital deductions for proprietary cleared OTC derivative positions. As amended, the Regulation would require an FCM to take a deduction when computing its ANC of 100 percent of the risk maintenance margin requirements for OTC proprietary positions cleared by a clearing organization of which the FCM is a clearing member, and 150 percent of the risk maintenance margin requirement for OTC proprietary positions cleared by a clearing organization of which the FCM is not a clearing member. We support this proposed amendment, which would make capital treatment for proprietary cleared OTC derivative positions under Regulation 1.17 the same as that afforded to proprietary futures and option positions. We further urge the Commission to revise the definition of "cover" in Regulation 1.17(j) to reflect that cleared OTC positions in proprietary accounts may be covered by positions that would qualify as cover for proprietary futures and options positions.

V. Proposal to Increase Risk-Based Capital Requirements

Since 2004, FCMs have been required to compute their risk-based capital requirements under Regulation 1.17(a)(1)(i)(B) as the sum of: (a) 4 percent of the total risk margin requirement for positions the FCM carries in "noncustomer accounts"; and (b) 8 percent of the total risk margin requirements for positions the FCM carries in "customer accounts."[2] CME Clearing and the CME Group exchanges have long been advocates of appropriate capital levels reflective of the risk inherent in the positions an FCM carries for its customers and noncustomers. CME and CBOT were among the first exchanges to adopt the Commission's risk-based capital requirements and apply them to their clearing members.

[2] The terms "noncustomer accounts" and "customer accounts" are defined in Regulation 1.17(b).

The Commission has now proposed to raise the levels for noncustomer and customer accounts from 4 and 8 percent (respectively) to 10 percent, so that an FCM's risk-based capital requirement would be 10 percent of the total risk margin requirement for positions carried in both customer and noncustomer accounts. In making this proposal, the Commission noted that the lower percentage currently assigned to positions of noncustomers (*i.e.*, persons affiliated with the FCM) arose from the belief that noncustomer accounts presented less risk to the FCM than customer accounts. More recently,

> ...the Commission has observed that the risk associated with noncustomer accounts may not necessarily be less than the risk associated with customer accounts under conditions of financial stress for the FCM. Therefore, to increase the financial integrity of the futures markets, the Commission is proposing to amend Regulation 1.17 to apply the same percentage requirement for both customer and noncustomer accounts.[3]

CME Group agrees that Regulation 1.17 should be amended to apply the same percentage requirement to both customer and noncustomer accounts. However, we believe the applicable percentage should be 8 percent (*i.e.*, the level that has been in use since 2004 for customer accounts) rather than 10 percent.

The current risk-based capital requirement with respect to customer accounts performed admirably in the past, including the recent financial crisis. During this period of extreme financial stress, no FCM defaulted or fell below its regulatory capital requirements. Although Lehman Brothers, Inc. ("LBI", an FCM/BD) was placed in liquidation in September 2008 following the bankruptcy of its parent company (Lehman Brothers Holdings, Inc.), LBI's capital requirements were driven by SEC Regulation 15c3–1, and none of its futures customers suffered financial injury as a result of its insolvency proceedings. This positive result was attributable not only to applicable capital requirements, but also to the Commission's customer segregation requirements. The collection of customer margin on a daily basis, and the required segregation of customer margin and positions from assets of the FCM (under both Section 4d of the CEA and Regulation 30.7), is the cornerstone for ensuring that FCMs can satisfy their financial obligations to customers.

No specific justification has been proffered for increasing the risk-based capital requirement to 10 percent. The Commission has observed that, in recent years, funds held on behalf of customers "have become concentrated among far fewer FCMs, further supporting additional measures to ensure the sound financial strength of such firms."[4] However, raising the risk-based capital requirement to 10 percent would likely exacerbate rather than ease the concentration of FCMs.

An historical analysis (which has been provided separately to Commission staff) shows that a significant number of clearing members of CME Clearing would not meet the proposed risk-based capital requirements of 10 percent. Some of these FCMs are subsidiaries of parent companies that are likely sources of additional funding. Others, however, are smaller FCMs that carry accounts of retail customers,

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[3] 74 Fed. Reg. 21293 (May 7, 2009).
[4] *Id.* at 21291.

which many larger FCMs are reluctant to carry. Particularly in the current economic climate, at least some FCMs may be unable to obtain the additional funds needed to meet the proposed increased levels.[5] Thus, raising the risk-based capital requirements as proposed may have the undesirable effects of further concentrating customer accounts among fewer FCMs, decreasing competitiveness among such firms, and increasing customer transactions costs. We therefore urge the Commission to make FCMs' risk-based capital requirements 8 percent of the total risk margin requirement for positions carried in customer and noncustomer accounts, rather than 10 percent as proposed.[6]

VI. Request for Comments on Increasing Capital Requirements for FCM/BDs

Currently, FCM/BDs must compare the minimum amounts of capital required under Commission Regulation 1.17 and SEC Regulation 15c3-1, and maintain capital in excess of whichever amount is greater. The Commission has requested comments on the advisability of requiring FCM/BDs to maintain minimum capital in excess of the sum of, rather than the greater of, these amounts. The Commission noted that "[t]he equity available to satisfy [any] unsecured claims of customers" in the event of the bankruptcy or insolvency of an FCM/BD "would be increased if the FCM/BD's capital requirements was not based only on the higher of the CFTC's or SEC's requirements, but rather the combined requirements of the two regulations."[7]

CME Group does not believe it would be advisable to increase minimum capital requirements for FCM/BDs to include the amount required under Regulation 1.17 and the amount required under SEC Regulation 15c3-1. As with the risk-based capital requirements for FCMs, existing capital requirements for FCM/BDs performed admirably in the past, including during the recent financial crisis. As noted above, none of LBI's futures customers suffered financial injury as a result of its insolvency proceedings.[8] Indeed, no FCM/BD insolvency has resulted in a loss of customer funds. Again, this is attributable not only to the capital requirements for FCM/BDs, but more basically to the customer segregation requirements under Section 4d of the CEA and Commission Regulation 30.7, which provide important financial safeguards to futures customers.

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[5] As explained in the comment letter submitted by Newedge USA, LLC, if the risk-based capital requirements were increased to 10 percent as proposed, minimum capital requirements for FCMs "could increase by as much as 45% without any change in their risk profile, solely because they hold large amounts of required customer margin deposits. Such a percentage increase can translate into FCMs being required to increase their capital by hundreds of millions of dollars."

[6] Our historical analysis shows that no FCM clearing members of CME Clearing would be unable to satisfy increased risk-based margin requirements of 8 percent for noncustomer accounts.

[7] 74 Fed. Reg. 21293.

[8] We understand the same is true with respect to LBI's securities customers.

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 Craig.Donohue@cmegroup.com; or Lisa Dunsky, Director and Associate General Counsel, at (312) 338-2483 or Lisa.Dunsky@cmegroup.com.

Sincerely,

Craig S. Donohue

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Walter Lukken
Commissioner Bart Chilton
Commissioner Jill Sommers
Mark Bretscher
Thelma Diaz