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May 24, 2007



**VIA ELECTRONIC MAIL**

Eileen A. Donovan
Acting Secretary
Commodity Futures Trading
Commission
Three Lafayette Centre
1155 21st Street, NW.
Washington, DC 20581

**Re: OCC Clearing Credit Default Options**

Dear Ms. Donovan:

The Chicago Mercantile Exchange Inc. ("CME") applauds the Commodity Futures Trading Commission's (the "Commission") decision to resolve jurisdictional issues and permit the exchange-based derivative industry to innovate and serve its customers. CME welcomes competition on a level playing field, as it has made clear in numerous recent filings with the Commission. The Notice of Proposed Order does, however, raise a number of issues that should be addressed before the Proposed Order is made final.

CME was the first derivatives exchange to propose futures contracts based on the probability that a single reference entity would experience a defined credit event and first to propose a futures contract based on an index whose value depended on the probability that a credit event would be experienced by one or more of a defined set of reference entities. CBOE and OCC, who now seek relief from the Commission, previously employed considerable influence to eliminate CME's innovation from the marketplace and to appropriate those innovations for their own benefit. This was a clear case of CBOE and OCC attempting to exploit the alleged uncertainties at the boundary of SEC and CFTC jurisdiction to gain a competitive advantage.

It would create an unfair playing field if CBOE and OCC were able to exploit the Commission's commitment to foster "responsible innovation and fair competition among boards of trade, other markets and market participants" (CEA § 3(b) of the Commodity Exchange Act ("CEA") to secure an exemption to advance their agenda, while continuing to bring pressure to bear to preclude CME from listing and clearing the products that were created by CME. At the very least, CBOE and OCC should be required to give their commitment to the Commission that they will withdraw their opposition, at the Commission and at the SEC, from CME's rules that will authorize it to trade and clear such products.

We are also concerned that the Commission seems to accept CBOE's and OCC's characterization of the contracts as options. We do not believe that this characterization is accurate or necessary to permit the Commission to grant the requested relief. CME has been consistent and clear in its explanation that the proposed contracts constitute futures—not options. Among other things, options imply a degree of optionality. Upon payment of the premium, option buyers assume rights but no obligations; option sellers assume an opposite risk profile. While some options operate pursuant to an automatic exercise feature, such a feature may generally be overridden at the discretion of the buyer. Buyers and sellers of the these credit default contracts enjoy no such optionality. Moreover, the contracts do not involve any strike prices or premium payments. The payout is fixed in advance of listing the contract and does not vary in relation to the price of any security of the referenced entity. The index based contracts are most properly characterized as a cash-settled index futures contract based on a digital index of credit event risks.

There are strong arguments that the proposed contracts are based on commodities, not securities. The events that may trigger a payment—bankruptcy or a failure to pay—are events that are non-dependent upon the price or value of a security. Indeed, the rules submitted by CBOE to the SEC do not provide for the future delivery of a security or, necessarily, for the delivery of any measure of value based on a security or an index of securities. While there is no final definition of an event of default, we can be confident that CBOE will include bankruptcy and restructuring within the definition when it comes time to list the product. Neither of those events can possibly be classified as a security, and they have been the events that most often trigger a payout on a credit default swap.

CBOE's drafting of its rule disguises that issue and the Commission's characterization of the CBOE definition of a "Credit Event" as "an "Event of Default" on any debt security issued or guaranteed by a specified "Reference Entity" suggests that CBOE's efforts to characterize its product as based on a security has been effective. A careful reading of page 19 of CBOE's rule submission confirms that an "Event of Default" will be specified by CBOE at the time the option class is listed. We urge the Commission to review the CBOE rule filing and correct this erroneous characterization.

Finally we are concerned that the Proposed Order is inconsistent with the requirements of Section 4(c)(2)(B)(i) of the CEA, which requires that the transaction "(i) Will be entered into solely between appropriate persons . . ." Section 4(c)(3)(K) grants the Commission considerable leeway, but the tentative decision to extend the exemption to retail customers because their broker is regulated creates an exception that swallows the rule. The requirement that the trading be limited to appropriate persons would be abrogated if the CFTC looked only to the status of the intermediary. Congress gave no hint that appropriate person could be defined in terms of the status of that persons intermediary.

CME appreciates the opportunity to respond to the Commission's Proposed Order. Please do not hesitate to contact me at 312-466-7469, John Nyhoff, Director, Research and Product Development, at 930-2310, or Matthew Kluchenek, Director and Associate General Counsel, at 312-338-2861.

Sincerely,

John W. Labuszewski, Managing Director
Research & Product Development