



# FUTURES INDUSTRY ASSOCIATION

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July 14, 2003

Ms. Jean A. Webb  
Secretary to the Commission  
Commodity Futures Trading Commission  
1155 21<sup>ST</sup> Street NW  
Washington DC 20581

COMMENT

**Re: Chicago Board of Trade and Chicago Mercantile Exchange Rules**

Dear Ms. Webb:

The Futures Industry Association ("FIA") is submitting this letter in response to the Commodity Futures Trading Commission's ("Commission's") invitation to comment on certain rules that the Chicago Board of Trade ("CBT") and the Chicago Mercantile Exchange ("CME") have filed with Commission for approval pursuant to Commission rule 40.5 (collectively, the "Rules").<sup>1</sup> The Rules are designed to implement the clearing link to which the CBT and the CME have agreed.

As the Commission is aware, FIA has long supported common clearing. In this regard, our members recognize that the proposed CBT-CME clearing link, although something less than common clearing, holds the promise of providing certain benefits for which we have argued. In particular, the link may permit FCMs and their customers to make more efficient use of their capital and allow FCMs to better monitor and manage the risks their customers are assuming across markets. To facilitate the expected implementation of this link, therefore, FIA has appointed a committee to work with the exchanges to resolve the numerous operational, business and legal issues that are certain to arise.

We also appreciate that the CBT and CME, in the aggregate, account for approximately 85 percent of all US futures volume. Therefore, the structure of the clearing link and, in particular the rights and obligations that each exchange is assuming and is imposing on its respective clearing members, require careful examination. Among other things, the Commission must assure that the structure of the clearing link would not "result in any unreasonable restraint of trade" or "impos[e] any material anti-competitive burden on trading on the contract market" in violation of section 5c(c)(2)(N) of the Commodity Exchange Act ("Act"). Consequently, we believe it is in the public interest for the exchanges to ask the Commission to approve the relevant

<sup>1</sup> FIA is a principal spokesman for the commodity futures and options industry. FIA's regular membership is comprised of approximately 40 of the largest futures commission merchants ("FCMs") in the United States. Among its associate members are representatives from virtually all other segments of the futures industry, both national and international. Reflecting the scope and diversity of its membership, FIA estimates that its members effect more than eighty percent of all customer transactions executed on United States contract markets.

exchange rules, rule amendments, and other actions necessary to implement this link. Further, it is appropriate for the Commission to request public comment in connection with its review.<sup>2</sup>

Nonetheless, we cannot support the procedures that the Commission has adopted here. The Commission first posted the Rules on its website at the end of the business day, July 8, and requested comment no later than Noon, July 14. The Commission, therefore, has accorded the public only three business days to analyze these rules and prepare meaningful comments. We recognize that the Commission has no statutory obligation to request public comment on these Rules.<sup>3</sup> However, having made the decision to do so, the Commission must recognize that three business days is simply not enough time to analyze these Rules properly and to prepare useful comments. Equally troubling, the Commission has reserved for itself less than one business day to analyze any comments that are received before it is scheduled to vote to approve or disapprove the Rules.<sup>4</sup>

In the limited time available to us, we have not had an opportunity to review the Rules in their entirety. However, one Rule with respect to which the CBT has requested Commission approval raises a number of substantive policy issues that do not lend themselves to easy resolution. CBT Regulation 701.01 would require each CBT clearing member to “comply in all respects with any statement of policy or other notice issued by the Exchange relating to the procedures and processes that must be followed to effectuate the transfer of open positions to any Clearing Services Provider.” Although the CBT submitted a statement of policy concerning the transfer of open positions between the Board of Trade Clearing Corporation and the CME concurrently with Regulation 701.01, our members are especially concerned that the authority to be granted the exchange under the regulation is not limited to this particular transfer of open positions.<sup>5</sup>

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<sup>2</sup> We would expect the Commission to review, and seek public comment on, rules submitted by any applicant for designation as a contract market or derivatives clearing organization. Because the CBT-CME clearing link affects established relationships, such review and opportunity for comment is, if anything, more important.

<sup>3</sup> Similarly, the exchanges had no obligation, in general, to file these Rules for Commission approval. With the exception of certain amendments to the terms and conditions of futures and options on futures contracts on agricultural products, section 5c(c) of the Act provides that a designated contract market or derivatives clearing organization may implement any rule or rule amendment without Commission approval by filing a written certification that the rule or rule amendment complies with the Act and any Commission regulation under the Act. We must assume, therefore, that the exchanges have requested the Commission to approve these Rules because they do not feel comfortable certifying that these Rules comply with the Act. In the alternative, the exchanges may want the additional protection from legal challenge—including any assertion that the Rules may result in any unreasonable restraint of trade or impose any material anticompetitive burden on trading—that comes with affirmative Commission approval.

<sup>4</sup> Commission rule 40.5 contemplates a 45-day review period and authorizes the Commission to extend the review period for an additional 30 days if the rule submitted for approval “raises novel or complex issues.”

<sup>5</sup> In contrast to Regulation 701.01, the CBT has not requested Commission approval of the statement of policy. Rather, pursuant to Commission rule 40.6, the exchange has certified that the statement of policy complies with the Act.

To the contrary, if the CBT were to decide to terminate its agreement with the CME and enter into an agreement with another derivatives clearing organization, Regulation 701.01 would appear to authorize the CBT Board of Directors, simply by issuing a "statement of policy or other notice", to direct its clearing members to transfer all open positions to the new clearing organization. Such instructions could be issued without approval of the CBT clearing members or the prior review and approval of the Commission.

Financial integrity is a critical consideration for market participants in determining where to effect transactions. The clearing organization at which a transaction is cleared is an essential element in any analysis in this regard. Once cleared, a futures contract becomes a contract between the relevant clearing organization and clearing member. The exchange on which the contract is executed—the CBT in this instance—is not a party to the contract. Yet, Regulation 701.01 appears to grant the CBT the authority to abrogate the contractual relationships between CBT clearing members and the clearing organization. If a market participant cannot have confidence that its transactions, once entered into, will continue to be cleared by the same entity until liquidated, the resulting uncertainty and potential systemic risk will only weaken confidence in the markets. The Commission, therefore, should carefully consider whether, from a policy perspective, it should approve a rule that grants the CBT and any other exchange that adopts a similar rule such broad authority.<sup>6</sup> Further, the Commission should examine whether the CBT or any exchange has the authority, as a matter of law, to force the abrogation of such contracts and, as important, whether the Commission has the authority to approve a rule that would impair these contractual rights and obligations.

In addition, approval of this regulation would effectively mean that the Commission has concluded that an exchange has the unfettered right to determine where contracts traded on that exchange are cleared. For the reasons described above, this position is especially troubling in circumstances in which an exchange elects to replace the existing clearing organization. As the Commission is aware, this is a significant policy issue on which FIA has previously expressed its views. We respectfully submit that such an important issue, and indeed all of the policy issues arising under Regulation 701.01 discussed above, should not be resolved on a timetable that affords the public only three days in which to comment and the Commission less than one day to analyze the comments received and reach a resolution.

FIA is also concerned that the Commission and the public are being asked to review discrete aspects of the clearing link without having a complete understanding of all of the rights and obligations to which the exchanges and market participants generally would be bound. By approving discrete aspects of the link, the Commission may be foreclosing meaningful review of the link in its entirety.<sup>7</sup>

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<sup>6</sup> Approval of Regulation 701.01 would be a precedent that would bind the Commission in similar circumstances.

<sup>7</sup> In this regard, the Rules, among other things, implement the terms and conditions of the Clearing Services Agreement between the CBT and the CME. Although this agreement is apparently on file with the

Jean A. Webb  
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In order to assure that the Commission and the public will have sufficient time to consider the implications of the CBT-CME clearing link without interfering with the timetable that the exchanges have established for implementation of this link, FIA respectfully urges the Commission to encourage the CBT and CME to withdraw their respective requests for approval of the Rules and, instead, self-certify the Rules in accordance with Commission rule 40.6. The Commission should further encourage the exchanges to thereafter submit the relevant Rules for approval as authorized in Commission rule 38.4. The Rules could then be reviewed and considered in a more thoughtful way.

Thank you for your consideration of this request. If you have any questions concerning the views expressed in this letter, please contact me at (202) 466-5460.

Sincerely,

John M. Damgard  
President

cc: Honorable James E. Newsome, Chairman  
Honorable Barbara Pedersen Holum  
Honorable Walter L. Lukken  
Honorable Sharon Brown-Hruska

Jane K. Thorpe, Director  
Division of Clearing and Intermediary Oversight

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Securities and Exchange Commission, we understand that it has not been filed with the Commission. Our initial review of this agreement has raised a number of questions that we believe the Commission should address before the link receives final approval. The Clearing Services Agreement is certainly a "rule" as defined in Commission rule 40.1. Therefore, we assume that the exchanges will either submit the agreement for approval pursuant to Commission rule 40.5 or, in accordance with Commission rule 40.6, will file a written certification that the agreement complies with the Commodity Exchange Act.

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