RECE[illegible]
C.
2003 JUL 15 PM 3:11
RECORDS SECTION

03-8
(12)

July 14, 2003

Via E-Mail (Secretary@cftc.gov)

Ms. Jean A. Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

2003 JUL 15 PM 3:03
RECEIVED
C.F.T.C.

Re: CME/CBOT Common Clearing Link Proposed Exchange Rules

Dear Ms. Webb:

On July 8, 2003, the Commodity Futures Trading Commission (CFTC) requested comment on a request by the Board of Trade of the City of Chicago (CBT) and the Chicago Mercantile Exchange (CME) that the CFTC approve a number of CBT and CME rules to implement a CME/CBT common clearing link. Eurex files this letter in response to that request for comment.

Among these proposed exchange rules, proposed CBT Regulation 701.01 would compel each clearing member to comply with whatever notice the CBT may issue transferring open contracts between Board of Trade Clearing Corporation (Clearing Corporation) and its clearing members to "any Clearing Services Provider."

Eurex, the world's largest derivative exchange, has formed a U.S. subsidiary with the intention of operating a U.S. designated contract market under the Commodity Exchange Act. We have signed a Letter of Intent with the Board of Trade Clearing Corporation (Clearing Corporation) agreeing that Clearing Corporation will act as the Derivatives Clearing Organization (DCO) for Eurex's U.S. futures exchange. Under the Letter of Intent, the parties have also agreed that Eurex Clearing AG and Clearing Corporation will establish a clearing link. Accordingly, Eurex and its U.S. futures market would be affected by any CFTC action that would have an adverse impact on Clearing Corporation.

We believe that this rule raises significant legal and economic issues that require greater than a 4-day period for analysis and comment. Specifically: 1) Commission approval of an open-ended exchange rule having no parameters or guidance with respect to the exercise of exchange discretion is contrary to the Commodity Exchange Act, CFTC

rules and past administrative practice; 2) a trade execution facility such as the CBT lacks legal authority to abrogate private contractual relationships between an established DCO and its clearing members by compelling the liquidation or movement of open positions absent a market emergency; and 3) the CFTC is required to analyze the proposed CBT regulation under section 15 of the Act and an analysis of the anti-competitive impact of CBT Regulation 701under the factors of section 15(b) of the Act precludes the CFTC from approving it.

1. <u>CBT Regulation 701.01 cannot be approved because it is impermissibly vague.</u>

Commission rule 40.1 defines "rule" as any rule, regulation, resolution, or interpretation, in whatever form adopted and any amendment or addition thereto. The CFTC has long required that exchange resolutions or interpretations implementing general exchange regulations authorizing broad discretionary action also be treated as "rules" within the meaning of the definition of "rule." For this reason, the Commission has required that authorizing rules include parameters describing implementing procedures and limiting the discretion that can be exercised under the general regulation. The CFTC has never permitted such a broadly written provision as exchange Regulation 701.01 to be the basis for abrogating the terms of open contracts. Moreover, approving such an open-ended rule would have the effect of granting the CBT a "blank check" that would render the CFTC's rule approval authority meaningless.

This is particularly troubling with respect to futures and options on futures on agricultural commodities. As part of the amendments to the Act implemented by the Commodity Futures Modernization Act of 2000, Congress specifically expressed its intent that material changes to the terms and conditions of open contracts in such commodities remain subject to prior CFTC approval. Section 5(c)(c)(1)(B) of the Act. Were the CFTC to approve CBT Regulation 701.01, its approval would have the effect of nullifying the Congressional intent that agricultural interests have an opportunity to comment on the merits of any material change to open contracts on these commodities, by allowing the CBT discretion to alter the terms at will. In this instance, the legal problem is exacerbated by the fact the comment period for the open-ended rule is extremely short.

2. <u>A trade-execution facility may order the transfer of open interest only in a market emergency.</u>

One of the fundamental changes to the law that the CFMA made was requiring for the first time that clearinghouses must be separately licensed from exchanges and, concomitantly, granting independent statutory authority to the CFTC to oversee regulation of DCOs. As part of the CFMA's policy of addressing separately the functions of trade execution, clearing and intermediation, the Act clarifies the rights and obligations of each of these functions with regard to the others. In this regard, it is doubtful that the open interest at a clearinghouse, as a matter of law, can be unilaterally moved by a transaction execution facility acting alone and without the consent of the

parties to the open contracts at issue -- the clearing house and its members. The Act grants certain rights and places certain responsibilities on the execution facility with regard to contracts executed on that facility. However, once a transaction has been accepted for clearing and novation, the clearinghouse becomes the counterparty to every transaction, and the contra-side of every transaction is a clearing member. Generally, with one statutory exception, the Act does not grant the execution transaction facility the right to unilaterally affect the contracts between the clearing house and its members. That one exception is found in Core Principle 6, which requires that a transaction execution facility adopt an emergency authority rule to permit it to liquidate or transfer open positions. Thus, Congress implicitly recognized that a transaction execution facility retained such authority over open positions on a DCO only subject to a specific, pre-existing exchange rule and only in the *context of a market emergency.* The application of proposed CBT Regulation 701.01 to positions already open on the Clearing Corporation meets neither of these criteria.

3. <u>CFTC Approval of CBT Regulation 701.01 is inconsistent with section 15(b) of the Act</u>

Section 15(b) of the Act provides that

> The Commission shall take into consideration the public interest to be protected by the antitrust laws and endeavor to take the least anticompetitive means of achieving the objective of this Act . . . in approving any bylaws, rule or regulation of a contract market.

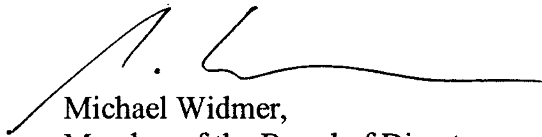
In examining the CBT and the CME's submissions under section 15, the Commission has to consider how empowering the CBT via the proposed Regulation 701.01 to compel clearing members to transfer their open contracts from one clearinghouse to another could possibly further the policies of the Act in the least anticompetitive means possible. The fact is that, on its face, the proposed regulation does nothing to further the purposes of the Act, and instead has a profoundly anticompetitive purpose and affect. CBT Regulation 701.01 is nothing more than an attempt by CBT to use its purported authority as a contract market to retain its monopolistic position in the market for U.S. Treasury futures contracts and to raise the already high barriers to new market entrants. Because of the high costs of reopening positions on a new facility that would re-establish the relationship with Clearing Corporation, this regulation would allow the CBT to arbitrarily force the open interest to move without customer choice. This could do much to undermine competition. And it does so without further any apparent legitimate purpose under the Act – and certainly cannot be justified as the least anticompetitive means of achieving any such legitimate purpose.

Eurex and its U.S. futures market do not object to CFTC approval of those proposed rule amendments that are actually necessary for the CBT and CME to implement their clearing link. However, the public's interest is ill served if, in the absence of a market emergency and merely as a tactical attempt to thwart the entrance of a competitor, a transaction execution facility is given the blanket authority to override a

DCO's existing rules and contractual agreements, and force the mass abrogation of existing contractual rights.

In light of these fundamental issues, among others, the comment period should be extended for an additional thirty days so that affected parties have an adequate opportunity to analyze and comment upon this proposal that raises such troubling legal and policy issues.

Respectfully submitted,



Michael Widmer,
Member of the Board of Directors
U.S. Exchange Holdings, Inc.

Michael McErlean,
Director
U.S. Futures Exchange, L.L.C.

Cc: The Honorable James E. Newsome
The Honorable Barbara Pederson Holum
The Honorable Walt Lukkens
The Honorable Sharon Brown-Hruska
Michael Gorham, Director Division of Market Oversight
Jane Kang-Thorpe, Director, Division of Oversight and Intermediary Oversight