COMMENT

08-9
(42)

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

Craig S. Donohue
Chief Executive Officer

January 5, 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: Proposed Rules for Trading Off the Centralized Market – 73 Fed. Reg. 54097 (Sept. 18, 2008)

Dear Mr. Stawick:

CME Group Inc. ("CME Group") appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "Commission") re-proposal with respect to amendments to Regulation 1.38, and Part 38, Appendix B guidance and acceptable practices for Core Principle 9 for Designated Contract Markets ("DCMs"), which states: "The board of trade shall provide a competitive, open, and efficient market and mechanism for executing transactions."

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 ("NYMEX"); and (4) the Commodity Exchange ("COMEX"). CME is also among the largest Derivatives Clearing Organizations in the world. CME Group serves the risk management needs of customers around the globe. As an international marketplace, CME Group brings buyers and sellers together on the CME Globex® electronic trading platform and on trading floors in Chicago and New York. CME Group offers 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, agricultural commodities, metals, and alternative investment products such as weather and real estate.

Background

On July 1, 2004, the Commission published a Notice of Proposed Rulemaking concerning Regulation 1.38 and guidance and acceptable practices with respect to DCM Core Principle 9 (the "July 1, 2004 NPRM"). In August 2004, CME and CBOT submitted comment letters as did the Futures Industry Association ("FIA") and several futures industry participants. On September 18, 2008, the Commission published a notice of proposed rulemaking that contains regulations, guidance and acceptable practices similar to what was proposed in the July 1, 2004 NPRM but with significant changes concerning (1) minimum size of block trades, (2) block trades between affiliated parties, and (3) exchanges of futures for a commodity or derivatives position, including transitory exchanges of futures for a commodity or

derivatives position ("transitory EFPs"). We comment on each of these areas below. We also comment on the Commission's proposed acceptable practices concerning testing of automated trading systems and several additional matters addressed in the proposed amendments to Regulation 1.38. We note that, in the current request for comment, the Commission took care to emphasize that acceptable practices are intended to "assist DCMs by establishing non-exclusive safe harbors." 73 FR 54098. The Commission also drew attention to the introduction to Appendix B to Part 38, which "makes it clear" that the acceptable practices in Appendix B are not the sole means of achieving compliance with the Commodity Exchange Act ("CEA"). *Id.*

Block Trades

1. Minimum Sizes of Block Trades

(a) The Commission's proposed methodology for determining the minimum sizes of block trades for established contracts is generally appropriate as one non-exclusive approach.

In its July 1, 2004 NPRM, the Commission proposed that an acceptable minimum size for block trades would be at a level larger than 90% of the transactions in the relevant market, or for new contracts with no relevant market, 100 contracts. CME's and CBOT's comment letters explained that these proposed thresholds were arbitrary and unresponsive to market needs. CME further observed that such a high level of prescription "is not consistent with the purposes of the Core Principles, and would contravene Congress' intent "to transform the role of the [Commission] to *oversight* of the futures markets." Pub. L. 106-554, 114 Stat. 2763 (2000) (emphasis added)."

In response to these and other comments, the Commission determined that "the acceptable practices will not set forth an explicit threshold, but will instead leave it to the DCMs to determine appropriate minimum sizes," based on the purpose for allowing block trades.[1] 73 FR 54100. We appreciate the Commission's recognition that multiple factors are relevant to the determination of an appropriate minimum block trade size and that such minimum sizes will vary among products. The Commission has also acknowledged that what may be considered a "large trade" may vary "even over time". 73 FR 54100. We believe that these differences may occur, for example, depending on how much time remains until the expiration of the relevant contract as well as the time of the trading day.

The Commission's current proposed guidance for compliance with Core Principle 9 provides that in determining the appropriate minimum size for block trades, DCMs should limit block trades to "large transactions" and ensure that the minimum size is appropriate for each specific contract. The proposal

[1] The proposed rulemaking states that block trades are allowed to be transacted off the centralized market because: (1) "the centralized market may not provide sufficient liquidity to execute large transactions without a significant risk premium"; and (2) "block trading facilitates hedging by providing a means for commercial firms to transact large orders without the need for significant price concessions and resulting price uncertainty for parties to the transaction that would occur if transacted on the centralized market." 73 FR 54099. CME Group agrees with these uses of block trades and further notes that other commercial needs may be met by use of block trades, such as the simultaneous execution of complicated hedging strategies, such as various calendar spread trading strategies.

seeks to apply the following principles to contracts that have been trading for one calendar quarter or longer:

> . . . the acceptable minimum block trade size should be a number larger than the size at which a single buy or sell order is customarily able to be filled in its entirety at a single price in that contract's centralized market. Factors to consider in determining what constitutes a large transaction could include an analysis of the market's volume, liquidity and depth; a review of typical trade sizes and/or order sizes; and input from floor brokers, floor traders and/or market users.

73 FR 54104.

CME Group believes that the Commission's formulation appropriately describes one of the non-exclusive definitions of, and non-exclusive factors which may be considered in determining, an appropriate minimum block trade size for established contracts. Moreover, the Commission has appropriately recognized, in its Federal Register release, that a block trade should be permitted where an order is so large that the prices at which the order could be executed in the centralized market "may diverge from prevailing market prices that reflect supply and demand" and tend "to reflect, to a significant degree, the cost of executing the trade", which would ultimately result in the reporting of prices that would be misleading to the public. 73 FR 54099.

> *(b) The Commission's proposed methodology for determining the appropriate minimum size of block trades for new contracts may not be appropriate for certain new or novel contracts for which more significant trading off the centralized market should be permitted.*

For new contracts, which the Commission generally defines as those which have been listed for trading for less than one calendar quarter, the Commission has stated that an acceptable minimum block trade size should be the size of trade that the exchange "reasonably anticipates" will not be able to be filled in its entirety at a single price in the centralized market. The Commission has proposed guidance with respect to how a DCM may estimate an appropriate minimum size for block trades in new contracts. Specifically, the Commission has indicated that a DCM may consider market data for a related futures contract, the same contract traded on another exchange, or an underlying cash market, as well as the anticipated volume, liquidity and depth of the contract, input from potential market users and the DCM's experience with offering similar new contracts. The proposed acceptable practices also state that if an exchange has no reasonable basis upon which to estimate an initial minimum size, a minimum block trade size of 100 contracts would be appropriate. In the event that a DCM were unable to estimate an initial minimum size, we understand that 100 contracts is not the only minimum block trade size that a DCM could set for such contracts, consistent with the Commission's position that the proposed acceptable practices are non-exclusive safe harbors, and do not set forth the only means of complying with Core Principle 9. However, we remain concerned that because a number is specified it may tend to be interpreted as a prescription.

(c) Any DCM listing a particular contract should set its block trade threshold size at the level which would constitute an appropriate minimum size for block trades on the most liquid DCM which lists a substantially identical contract.

The Commission has stated in a footnote in the notice of rulemaking that the proposed guidance regarding threshold size for block trades "could result in different DCMs arriving at different minimum size requirements for the same or similar futures contracts, if the liquidity and volume on each DCM is different." 73 FR 54100, fn. 14. We believe that, where the Commission's suggested formulation is being relied upon by a DCM for purposes of falling within the acceptable practices safe harbor, a DCM should be required to set its minimum block trade size at a level that would be appropriate for the most liquid substantially identical contract that is trading on any centralized DCM market. Indeed, it appears that, in its July 1, 2004 NPRM, the Commission may have adopted the view that trading in all markets offering similar contracts should be considered, by defining the "relevant market" as "the subject futures or options market, *any related derivatives market*, and/or the underlying cash market, as appropriate." (Emphasis added). 69 FR 39885.

In addition, as noted above, the currently proposed guidance states that a DCM could estimate an appropriate minimum block trade size for new contracts based on market data relating to the same contract traded on another exchange. If a DCM were permitted to set a minimum size for block trades in a contract that it is newly listing, without considering available information about trading activity in a substantially identical liquid market on another DCM, it could impair the usefulness of the price discovery information being provided by the previously listing DCM by setting its own threshold too low. It should be noted that we are not suggesting that if a DCM sets a higher block trade size than what the guidance defines as an appropriate minimum, any DCM that subsequently lists a substantially identical contract must adopt that higher threshold. Rather, in order to receive safe harbor treatment, any DCM listing a particular contract should be required to set its block trade threshold size at the level which would constitute an appropriate minimum size for block trades in the most liquid substantially identical contract on any DCM, to the extent that it is able to determine such appropriate minimum size.[2]

(d) Annual reviews of minimum block trade size thresholds would be appropriate.

The Commission proposes as an acceptable practice that a DCM should review its minimum size thresholds "no less frequently than on a quarterly basis to ensure that the minimum size remains appropriate for each contract." No justification is provided for requiring reviews of minimum size thresholds every three months, which we believe is far too frequent. Shifts in volume, liquidity and market depth of a contract that may impact the size of trades that could move a market typically do not occur over such a short time period. Furthermore, a DCM may have different minimum size thresholds in the same product for different times of day, different contract months, and/or different types of trades. Quarterly reviews of thresholds would entail a substantial amount of unnecessary work for DCMs, and the specter of frequent changes to minimum size thresholds may result in confusion in the marketplace. Simply put, the significant and real costs of regulatory compliance with such a condition far outweigh any

[2] A DCM that is newly listing a contract should not be held to an unreasonable standard if it does not, in fact, have access to sufficient relevant information to determine what minimum block trade size would be appropriate for the DCM listing the substantially identical contract.

perceived hypothetical benefit from such a frequent review. For all of these reasons, CME Group believes that annual reviews of minimum size thresholds would be appropriate.

In the last sentence in Section (a)(3)(i) of the proposed guidance, the Commission states that its proposed periodic review of the minimum size thresholds for block trades should take into account the sizes of trades in, and the volume and liquidity of, the centralized market. However, earlier in that section, in discussing the initial determination of what constitutes a large transaction, the Commission states that it "could include an analysis of the market's volume, liquidity and depth; a review of typical trade sizes and/or order sizes; and input from floor brokers, floor traders and/or market users." Rather than adding potential confusion by implying that, upon periodic review of the thresholds for block trades, the sole acceptable considerations are the sizes of trades in the centralized market and the volume and liquidity of that market, the Commission should delete the last sentence in Section (a)(3)(i) and modify the penultimate sentence to add a clause that refers back to the same factors that could be considered in determining the initial appropriate size for block trades in the relevant contract.

2. Block Trades Between Affiliated Parties

(a) The same acceptable practices should apply to all block trades regardless of whether they are between affiliated or non-affiliated parties.

The Commission has stated that block trades between affiliated parties require appropriate measures to guard against "the heightened possibility that transactions between two closely related parties are more susceptible to abuse, such as setting unreasonable prices, artificially boosting volume, money passing or wash trading." 73 FR 54100. The Commission therefore proposes to amend Regulation 1.38 by adding new subsection (b)(2), which states:

> (2) *Block trades between affiliated parties; requirements.* An affiliated party is a party that directly or indirectly through one or more persons, controls, or is controlled by, or is under common control with another party. In addition to the other requirements of this section, block trades between affiliated parties are permitted only in accordance with written rules of a contract market that provide that:
>
> (i) The block trade price must be based on competitive market price, either by falling within the contemporaneous bid/ask spread on the centralized market or calculated based on a contemporaneous market price in a related cash market;
>
> (ii) Each party must have a separate and independent legal bona fide business purpose for engaging in the trades, and
>
> (iii) Each party's decision to enter into the block trade must be made by a separate and independent decision-maker.[3]

[3] Regulation 1.38 is referenced in proposed acceptable practices for Core Principle 9, which provide that: (1) "Contract market rules could permit block trades between affiliated parties that meet the requirements of Regulation 1.38 and are otherwise appropriate parties"; and (2) "Block trades between affiliated parties are subject to the pricing requirements of § 1.38(b) of this chapter." 73 FR 54105.

73 FR 54104.

CME Group believes that a separate rule for block trades between affiliates such as proposed Regulation 1.38(b)(2) is unwarranted. The better and more consistent approach would be to apply the proposed acceptable practices for block trades between non-affiliates to block trades between affiliated parties. Those proposed acceptable practices require that block trades be conducted at a "fair and reasonable" price. 73 FR 54105. The proposed acceptable practices do not purport to dictate what prices will be considered "fair and reasonable", but they provide that "[c]onsideration of whether a block trade price is fair and reasonable could take into account", among other things, "the parties to the block trade." *Id.* This is consistent with the language of DCM rules that require block trades to be executed at a "fair and reasonable" price in light of, among other things, "the circumstances of the markets or the parties to the block trade."[4]

Proposed Regulation 1.38(b)(2)(i), on the other hand, narrowly specifies that the price of a block trade between affiliates must either fall within the contemporaneous bid/ask spread on the centralized market or be based on a contemporaneous market price in the related cash market. Such a highly prescriptive regulation may effectively deny affiliated parties the ability to enter into valid transactions that are available to other market participants that are not affiliates. Such an unintended consequence can be avoided by applying the same proposed acceptable practices to all block trades. DCM surveillance systems can be and are currently being used to determine whether the price of a block trade is not fair and reasonable, and whether any trade practice violations such as wash trading have occurred in connection with a block trade, whether between affiliated or non-affiliated parties. For these reasons, we urge the Commission not to adopt proposed Regulation 1.38(b)(2).

(b) The proposed acceptable practices on recordkeeping for block trades between affiliates are impracticable and should not be adopted.

The Commission proposes to add the following acceptable practices concerning recordkeeping for block trades: (1) "Block trade orders must be recorded by the member and time-stamped ... *and must indicate when block trades are between affiliated parties*"; and (2) "The contract market should identify block trades as such on its trade register, *and should identify when block trades are between affiliated parties.*" 73 FR 54105. (Emphasis added.) However, as explained in the FIA's comment letter regarding the July 1, 2004 NPRM:

> ... it is important to understand that an FCM would often find it impossible to indicate at the time a block order is placed that the transaction is between affiliates. The affiliated status of parties to a block transaction is not always evident to the traders responsible for effecting the transaction. Affiliate relationships may not be apparent from the names of the clients. In addition, traders employed by large institutional investment advisers do not always know the exact legal entity for which they are trading. For instance, a trader may only know an account number. This is particularly true in a give-up situation. Practically, an FCM cannot investigate the identity of each party to a block transaction and their possible relationship before submitting the transaction for posting within the short time frames required by exchange rules.

[4] *See, e.g.,* CBOT Rule 526D, CME Rule 526D, COMEX Rule 104.36C(4).

In preparing the trade register, a DCM necessarily relies on information furnished by FCMs. For that reason, block trades between affiliates that cannot be identified as such by an FCM also cannot be identified as such by a DCM on the trade register. The Commission notes in its proposal that acceptable practices serve as "examples of how exchanges may satisfy particular requirements of the Core Principles" and "are intended to assist DCMs by establishing non-exclusive safe harbors." 73 FR 54098. The proposed acceptable practices on recordkeeping for block trades between affiliates (which are set forth above in italics) are not achievable. In short, they would create safe harbors that cannot be reached. Accordingly, these proposed acceptable practices should not be adopted.

Exchange of Futures for a Commodity or for a Derivatives Position

The Commission has proposed detailed acceptable practices with respect to exchanges of futures for a commodity or derivatives position (together "EFPs"). These acceptable practices expand upon and modify the acceptable practices that the Commission had proposed in its July 1, 2004 NPRM. CME Group commends the Commission for clarifying, consistent with existing CME and CBOT rules, that a DCM may permit a third party to facilitate the purchase and sale of the commodity or derivatives leg of an EFP, if the commodity or derivatives position is passed through to the party that receives the futures position. We suggest several modifications to other elements of the Commission's proposal as it relates to EFPs, as described below.

(a) A requirement that at least one leg of an EFP should be priced at the prevailing market price is unduly restrictive.

The proposed acceptable practices state that "[t]he price differential between the futures leg and the commodities leg or derivatives position should reflect commercial realities, and at least one leg of the transaction should be priced at the prevailing market price." Current CME, CBOT and NYMEX rules and/or compliance policies require that EFPs must be executed at commercially reasonable prices that are mutually agreed upon by the parties to the transaction and do not require that one leg must be priced at the prevailing market price as proposed by the Commission. We do not believe that there should be any such requirement.

The effective price of an EFP is clearly the price differential between the component legs of the transaction rather than the specific prices of each component leg. The futures legs of most EFPs are priced within the applicable daily trading range. However, there may be commercially appropriate reasons for pricing the legs of an EFP at prices other than the prevailing market price at the time of the transaction, just as there are with futures spread transactions for which the component legs are frequently priced away from the prevailing market. Market participants should retain flexibility in pricing the legs of an EFP as long as the price differential reflects commercial realities. The proposed acceptable practices, as well as existing DCM rules, already require that an EFP must be bona fide, and the market surveillance programs utilized by DCMs are capable of identifying aberrantly priced EFPs for further investigation regarding whether they are bona fide.

(b) Transitory EFPs should be permitted if they meet the conditions specified in existing DCM rules.

The Commission's proposed acceptable practices also provide that a transitory EFP (which "involves both an EFP and an offsetting cash commodity transfer", 73 FR 54101) is permissible when each part of the

transaction – the EFP itself and the related cash transaction – is a standalone, bona fide transaction. That is, "[t]he cash transaction must be able to stand on its own as a commercially appropriate transaction, with no obligation on either party that the cash transaction be dependent upon the execution of the related exchange of futures for commodities or for derivatives positions, or vice versa." 73 FR 54106.

For many years, DCMs have permitted transitory EFPs in defined circumstances and subject to certain conditions. For example, CME and CBOT Rule 538 (Exchange of Futures for Related Positions (EFRPs)) set forth the requirements for EFPs.[5] This rule does not specifically address transitory EFPs. However, CME Group Market Regulation Advisory, CME & CBOT RA0815-3 (Exchange of Futures for Related Positions) (September 8, 2008), contains the following Question and Answer[6]:

> Q17: Are transitory EFRPs permitted?
>
> A17: Transitory EFRPs in which two parties execute an EFRP and subsequently execute an economically offsetting cash, swap or OTC transaction with each other are prohibited except as noted below.
>
> Transitory EFPs are permitted in CME Currency futures subject to the following requirements:
>
> a) The seller of the futures contract must simultaneously purchase the cash commodity and the buyer of the futures contract must simultaneously sell the cash commodity.
>
> b) All documents typically generated in accordance with cash market conventions must be generated and retained.
>
> c) The execution time of the EFP must be recorded on the order ticket and, upon submission of the EFP for clearing, on the order entry screen.
>
> d) All other Exchange and CFTC requirements regarding EFP transactions must be adhered to in connection with the transaction.

Transitory EFPs were also permitted in CBOT metals contracts prior to the transition of those contracts to NYSE Liffe, and transitory EFPs are currently permitted for NYMEX and COMEX products. CME Group appreciates the Commission's recognition that there are circumstances in which transitory EFPs may be appropriate. Transitory EFPs can serve customers' needs in a number of markets, such as those for currencies and metals, because of the nature of the related cash markets.

---

[5] The CME and CBOT definition of an EFRP includes Exchanges for Physicals and Exchanges for Risk (swaps and other OTC instruments). Therefore, it is consistent with the Commission's definition of an exchange of futures for commodities or for derivatives positions, which are referred to herein for ease of reference as EFPs.

[6] Although a transitory EFRP is described in Question A17, for illustrative purposes, as a transaction in which two parties execute an EFRP and subsequently execute an economically offsetting cash, swap or OTC transaction, it was not meant to exclude a transaction in which a cash, swap or OTC transaction was executed prior to the EFRP and was subsequently offset by the cash, swap or OTC component of the EFRP.

We believe that it is sufficient for the acceptable practices to simply require that the related cash transaction that offsets the cash leg of the EFP must involve an actual transfer of ownership of the commodity or derivatives position and that the EFP itself must be bona fide, consistent with the existing CME and CBOT Market Regulation Advisory. In its October 1, 1987 Report on Exchanges of Futures for Physicals (1987 EFP Report), the Commission's former Division of Trading and Markets stated that:

> Also relevant to the inquiry is whether the parties are obligated to complete both the cash transfer and the EFP (i.e., whether the transfer of title is conditioned on the execution of another contract, the EFP). The existence of conditions tying the EFP and cash transfer together *may* indicate that the cash transfer cannot stand on its own and that title was not transferred in the initial cash transfer. (Emphasis added).

1987 EFP Report, pg. 198. This language correctly indicates that such obligations may, but need not always, lead to the conclusion that the related cash transaction was not bona fide. Other factors, such as the generation of documents typical of cash market conventions, as required by CME, CBOT and NYMEX, may provide evidence that the cash transfer is a commercially appropriate transaction that involves a legitimate transfer of title. Therefore, the Commission should delete the language that categorically states that there may not be any obligation on either party that the cash transaction be dependent on the execution of the related EFP.

Testing of Automated Trading Systems

Current guidance for Core Principle 9 provides that "information gathered by analysis, oversight or *any program of objective testing* and review of any automated systems regarding system functioning, capacity and security should be made available to the Commission." (Emphasis added.) The Commission proposes to move this provision to acceptable practices for electronic trading systems and to revise the language to state: "Information gathered by analysis, oversight or *any program of testing* and review of any automated systems regarding system functioning, capacity and security should be made available to the Commission." 73 FR 54105 (Emphasis added). The Commission describes this provision as applying to "test results of any 'non-objective' testing carried out by or for a DCM (such as informal in-house reviews) regarding the system functioning, capacity or security of any automated trading systems." 73 FR 54103. It appears that the revised provision merely encompasses any periodic non-objective testing designed to accomplish the same goals as the objective testing referenced in existing guidance. However, it would be helpful if the Commission would clarify the scope of the non-objective testing it believes should be made available to the Commission.

Other Matters Addressed in the Proposed Amendments to Regulation 1.38

(a) *A DCM should be permitted to self-certify rules that relate to trading off the centralized market except in circumstances where it wishes to adopt a minimum block trade size that is lower than the minimum block trade size that is appropriate for another DCM that lists a substantially identical contract.*

Regulation 1.38 currently permits the non-competitive execution of transactions pursuant to exchange rules that have been approved by the Commission. The Commission has proposed to modify Regulation 1.38 to explicitly permit DCMs to self-certify any rules or rule amendments that relate to trading off the centralized market. We support this amendment to the extent that such self-certified rules comply with

Core Principle 9. However, if the Commission chooses not to adopt the position that we have discussed above with respect to substantially identical contracts traded on multiple DCMs, we believe that the Commission should continue to require pre-approval in certain limited circumstances. In particular, if a DCM wishes to set a low block trade threshold with respect to a contract that is new to that DCM, while another DCM has a liquid market in a substantially identical contract, without regard to the higher minimum block trade threshold that is appropriate for the liquid market, the Commission should conduct a prior review of that threshold. In such a case, we believe that Commission approval is necessary to ensure that such a proposed minimum block trade size will not impair the usefulness of the price discovery information being provided by the established market.

(b) The Commission should make it clear that its inclusion of "inter-exchange spread transactions" in the list of transactions that may be executed off the centralized market is not intended to legitimize certain transactions that are explicitly prohibited by existing DCM rules.

The Commission has also proposed to expand the list of transactions that may be executed off the centralized market, pursuant to rules that have been certified to or approved by the Commission, to include "inter-exchange spread transactions". This type of transaction was not listed in the proposed amendments to Regulation 1.38 contained in the July 1, 2004 NPRM, and the Commission has not provided any explanation for this addition. We request that the Commission clarify that this language is not intended to legitimize certain transactions that are explicitly prohibited by existing DCM rules. For example, as described in the Answer to Question 16 in CME Group Market Regulation Advisory, CME & CBOT RA0815-3 (Exchange of Futures for Related Positions)(September 8, 2008):

> Two parties may not execute contingent EFRPs in which the execution of one EFRP transaction is contingent upon the execution of another EFRP transaction and the cash, swap or OTC transactions related to the two EFRPs economically offset. Such transactions are considered to be prearranged futures trades that circumvent the open market execution requirement.
>
> For example . . . two parties are prohibited from executing an EFRP on the CME or CBOT and a contingent EFRP on another exchange in which the related position transactions of the two EFRPs economically offset.

The Commission should make it clear that any permissible "inter-exchange spread transactions" would only include actual spread transactions that are allowed by the rules of both affected exchanges.

Additional Issues

The Commission has taken the position that off-exchange transactions should not become the exclusive or predominant method of trading in a DCM market. However, there are certain new or novel products for which more significant off-exchange trading may be appropriate. Some innovative new products, particularly those that do not have organized underlying cash markets, may not be conducive to primarily trading on a centralized market. By permitting such products to trade off-exchange in accordance with DCM rules that have been certified to or approved by the Commission, the Commission would ensure that market participants would receive the benefits of a regulated DCM and of clearing by a Derivatives Clearing Organization ("DCO"). For example, the price discovery mechanism would be enhanced by providing the transparency that may not exist in related over-the-counter markets. Furthermore, DCMs should not be placed at a competitive disadvantage with various European exchanges that list competing

products where market participants have shown a clear business preference for much of the volume to be executed off the centralized trading platform. Therefore, the Commission should allow DCMs to retain the flexibility to list products that are not primarily traded on the centralized market in order to meet certain purposes of the CEA to both ". . . promote responsible innovation and fair competition among boards of trade, other markets and market participants." Section 3(b) of the CEA.

As a related matter, CME Group exchanges currently list certain products for clearing for which a significant percentage of transactional volume is submitted for clearing via EFP transactions. CME Group has been involved in continuing discussions with Commission staff in connection with the Commission's consideration of the appropriate regulatory treatment of cleared-only products. The issues which CME Group has been discussing with Commission staff are inter-related with a number of the issues raised by the Commission's current proposal. Therefore, we would strongly encourage the Commission not to adopt any amendments to Regulation 1.38 or Core Principle 9 guidance and acceptable practices until these matters have been resolved, in order to eliminate potential confusion in the marketplace.

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; Richard Lamm, Managing Director, Chief Regulatory Counsel, at (312) 930-2041 or Richard.Lamm@cmegroup.com; Lisa Dunsky, Director and Associate General Counsel, at (312) 338-2483 or Lisa.Dunsky@cmegroup.com; or Anne Polaski, Associate Director and Regulatory Counsel, at (312) 338-2679 or Anne.Polaski@cmegroup.com.

Sincerely,

Craig S. Donohue

Craig S. Donohue
Chief Executive Officer
CME Group Inc.

cc: Acting Chairman Walter Lukken
Commissioner Bart Chilton
Commissioner Michael Dunn
Commissioner Jill E. Sommers
Ananda Radhakrishnan
John Lawton
Richard Shilts
David Van Wagner
Gabrielle Sudik