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COMMENT

VIA ELECTRONIC MAIL

David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
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Washington, DC 20581
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Re: **Proposed Rules for Significant Price Discovery Contracts on Exempt Commercial Markets
– 73 Fed. Reg. 75888 (December 12, 2008)**

Dear Mr. Stawick:

CME Group, Inc. ("CME Group") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or the "Commission") proposed rulemaking ("Proposal") with respect to **Significant Price Discovery Contracts ("SPDC") on Exempt Commercial Markets ("ECM")**. In its Proposal, the CFTC set forth proposed new rules to implement the CFTC Reauthorization Act of 2008 ("Reauthorization Act"). **The Commission also proposes to amend existing regulations for registered entities to clarify that such regulations will be applicable to ECMs with SPDCs.**

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 designated contract markets ("DCM")**: (1) the Chicago Mercantile Exchange ("CME"); (2) the Chicago Board of Trade ("CBOT"); (3) the New York Mercantile Exchange, Inc. ("NYMEX"); and (4) the **Commodity Exchange, Inc. ("COMEX")**. CME is also among the largest Derivatives Clearing Organizations ("DCO") 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, emissions, agricultural commodities, metals, and alternative investment products such as weather and real estate.

Background

The CFTC sets the stage for its proposed new rules and proposed Guidance on Significant Price Discovery Contracts ("Guidance") by setting out a detailed background. In its review, the CFTC summarizes the multi-tiered regulatory scheme for trading facilities provided by the landmark Commodity Futures Modernization Act of 2000 ("CFMA"); the changing ECM landscape; the CFTC's oversight of ECMs, its ECM empirical study and its subsequent ECM hearing; and finally the Commission's legislative recommendations that led to the Reauthorization Act. Given the new regulatory structure that is set forth in the Proposal, which distinguishes between SPDCs that are cleared and those that are uncleared, there is merit in reviewing the background on this point.

Congress determined to amend the Commodity Exchange Act ("CEA") because a broad consensus developed within the derivatives community as well as within Congress that when a contract traded on an ECM matured and began to serve a significant price discovery function for transactions in commodities in interstate commerce:

"the contract warranted increased oversight to deter and prevent price manipulation or other disruptions to market integrity, both on the ECM itself and in any related futures contracts trading on DCMs. Such increased oversight would also help to ensure fair competition among ECMs and DCMs trading similar products and competing for the same business." (Proposal at 75891.)

This concern respecting market manipulation and other disruptions to market integrity applies regardless of whether a transaction in a SPDC is cleared or uncleared.

The CFTC's background discussion briefly summarized a study by the CFTC's Office of Chief Economist ("OCE"). That study reviewed the relationship between natural gas contracts trading on ICE¹ and NYMEX. OCE collected transaction prices for ICE and NYMEX natural gas contracts between January 3, 2006, and December 31, 2006, and evaluated trading for 12 separate contract months in each market. OCE concluded that, based on the data reviewed, both ICE and NYMEX are significant price discovery venues for natural gas futures contracts. OCE's study focused on all price activity in the relevant ICE natural gas contract and did not restrict its analysis to cleared trades in that contract.

¹ As noted in the Proposal, "Intercontinental Exchange, or ICE, consists of four separate entities: ICE OTC, to which this document refers, is an ECM trading energy products. ICE Future Europe trades energy futures and is regulated by the Financial Services Authority of Great Britain; ICE Futures US focuses primarily on futures based on soft commodities (e.g., coffee, sugar, cocoa, cotton) and financial futures and is regulated by the CFTC; ICE Futures Canada trades futures and options and is regulated by the Manitoba Securities Commission." n .19 at 75889.

Furthermore, when the CFTC undertook increased surveillance of trading of certain ICE natural gas swap contracts, the Commission did not limit itself to reviewing activity in cleared trades in such products. Indeed, in the second of three special calls that the CFTC issued to ICE, the Commission specifically sought individual trader position data in addition to the positions held with clearing members, which had been requested in the first special call.

Following the CFTC's September 18, 2007, hearing, the Commission subsequently published a report in October 2007, the Report on the Oversight of Trading on Regulated Futures Exchanges and Exempt Commercial Markets ("ECM Report"), setting forth its findings and legislative recommendations. Among the four recommendations in that report, with regard to an ECM contract determined to perform a significant price discovery function, the CFTC recommended that such contracts be subject to large trader reporting requirements and, as appropriate, position limits or accountability levels comparable to requirements on DCM contracts. The CFTC did not restrict such recommendations to cleared trades but made them applicable to all activity in the ECM contract.

Congress did not limit the requirements on SPDCs to cleared contracts; it gave the CFTC flexibility and discretion with regard to the scope of these new requirements.² It is reasonable to conclude that the flexibility granted to the CFTC was to be exercised in accordance with the findings of the ECM Report as well as with the testimony by CFTC officials. Nothing presented to Congress by the CFTC suggested that regulation of SPDCs should be limited to those trades that were cleared. To the contrary, a case was presented to Congress that narrowing position limit rules to cleared trades would create a loophole and encourage market participants to avoid the position limits and other requirements by choosing not to clear transactions.

In light of the above, this comment letter will focus principally on the position limit/level and large trader reporting requirements set forth in the Proposal. These new requirements go to the very heart of the new obligations that Congress has imposed on ECMs.

² Pursuant to paragraph (D) of new Subsection (7) of Section 2(h), Congress merely provided that the Commission shall "take into consideration the differences" between cleared and uncleared trades when reviewing the implementation of the Core Principles by an electronic trading facility. This consideration is reasonable given that the CFTC's previous experience with such requirements only related to contracts executed on a DCM that are required to be cleared on a DCO. Thus, the imposition of requirements on uncleared trades and monitoring of the implementation of such requirements is an issue of first impression for the Commission. Similarly, while Paragraph (C)(ii) of Subsection (7) gives the electronic trading facility reasonable discretion, including with respect to cleared and uncleared trades, in establishing the manner of compliance with the core principles, this discretion was only intended to provide the same general level of discretion available to DCMs operating under a Core Principles oversight regime.

Position Limits and Accountability Levels

We commend the Commission on a number of aspects of the proposed acceptable practices for compliance with Core Principle IV (POSITION LIMITATIONS OR ACCOUNTABILITY). We agree with the CFTC that for an SPDC in an exempt commodity, it will be necessary to have hard speculative position limits in the spot month and position accountability levels should be established for non-spot individual months and for all months combined. We also agree that an ECM that lists a SPDC that is "economically equivalent" to another SPDC or to a contract traded on a DCM should set the spot month limit for its SPDC at the same level as that in place for the economically equivalent contract. Finally, we agree that the ECM should have account aggregation rules in place for SPDCs that apply to accounts under common ownership or control or that are traded according to an express or implied agreement.

That stated, we have grave concerns with regard to the proposed guidance in Appendix B for compliance with Core Principle IV that would only require spot month limits for cleared trades. For uncleared trades, the CFTC is proposing to require a "volume accountability level" ("VAL"). Under the terms of the Proposal, the VAL would need to be set by the ECM at the same level as the spot month limit. Other than the new name or reference, it appears that a VAL otherwise would operate in the same manner as a position accountability level.³ While the ECM would have a general duty to monitor the VAL, there is no requirement anywhere in the Proposal that provides for any interaction between the monitoring of the cleared trades under the hard limit and the monitoring of the uncleared trades under the more flexible VAL.

The Commission states that "[u]ncleared transactions in SPDCs potentially play an important role in risk management strategies and price formation." (emphasis added.) p. 75896. However, there is no analysis or explanation describing why this role is only a potential one. When a trade in a SPDC contract is executed on an ECM, the price information on that trade generally is made available to other eligible commercial entities ("ECE") qualified to trade on that platform on a real-time or near real-time basis. The ECM does not delay distributing this information on an executed trade until there is clarification as to whether or not a particular trade will be cleared. It is reasonable to presume that the ECM does not utilize such a delay because the later status (of whether a trade is cleared or uncleared) has no real bearing on the value to the market of the price information reflected in that trade. Consequently, the distinction being

³ In this regard, the Proposal provides that "the electronic trading facility should initiate an investigation to determine whether the individual's trading activity is justified and is not intended to manipulate the market" and that "as part of its investigation, the electronic trading facility should inquire about the trader's rationale for holding a position in excess of the accountability levels." p. 75916. Historically, DCMs have had broad discretion in initiating inquiries once an accountability level has been exceeded; this flexibility is reflected in the relevant DCM rules. For example, NYMEX Rule 9.26(A)(1) requires, *inter alia*, any person who owns or controls positions in excess of the prescribed levels to "promptly supply to the Exchange such information as the Exchange may request. . ." (emphasis added.). While we believe that SPDCs on ECMS should be subject to comparable standards to those applicable for DCMs, we do not believe that they should be subject to heightened standards exceeding those imposed on DCMs.

advanced for the first time in the Proposal between cleared and uncleared trades is clearly at odds to and inconsistent with the CFTC's prior analysis and guidance to Congress.

The spot month limits set by rule by DCMs are typically determined in close consultation with CFTC staff prior to the filing of the applicable rule amendments. In general, the guidance from CFTC staff has been that, absent the approval of a hedge exemption from the spot month limit, any position in excess of the established position limit is deemed by the CFTC to be of sufficient market integrity concern that such a position must be regarded as a rule violation necessitating an SRO response to deter any further instances of exceeding that specified position limit quantity.

Yet, under the Proposal, even without an ECE obtaining a hedge exemption from the ECM, the ECE automatically would be able to maintain open positions in the SPDC that would be at least double the size of what otherwise would be permissible for the "economically equivalent" contract on a DCM. Moreover, as long as the ECE could present some evidence to the ECM that it was not intending to manipulate the market, it would be permitted to maintain an even larger number of positions without a hedge exemption. Cleared and uncleared trades are all in the same SPDC and pose the same market integrity concern. However, because the Proposal would establish a lesser standard for one category of SPDCs, the CFTC seems to be signaling that market integrity is of lesser interest for these contracts. We disagree.

Congress passed the Reauthorization Act because it understood that, once a contract was deemed to be a SPDC, such a contract raised the same level of market integrity public policy interests and concerns as contracts traded on a DCM. However, under the approach set forth in the Proposal, the standards in effect at an ECM for a SPDC would be inherently more lax than the requirements applicable for a contract trading on a DCM. The proposed approach perpetuates the tilted competitive field that provided an incentive for market participants to shift trading activity from the regulated DCM to the unregulated and less transparent ECM. It also impairs the ability of DCMs to fulfill their responsibilities to prevent market distortions.

In August of 2006, NYMEX proactively took steps to maintain the integrity of its markets by ordering Amaranth to reduce its open positions in the Natural Gas futures contract. Amaranth did so, but Amaranth then sharply increased its positions on the unregulated and nontransparent ICE electronic trading platform. Because the ICE and NYMEX trading markets for natural gas are tightly linked components of a broader natural gas derivatives market, Amaranth's response to NYMEX's regulatory directive did not reduce Amaranth's overall market risk nor the risk of Amaranth's guaranteeing clearing member. Furthermore, the integrity of NYMEX markets continued to be affected by and exposed to Amaranth's outsized positions in the natural gas market. Moreover, NYMEX had no efficient means to monitor Amaranth's positions on ICE or to take steps to require Amaranth to reduce its participation in that trading venue.

Under the Proposal, an ECM would be required to establish a spot month limit on cleared positions. Nonetheless, as noted previously, the Proposal also would in effect allow ECEs to begin with positions that could be at least double of those that could be maintained on a DCM for essentially the same

Mr. David Stawick
February 10, 2009
Page 6

contract. The only apparent justification in the Proposal for this disparate treatment was the comment that the CFTC is:

“cognizant of the fact that uncleared trades conducted on the ECM may be offset by trades done off the facility. Such offsetting transactions consummated outside of an ECM typically are not reported to the facility. Thus, the ECM likely would find it difficult to net uncleared transactions and maintain records of traders' uncleared positions in a given SPDC.” p. 75896.

We understand that it could be impracticable to require ECEs routinely to report all of their OTC positions in contracts similar to a SPDC to the ECM. However, in our view, imposing different regulatory requirements between cleared and uncleared trades that are executed on the ECM does not sufficiently enhance the integrity of the ECM-traded contract as was intended by Congress. In fact, the Proposal essentially presents a non-competitive, inequitable and potentially unworkable solution to a market issue deemed serious enough by Congress to warrant prompt legislative action.

We believe that the scope of the regulation should be consistent with the Congressional purpose. Consequently, we believe strongly that there should be one position limit and one associated set of accountability levels for non spot contracts that applies across all activity for a SPDC, including all cleared trades (whether executed on the system or submitted as block trades) in that SPDC as well as any uncleared trades executed on the system in that SPDC.

It is true that, as noted above by the Commission, uncleared trades can be offset by trading done off the facility. But cleared trades similarly can be hedged or offset by trading done off the facility as well. Therefore, even the netting that is applicable to cleared trades is subject to some approximation. In light of this reality, we believe that potential concerns about positions being hedged or offset off the facility are best addressed by having one uniform standard that applies to both cleared and uncleared trades and then allowing ECEs to provide data on offsetting positions in the context of their ongoing hedge exemptions from position limits that presumably would be maintained by many ECEs who are active on the system. This should significantly reduce the extent of reporting to the ECM of OTC transactions executed off the facility but would still provide for a seamless and consistent treatment across all activity on the ECM in the SPDC that fully addresses the market and price impact of such activity. Furthermore, non spot-positions subject to position accountability would be applicable to both cleared and uncleared trades and would be subject to review and appropriate action by the ECM.

Congress concluded last year that once a contract is deemed to be a SPDC, the regulatory safeguards in place for that SPDC on the ECM needed to be essentially similar to an “economically equivalent” contract that is listed for trading on the DCM. Given that a SPDC might be linked to a contract traded on a DCM through arbitrage or through linkage to a DCM settlement price, it is difficult to understand why Congress would want any other result to govern.

Large Trader Reporting

Under the acceptable practices for compliance with to Core Principle IV in Appendix B the Commission notes in (b)(8)(ii) that an ECM should establish an effective program for enforcement of position limits for SPDCs, which should include a large trader reporting system to monitor and enforce daily compliance with position limit rules. These acceptable practices do not establish any reporting requirements to facilitate daily monitoring of the VALs that are proposed for uncleared trades in an SPDC. As noted above, we believe strongly that it is necessary for both cleared and uncleared trades to be included within the scope of the position limit and position accountability level rules. Accordingly, consistent with that recommended approach, we believe that Appendix B should be revised to make clear that daily large trade reporting should be implemented for all cleared trades and also for all uncleared trades that are executed on the system.

Identification of SPDCs

The Reauthorization Act sets forth four factors to be considered by the CFTC in determining whether a contract is a SPDC: price linkage, arbitrage, material price reference and material liquidity. There is no priority in this list in the statute, nor do all of the factors need to be present. As noted in the Proposal, the Conference Committee Report on the Reauthorization Act provides the Commission with flexibility in applying these criteria to particular contracts and markets. p. 75892.

In general, we find the guidance on these factors set forth in proposed Appendix A to Part 36 to be thoughtful and well-reasoned. We do note (and appreciate) the Commission's emphasis on the flexibility that it has been accorded in this area. Thus, for example, for both the arbitrage and the price linkage factors, the CFTC proposes to use as a threshold a 2.5 per cent price range (between prices in the potential SPDC and the other related contract) for 95 per cent of closing or settlement prices over the most recent quarter; a linkage to another contract at this level therefore could potentially support a finding that an ECM contract was a SPDC. We believe that this is a reasonable test to use as a basic threshold.

However, there may be instances where the CFTC staff could find that the available evidence supports a finding of a SPDC where for example, the data demonstrated a 2.5 per cent price range for 90 per cent of closing or settlement prices over the most recent quarter. As we understand it, Appendix A would provide Commission staff with sufficient guidance to review and assess such contracts.

Timeframes for Identification of SPDCs and for Compliance with SPDC Requirements

Under proposed new CFTC Rule 36.3(c)(3), the Commission would issue an order "[a]fter consideration of all relevant information. . . ." p. 75911. The Proposal does not, however, provide for a specific timeframe for rendering an order. In light of the market integrity concerns and public policy interests underlying the statutory revisions establishing new regulatory oversight requirements for SPDCs, we believe that it would be in the public interest for such determinations to be issued within a reasonable timeframe following the close of the comment period. We therefore suggest that the Commission

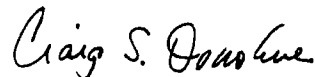
Mr. David Stawick
February 10, 2009
Page 8

consider revising this proposed rule to include a provision under which, absent special circumstances, such orders generally would be issued within 60 days following the close of the comment period.

We have a related concern respecting compliance with the applicable Core Principles. Under proposed subsection (4) of Rule 36.3(c), an ECM would have 90 days from the issuance of the CFTC's order to submit a written demonstration of compliance with the Core Principles. The market integrity interests and concerns associated with such Core Principles also need to be taken into account with regard to this time frame. In addition, it is reasonable to conclude that, from a programmatic perspective, ECMs are already on notice from the passage of the Reauthorization Act as to the possibility that one or more of their contracts may become a SPDC at some future date. Accordingly, we recommend that the Commission amend this timeframe from 90 to 45 days. Similarly, the CFTC proposes to allow a 90-day grace period (from the date of the ECM's implementation of its new rules) to market participants who have open positions in a SPDC contract. For the reasons noted above, we believe that the overall market would be better served with a 45-day grace period.

CME Group thanks the Commission for the opportunity to comment on the Proposal. We would be happy to discuss any of these issues with the Commission. If you have any comments or questions, feel free to contact me at (312) 930-8275 or at Craig.Donohue@cmegroup.com; or Richard Lamm, Managing Director, Chief Regulatory Counsel at (312) 930-2041 or at Richard.Lamm@cmegroup.com; Thomas LaSala, Managing Director, NYMEX Chief Regulatory Officer, at (212) 299-2897 or at Thomas.Lasala@cmegroup.com; or Brian Regan, Managing Director, Regulatory Counsel at (212) 299-2207 or at Brian.Regan@cmegroup.com.

Sincerely,



Craig S. Donohue

cc: Acting Chairman Michael Dunn
Commissioner Walter Lukken
Commissioner Jill E. Sommers
Commissioner Bart Chilton
Susan Nathan, Senior Special Counsel, Division of Market Oversight (via e-mail)