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CME Group
A CME/Chicago Board of Trade Company

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VIA E-MAIL

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

Re: Concept Release on the Appropriate Regulatory Treatment of Event Contracts
73 F.R. 25669 (May 7, 2008)

Dear Mr. Stawick:

CME Group Inc. ("CME Group") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("Commission's") Concept Release on the Appropriate Regulatory Treatment of Event Contracts.

CME Group was formed by the July 2007 merger of Chicago Mercantile Exchange Holdings Inc. and CBOT Holdings, Inc. CME Group is the parent of Chicago Mercantile Exchange Inc. ("CME") and Board of Trade of the City of Chicago, Inc. ("CBOT"). CME Group also owns Swapstream Operating Services Limited, an OTC trading facility, and owns an interest in FXMarketspace Limited, an FX trading platform that is authorized and regulated by the United Kingdom's Financial Services Authority. CME Group serves the global risk management needs of our customers and those who rely on the price discovery provided by the competitive markets maintained by CME Group. CME Group offers a comprehensive selection of benchmark products in most major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, agricultural commodities, energy, and alternative investment products such as weather and real estate. Additionally, CME Group offers order routing, execution and clearing services to other exchanges by means of our Globex® electronic trading platform and our clearing house. CME Group is traded on NASDAQ under the symbol "CME."

This letter will address: (a) the difficulties in defining event contracts as distinct from other futures and options contracts, (b) the permissibility of trading event contracts that meet the Commodity Exchange Act ("CEA") definition of "excluded commodities" on designated contract markets ("DCMs") and derivatives transaction execution facilities ("DTEFs")(together, "registered exchanges"), and (c) intermediation in event markets.

I. There is no clear distinction between event contracts and other futures and options contracts

The Commission proposes to distinguish event contracts from other futures and options contracts by defining them as information aggregation vehicles that are linked to eventualities or measures that neither derive from, nor correlate with, market prices or broad economic or commercial measures. At the outset, it should be noted that there is no requirement in the CEA or Commission regulations that commodities underlying futures and options contracts must correlate with market prices. Indeed, U.S. DCMs currently list contracts that are based on standard quantity-based economic indicators rather than market prices, *e.g.*, CME's Nonfarm Payroll futures. There is also not any requirement that events or measures underlying futures and options contracts must correlate with broad economic or commercial measures.

In particular, the Commission has attempted to distinguish between event contracts and certain contracts that have previously traded, or are currently trading, on U.S. DCMs based on whether the economic consequences of the event or occurrence are generally-accepted and predictably correlate to measures of broad economic or commercial activity. However, the Commission's examples reveal the difficulties in drawing this line. For example, the Commission described the likelihood of the formation of a specific type of storm within an identifiable geographic region as an environmental event that may not predictably correlate to commodity market prices or measures of broad economic or commercial activity. At the same time, the Commission acknowledged that the CBOT's former catastrophe single event insurance option contracts, which paid out a fixed amount if insured property damage exceeded a certain amount for a specific region during a specified interval of time, while not strictly price-based, rested on generally-accepted and predictable financial, commercial or economic consequences. Similarly, the Commission stated that quantifications of weather phenomena, such as the volatility of temperature levels, constitute an environmental measure that may not predictably correlate to commodity market prices or measures of broad economic or commercial activity, while acknowledging that already listed contracts that are based on temperature volatilities, *e.g.*, CME's Degree Days Index futures, fall into the category of those contracts that rest on generally-accepted and predictable financial, commercial or economic consequences.

We do not believe that event contracts should be placed in a separate category and be subject to a different set of requirements or conditions prior to listing on a DCM or DTEF. For purposes of the following analysis we are using "event contract" to mean contracts based on narrow commercial measures and events, environmental measures and events, and general measures and events.

II. <u>Event contracts that involve "excluded commodities", as defined in Section 1a(13)(iv) of the CEA, should be permitted to trade on registered exchanges</u>

Sections 2(a)(1)(A) and 4c(b) of the CEA together provide the Commission with exclusive jurisdiction, with certain exceptions, with respect to commodity futures and options contracts. In determining whether event contracts are within the Commission's jurisdiction, the relevant threshold inquiry is whether they involve "commodities". The CEA does not restrict the concept of a "commodity" to a material item or even a stream of payments. Section 1a (4) of the CEA enumerates certain commodities and states that commodities include "all other goods and articles, [except onions], and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." As the Commission noted in its Concept Release, Section 1a(13) of the CEA provides further guidance as to the definition of a commodity by identifying four separate categories of "excluded commodities".[1] Section 1a(13)(iv) describes one type of excluded commodity as an occurrence, extent of an occurrence, or contingency that is beyond the control of the parties and that is associated with a financial, commercial, or economic consequence. The interests underlying many of the event contracts described by the Commission would meet the definition of an excluded commodity contained in Section 1a(13)(iv). This definition does not require that such commodity interests must correlate to market prices or that their economic consequences must be broad-based. Rather, the occurrence or contingency must only be "associated with" a financial, commercial, or economic consequence.

There are many types of geopolitical events that can be expected to have financial, commercial or economic consequences that may be more or less predictable, and that clearly fall within the definition of excluded commodities in Section 1a(13)(iv). These include, but are not limited to, governmental actions or decisions regarding tax rates, government spending, limitations on foreign investment, trade sanctions and embargoes and immigration policy; official declarations of war; and United Nations votes and resolutions. Event contracts based on the likelihood or the expected extent of such geopolitical events would provide for the hedging of legitimate business risks that cannot be effectively hedged with more traditional futures and options products. Examples of some of the potential hedging needs created by the risks of the financial, commercial or economic consequences of some of these types of events are described below:

(a) Decisions regarding tax rates – If a government raises tax rates, many individuals and business entities would effectively lose income or profits. These potential risks could be hedged with event contracts related to government decisions regarding tax rates.

(b) Government spending – Changes in the amount of government spending have clear financial, commercial and economic implications. The funding for such spending is likely to come from a combination of current taxes and government borrowing. Therefore, futures contracts that are based solely on interest rates, which reflect a cost related to the borrowing component of government spending, would not provide a sufficient hedging vehicle for those who have economic risks related to the amount of government spending. A contract based on changes in government spending levels could provide a useful hedge to address those risks.

(c) Limitations on foreign investment – An emerging market could potentially impose new restrictions on a foreign investor's ability to repatriate its capital. If a U.S. firm had invested in such a market, it might be forced to sell its interest to a local firm at a discount in order to recover a portion of its investment. This potential economic loss could not be hedged solely with futures based on the emerging market's currency exchange rate,

[1] Section 2(d) of the CEA provides that the statute does not apply to a transaction in an excluded commodity if it is entered into only between eligible contract participants and if it is not executed or traded on a trading facility. This Section should not be read to imply that an excluded commodity cannot be executed on a registered exchange. There are a number of futures and options currently trading on DCMs that are based on excluded commodities. Furthermore, Section 5a(g)(1) of the CEA explicitly permits DTEFs to list contracts involving excluded commodities in addition to those commodities that meet the requirements for underlying commodities that may be traded on a DTEF as described in Section 5a(b)(2).

which could depend on many other factors such as commodity prices for the emerging market's main exports. An event contract could provide a more effective hedging vehicle with respect to the risk of limitations on foreign investment in the emerging market.

(d) Trade sanctions and embargoes - A U.S. chemical company that needs petroleum-based feedstocks to run its processes could use existing futures to hedge petroleum prices. However, if the government of a petroleum-producing country restricts the flow of crude oil or limits exports of petroleum, the chemical company may not be able to get feedstocks for its processes at any price. Therefore, event contracts based on trade sanctions and embargoes could offer a more effective hedge than contracts based solely on petroleum prices.

(e) Immigration policy – The U.S., Canada, the European Union, and the Gulf States all rely heavily on immigrant labor in large parts of their economies, including the construction trades, agriculture, food processing, and service sectors. The relative availability of immigrant labor is affected both by economic and political conditions in labor-exporting countries and by immigration policies such as quotas and enforcement regimes in labor-importing countries. The risks created by potential changes in immigration policy, which cannot be hedged with any other types of futures contracts, might be hedged with event contracts.

(f) Official declarations of war – The costs and economic dislocations that follow from wars are self-evident and event contracts based on official declarations of war may provide an opportunity to hedge against some of those financial consequences. The declarations of war that should be permitted to form the basis of event contracts should be defined under internationally-recognized legal standards to include only official declarations of war by the governing authority in a recognized state against another recognized state.

Event contracts based on the types of geopolitical events described above would meet legitimate hedging needs resulting from the anticipated financial, commercial or economic consequences of those events. Because the prices of such contracts would reflect market expectations regarding the probability of the underlying events, they would also provide valuable information that may help guide investment decisions.[2] Therefore, geopolitical event contracts, or any other type of event contracts that are based on excluded commodities, *i.e.*, those that are beyond the control of the parties and that are associated with a financial, commercial, or economic consequence, should be permitted to trade on registered exchanges.[3]

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[2] As the Commission noted in its Concept Release, the legislative history of the CEA reveals that Congress recognized that commodity futures trading provides a valuable benefit to commercial interests in part through its provision of market information and products that facilitate the making of marketing, financing, and distribution decisions. S. Rep. No. 93-1131, at 12 (1974).

[3] Moreover, since the commodity interests underlying these contracts would meet the definition of excluded commodities under the CEA, there would be no need for the Commission to exercise its Section 4(c) exemptive authority with respect to such event contracts. In addition, event contracts based on excluded commodities should be permitted to trade on markets that elect to operate as exempt boards of trade under Section 5d of the CEA, in that they would be contracts involving commodities with no cash market.

III. Event contracts that are not based on "excluded commodities" should not be permitted to trade on registered exchanges

The interests underlying certain contracts that the Commission has described as event contracts would not meet the definition of an excluded commodity contained in Section 1a(13)(iv) of the CEA and, therefore, should not be permitted to trade on registered exchanges. Such contracts would include those based on an occurrence that is not beyond the control of the parties because the outcome can be controlled by one or several private individuals that might trade the contract. For example, a futures contract based on the occurrence or non-occurrence of a celebrity marriage would not involve an excluded commodity as defined in Section 1a(13)(iv) because the celebrities themselves could trade the contract and could control the outcome of the underlying event. Similarly, a contract based on a specific farmer's crop yield would likely not be an excluded commodity because the farmer would have some control (albeit not total control) over his own crop yield. Other events that would not be excluded commodities because they can be controlled by one or a small group of individuals are sporting events, terrorist attacks, and assassinations. Of particular relevance in this regard is Core Principle 3 in Section 5(d) of the CEA, which requires that DCMs shall only list contracts that are not readily susceptible to manipulation. The listing of an event contract for which an individual or a small number of individuals could make the event occur or not occur would be inconsistent with this Core Principle because such a contract would be susceptible to manipulation.[4]

IV. FCMs should be permitted to intermediate event contracts on registered exchanges pursuant to the same requirements that apply to other contracts

The Commission has asked whether there are any types of trader or intermediary conduct peculiar to event contracts that should be prohibited or monitored closely by regulators. Registered exchanges are required to comply with Core Principles that protect market participants from manipulation, fraud, and other abusive practices. Traders and futures commission merchants ("FCMs") that are members of a registered exchange are already subject to stringent customer protection requirements with respect to their trading and intermediation of futures and options contracts, and these requirements should also apply with respect to contracts based on events that meet the CEA's definition of excluded commodities.

V. Conclusion

As discussed above, CME Group believes that event contracts are within the Commission's jurisdiction to the extent that they are based on interests that meet the CEA's definition of excluded commodities, and such contracts should be permitted to trade on registered exchanges.

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[4] However, this should not prohibit the trading of event contracts based on governmental action, even though a head of state or a small group of government officials may make, or influence, such action. For example, the CBOT has traded contracts based on interest rates for many years, and the fact that a few individuals at the Fed may be able to strongly influence interest rates has never raised a concern with respect to those contracts.

Furthermore, FCMs should be permitted to intermediate such contracts, pursuant to existing customer protection requirements. CME Group also requests that the Commission confirm that by attempting to define a certain category of contracts as event contracts, and engaging in an examination of the appropriate regulatory treatment of such event contracts, the Commission does not intend to draw into question or modify the regulatory treatment of any of the types of contracts that are currently listed, or that have previously been listed, by any DCM.

We would be happy to discuss any of these issues with Commission staff. Please feel free to contact me at (312) 930-8275 or Craig.Donohue@cmegroup.com; Richard Lamm, Managing Director, Regulatory Counsel, at (312) 930–2041 or Richard.Lamm@cmegroup.com; or Anne Polaski, Associate Director and Regulatory Counsel, at 312-338-2679 or Anne.Polaski@cmegroup.com. Thank you for your consideration.

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
Richard Shilts
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