

From: Szarmack, Stephen <Stephen.Szarmack@cmegroup.com>
Sent: Monday, July 12, 2010 5:45 PM
To: colocation <colocation@CFTC.gov>; Stawick, David <dstawick@CFTC.gov>
Cc: Szarmack, Stephen <Stephen.Szarmack@cmegroup.com>
Subject: Co-location/Proximity Hosting Services
Attach: 100712 CFTC Comment Letter.pdf

Dear Mr. Stawick:

Attached please find CME Group's comment letter in response to the CFTC's proposed rule on co-location/proximity hosting services which was published in the Federal Register on June 11, 2010 (Vol. 75, No. 112). Please let me know if you have any issues opening the document.

Regards,

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July 12, 2010

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: Co-Location/Proximity Hosting Services – 75 Fed. Reg. 33198 (June 11, 2010)

Dear Mr. Stawick:

CME Group Inc. (“CME Group”), on behalf of its four designated contract markets (“Exchanges”), appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (the “CFTC” or “Commission”) proposed rulemaking (“Release”) with respect to co-location and proximity hosting services. In the Release, the Commission proposes a rule that requires Designated Contract Markets (“DCMs”), Derivatives Transaction Execution Facilities (“DTEFs”) and Exempt Commercial Markets (“ECMs”) that list significant price discovery contracts (“SPDCs”) to comply with four proposed requirements if they plan to offer co-location and/or proximity hosting services to market participants.

CME Group is the world’s largest and most diverse derivatives marketplace. We operate four separate Exchanges, including the Chicago Mercantile Exchange, Inc (“CME”), the Board of Trade of the City of Chicago, Inc. (“CBOT”), the New York Mercantile Exchange, Inc. (“NYMEX”) and the Commodity Exchange, Inc. (“COMEX”). The CME Group Exchanges offer 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, metals, agricultural commodities, and alternative investment products.

We also operate CME Clearing, one of the largest central counterparty clearing services in the world, which provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter derivatives transactions through CME ClearPort®.

The CME Group Exchanges serve the hedging, risk management and trading needs of our global customer base by facilitating transactions through the CME Globex® electronic trading platform, our open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions.

I. Overview and Background

The background for the Release is based in part on issues presented to the Commission a number of years ago when electronic trading was a novel concept. In 1990, the Commission issued a Policy Statement Concerning the Oversight of Screen-Based Trading Systems ("Policy Statement") which consisted of ten principles that stated broad regulatory concepts arising from cross-border screen-based trading. Two of those principles have particular relevance with respect to the Release. The first principle states that, "From a technical perspective, the system should be designed to operate in a manner which is equitable to all market participants and any differences in treatment among classes of participants should be identified." The second principle states that, "Procedures should be established to ensure the competence, integrity, and authority of system users to ensure that system users are adequately supervised and that access to the system is not arbitrarily or discriminatorily denied."

Since the time of the Policy Statement, futures and options trading has dramatically changed as system providers and sponsors developed and implemented new and innovative technologies for market participants. A primary reason for the dramatic changes in futures and options trading has been the changes and evolution of technologies for generating and executing orders. The new technologies have greatly improved the speed, capacity and sophistication of the trading functions that are available to market participants.

In response to the emphasis on speed by trading firms, DCMs and other trading venues have adopted highly automated trading systems that offer extremely high speed order entry and execution. Also, to reduce latency in transmitting market data and order messages, a number of trading markets offer co-location and/or proximity hosting services in close proximity to the trading market's matching engine. As such, the growth of co-location and proximity hosting services is associated with the development of so-called "high frequency trading" in the futures and options markets.

As a result of the substantial changes in technology, products and platforms of U.S. futures and options trading since the Commission's Policy Statement, as well as the large volume increases generated by market participants using co-location and/or proximity hosting services, the Commission has decided to review some of the issues raised in the Policy Statement through the Release in order to deter and prevent potential disruptions to market integrity.

CME Group believes that it is uniquely qualified to provide comments on the Release because the CME Group Exchanges are all DCMs that list SPDCs. In addition, the CME Group Exchanges currently offer proximity hosting services and plan to offer co-location services in early 2012. Further, one of the original motivations for the Policy Statement in 1990 was the development and implementation of the CME Globex electronic trading platform.

II. Equal Access

The Release proposes that co-location and proximity hosting services be available to all qualified market participants willing to pay for the services. Co-location and proximity hosting services may not be offered on a discriminatory basis to only select market participants and access should be equitable, open and fair. In addition, DCMs must ensure there is sufficient availability of such services for any and all willing and qualified participants.

CME Group agrees with the access provision of the CFTC's co-location and proximity hosting services rule. In fact, one of the guiding principles CME Group has developed with respect to its co-location and proximity hosting services is that, "all customers will be treated equitably." CME Group's co-location and proximity hosting services will be available to all willing and qualified customers in an equitable and fair manner.

The Release also states that, "if the availability of a service becomes limited, thereby leaving some market participants or third-party service providers without adequate access, the Commission would not view access to those services as open and fair." While CME Group concurs that co-location and proximity hosting services must be offered to all willing and qualified customers in an equitable and fair manner, it is possible that logistical and unforeseen circumstances may impact the timely delivery of such services. For example, providing co-location and proximity hosting services is an expensive and time-consuming process involving activities that are outside the immediate control of a DCM. These activities include, among others, the purchase of land or a building, approvals of various governmental agencies and the availability and installation of the required technology to operate the facility.

In addition, CME Group is currently surveying interest in its co-location and proximity hosting services and is building out Phase 1 of its offering. In the event that demand exceeds the Phase 1 supply, CME Group will begin to build out Phase 2 of our offering and subsequent phases as necessary to meet demand. However, we do not believe that temporary delays or the inability to meet initial demand for co-location and proximity hosting services for a particular phase would render such services "unfair and not open" under the proposed rules set forth in the Release.

Related to the same concept, a DCM offering co-location and proximity hosting services may at some time in the future exhaust its available space and power.¹ CME Group has planned for substantial expansion at its co-location facility and fully anticipates having adequate capacity to meet client demands. However, the decision to invest in additional facilities beyond a company's current business plan should reside with the provider of the co-location services. We do not believe that the proposed rules should give the Commission the authority to direct if and when CME Group would, for example, be required to purchase land and build out a new co-location facility if the demand for such services exceeded the supply. If the available space in the facility is completely occupied at some time in the future, CME Group

¹ CME Group's co-location facility is very robust and is based on a Tier 3 design with many additional security, fire protection and infrastructure enhancements. The facility is served by two 138,000 volt transmission quality services from two separate generation plants through our privately owned and operated substation. The substation provides up to 92 MW of redundant power with a planned initial deployment of 12.5 MW of redundant power for the co-location space.

proposes that to the extent space in the facility has been provided to third-party hosting service providers that have the general ability to offer their proximity hosting services to many market participants, a DCM will have satisfied its obligations under the proposed equal access rule. CME Group requests that the Commission clarify in the final Release that it is not the intention of the Commission to dictate business requirements to DCMs based on the equal access language in the rule.

III. Fees

The provision in the Release regarding fees is designed to ensure that fees are not used as a means to deny access to some market participants by pricing them out of the market. The Commission is seeking to ensure that the fees charged to market participants and third-party proximity hosting services remain equitable and do not become an artificial barrier to effective market access. The Release also states that the Commission would not view preferential pricing for certain market participants or certain classes of market participants as equitable pricing.

CME Group agrees with the fees provision in the CFTC's co-location and proximity hosting services rule. Fees charged for co-location and proximity hosting services must be equitable and not operate as a barrier to market access. In addition, CME Group agrees that there should not be preferential pricing or special treatment for certain market participants or classes of market participants. A principle that is applicable to CME Group's co-location and proximity hosting services is that, "pricing will be non-discriminatory and transparent." CME Group is developing its pricing parameters for its co-location and proximity hosting services and such fees will be comparable to current market prices for equivalent services.

IV. Latency Transparency

The Release also contains a provision related to latency transparency that would ensure that general information concerning the longest, shortest and average latencies for all connectivity options are separately detailed and readily available to the public on regulated markets' web sites. Alternatively, the Commission is reviewing another approach for disclosing latency information that would be based on the percentile of speed rather than the longest, shortest and average latencies.

The proposed latency transparency rules require a DCM providing co-location and proximity hosting services to provide monthly public disclosures relating to the average "latencies" of connectivity options offered. Although CME Group supports the general principle of transparency in this context, we believe the current formulation of the latency transparency rule is potentially overreaching and lacks sufficient detail in terms of measurement criteria. We respectfully request clarifications and revisions to address the concerns outlined below.

First, the Release can be interpreted to require disclosure of certain information that would not be within the control of a DCM. The Release elaborates on the latency disclosure requirement set forth in the rule by explaining that "specific and separate detail" should be provided by a DCM offering co-location and proximity hosting services with respect to each of the following connectivity options:

“where a market participant is directly co-located with a trading market; where a market participant is indirectly co-located through a clearing firm, futures commission merchant, introducing broker, or some other entity or market participant; where a market participant is connected via the services of a third-party proximity hosting provider; and all other manners by which market participants connect to the trading markets’ electronic trading system(s).”

A DCM can generally measure and report the latency associated with the connections it controls. A DCM would not, however, be able to measure and report latencies associated with the activities of a third-party such as an end user’s clearing firm, broker or third-party service provider. In our view, a DCM should not be responsible for making reports regarding any point in the order processing chain that is not within its direct control since a number of outside factors can impact latency information. We believe this point should be clarified in the Release for the proposed rule.

Second, we believe the Release lacks sufficient detail with respect to the definition of the term “latency.” The proposed rule requires disclosure of “latencies” but does not set out precise measurement points to ensure a uniform application of the concept. Without specific and precise standards for measurement, one DCM could adopt a methodology that may or may not be equivalent to how another DCM defines the term. Consumers will not be assured of the “apples-to-apples” comparison that is the central purpose of the disclosure requirement.² Further, there are also competitive concerns that are implicated. If DCMs are left to choose how to measure latencies, some may choose to define them in a way that results in the shortest possible timeframes disclosed. This could lead to situations where one DCM’s published latencies are smaller than another’s purely because of definitional differences even if there were not actual differences when objectively measured.

In addition, given the various pathways and means of accessing a DCM’s match engine, CME Group believes it would be more appropriate for DCMs to provide latency information in terms of a range per access method instead of attempting to attribute a single specific latency number to each and every access method. For example, CME Group works with a number of telecommunication providers and each provider may have multiple paths between New York and Chicago. Accordingly, the many different telecommunication paths between New York and Chicago for Globex access have a range of latency statistics among them as well as different service offerings among them. If we are not able to provide latencies in terms of a range, we would be identifying specific telecommunication providers by name and the latency statistics associated with each. We believe providing a latency range per access method will adequately educate market participants. CME Group also suggests that a quarterly or semi-annual disclosure of latency information is more appropriate than monthly reporting. On a month-to-month basis, latency information is not likely to change in any material manner and there is staff time and expense associated with obtaining and posting latency information on the web site.

Although we believe that disclosure to users regarding latency information is generally appropriate and reasonable, we do not necessarily believe that a regulatory mandate is the best approach. We believe the marketplace for co-location and proximity hosting services is well-equipped to sort out material

² The Proposing Release’s expressed purpose of requiring latency transparency was to ensure “that any market participant considering co-location or proximity hosting services could regularly assess whether the continued cost of the services is worth the benefits obtained.”

differences between connectivity offerings. To the extent latency disclosure is regulated, however, we believe the requirement should include sufficient detail to allow accurate comparisons between markets and generally provide the public with useful “apples-to-apples” comparisons.

V. Third-Party Providers

The provision in the Release that relates to third-party providers would ensure that DCMs obtain all information about market participants, their systems and their transactions from third-party providers necessary to carry out self-regulatory responsibilities and other obligations under the Commodity Exchange Act and the CFTC Regulations (“Regulations”). The CFTC suggests in the Release that a DCM should enter into a contractual agreement with such third-party providers on terms consistent with the Act and the Regulations so that a DCM will be able to adequately perform its regulatory responsibilities. The proposed requirements would better prevent third-party proximity hosting services from improperly shielding the identities of market participants from the regulatory oversight of DCMs and the CFTC.

In the event the provision related to the gathering of information from third-party providers required under the Commodity Exchange Act and its Regulations remains in the proposed rule, CME Group will endeavor to comply with the requirement. However, DCMs do not have direct control over such third-party information because the information is not “physically” in the possession of the DCM. In this situation, DCMs act as a conduit and can only provide to the CFTC the information received from the third-party provider. Accordingly, prior to approving a third-party provider for proximity hosting services, DCMs must confirm that such third-party provider has the ability to provide the required customer and proprietary information and trading-related information to the DCM and that the third-party provider is also willing to execute an agreement to comply with the requirement.

We note that the proposed rule’s prohibition on barring third-parties from providing connectivity services to market participants clearly does not apply to every type of third-party. Only “otherwise eligible and qualified third-parties” are within the scope of the rule. Necessarily, in our view, the determination of whether a third-party is “otherwise eligible and qualified” will rest with the DCM offering co-location connectivity. For the sake of clarity, we believe third-parties bundling services including connectivity, market data and order transmission are the types of third-parties that should be interpreted within the scope of the rule. In our view, a DCM would not be required under the proposed rule to accommodate a third-party merely because, for example, such third-party acquired real estate near the DCM’s trading host.

VI. Conclusion

The co-location and proximity hosting services rule proposed by the Commission is very timely in light of continuing technological developments in the futures industry. CME Group is in general agreement with the four broad concepts that are proposed in the Release relating to equal access, fees, latency transparency and third-party providers. CME Group’s own guiding principles related to equal access and fees associated with co-location and proximity hosting services are very similar to the Commission’s proposal. However, CME Group requests the Commission clarify several points in the Release. In

David Stawick
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particular, we have concerns regarding the financial obligations that could potentially be imposed on CME Group under the concept of equal access, the accuracy of, or requirement for, latency measurements for activity that is outside of our control, the definition of the term "latency" and the ability to determine whether a third-party provider is "otherwise eligible and qualified" to provide connectivity services.

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 or Stephen Szarmack, Regulatory Counsel at (312) 648-5422 or Stephen.Szarmack@cmegroup.com.

Sincerely,

A handwritten signature in cursive script that reads "Craig S. Donohue".

Craig S. Donohue

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia