CME Group

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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: Process for Review of Swaps for Mandatory Clearing (RIN 3038–AD00)
(Federal Register Vol. 75, No 211, Page 667277)

Dear Mr. Stawick:

CME Group, Inc. ("CME Group"), on behalf of its four designated contract markets ("Exchanges" or "DCMs"), appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "CFTC" or "Commission") Notice of Proposed Rulemaking ("Release") that was published in the Federal Register on November 2, 2010. In the Release, the Commission seeks comment on proposed rules that, in our view, would impose onerous requirements on derivatives clearing organizations ("DCOs") that seek to clear swap contracts. Among other things, the proposed rules attempt to shift to DCOs the responsibility for developing an evidentiary basis for mandating clearing of a particular swap.

CME Group believes that DCOs should only be obligated to (1) notify the Commission of the swaps the DCO intends to accept for clearing, and (2) demonstrate the ability to continue to comply with DCO Core Principles. We request that the Commission revise its proposed rules accordingly.

CME Group, the world's largest and most diverse derivatives marketplace, consists of four separate Exchanges: 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"). These 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.

CME also includes 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®.

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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. Executive Summary

Section 2(h) of Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("DFA") contemplates two related but different determinations on the part of the Commission. First, the Commission must decide, in response to a DCO's required submission, whether a DCO should be allowed to clear a given swap or group, category, type or class of swaps. Second, the Commission must determine whether to apply DFA's mandatory clearing requirement to a given swap or group, category, type or class of swaps. The Commission must make the first determination in response to a submission by a DCO seeking permission to clear a swap. The Commission may make the second determination based on its own review of the available evidence which may include the DCO's core principle-focused submission. As the proposed regulation stands, however, DCOs are required to make overwhelming submissions addressing not only their ability to clear a swap, but also all the factors the Commission is required to consider in determining whether to apply the mandatory clearing requirement. This puts DCOs in a position of having to go through a long, arduous and costly process if they desire to clear a swap. The process, as it stands now, is effectively a disincentive to clear new swaps, and this undermines the purpose of DFA.

Because these two determinations should be considered separate, the Commission should require a DCO to address only its own ability to clear a swap in its submission for permission to clear. The Commission should also provide additional guidance in its proposed regulation in order to make the DCO swap submission process more clear and efficient. The Commission should clarify that a DCO is not required to make any submission for swaps it cleared before the enactment of DFA, and the Commission should extend this exemption from filing to swaps a DCO also cleared before the effective date of the clearing requirement. Additionally, in order to provide clarity as to the requirements of the swap submission process, the Commission should (1) define what constitutes a "group, category, type, or class of swaps," so that DCOs may make their submissions by the most accurate and efficient means possible; and (2) specifically express what information a DCO must submit in order to demonstrate its ability to comply with the Core Principles when the DCO accepts a new swap for clearing.

II. Comment

As the Commission notes in the Release, DFA established a comprehensive new regulatory framework for swaps and certain security-based swaps. The Commission states, at the start of each of its proposed rule makings, "Title VII of the Dodd-Frank Act . . . .was enacted to reduce risk, increase transparency, and promote market integrity within the financial system by, among other things: . . . (2) imposing clearing and trade execution requirements on *standardized* derivative products . . . ." This statement is not strictly accurate. The DFA did not adopt a standardization test for either the clearing or trading requirement. DFA adopted a multi-factor test of enormous complexity and questionable utility to determine which swaps are subject to the mandatory clearing requirement. Separately, and appropriately, DFA calls for DCOs to submit plans to accept for clearing certain swaps and to show in that submission why accepting those swaps would be consistent with Section 5b(c)(2) of the Commodity Exchange Act ("CEA"). See CEA § 2(h)(2)(D)(i).

The Commission stated that the purpose of the Release is to "implement procedures for determining the eligibility of a DCO to clear swaps that it plans to accept for clearing; for DCOs submitting swaps to the Commission for review; for Commission-initiated reviews of swaps; and for staying a clearing requirement while the clearing of a swap is reviewed." The proposed regulations substantially exceed that legitimate purpose. The proposed regulations do not reflect a careful consideration of the structure of the industry or of the information available to DCOs, and they are not grounded in any analysis of their effectiveness or efficiency, as required by law.

As amended by DFA, Section 2(h) governs the Commission's responsibility to determine whether a swap that a DCO chooses to clear may be cleared; it also requires the Commission to make determinations respecting whether a swap is subject to the mandatory clearing requirement. Section 2(h) thus contemplates two different determinations to be made by the Commission in the area of cleared swaps. First, Section 2(h)(2)(B)(i) requires a DCO to make a submission to the Commission when the DCO plans to accept a swap or group, category, type or class of swaps for clearing. The purpose of the DCO's submission is to enable the Commission to make the determination required under Section 2(h)(2)(D)(i) — whether that particular DCO may accept the applicable swap for clearing consistent with the DCO Core Principles.

In addition to the determination required by Section 2(h)(2)(B)(i), the Commission must also consider whether to make a determination as to what swaps are required to be cleared. Only those swaps the Commission determines are required to be cleared are subject to the DFA clearing mandate in Section 2(h)(1). Section 2(h) adopts two triggers that initiate the Commission's decision-making process regarding application of the clearing requirement. One trigger is a Commission-initiated review based on its ongoing obligatory review of the swaps market. CEA § 2(h)(2)(A). The other trigger is an application by a DCO to clear a particular swap or class of swaps. CEA § 2(h)(2)(B). But the Commission's determination whether to apply the clearing mandate to a swap is a different determination than the determination whether a particular DCO may accept a swap for clearing under the Core Principles. In fact, DFA contemplates that a swap may be accepted for clearing on a DCO and not be subject to the Commission-imposed clearing mandate consistent with Section 2(h)(2)(A).

As such, the Commission should limit the breadth of the submission required by a DCO seeking approval to clear a swap to addressing whether clearing such a swap comports with the DCO Core Principles. The factors listed in Section (h)(2)(D)(ii) are most relevant to the Commission's determination as to whether the mandatory clearing requirement should apply to a swap, not its determination, based on a DCO's submission, of whether the DCO can clear the swap. CME Group requests that the Commission not require DCOs to perform an analysis of the Section (h)(2)(D)(ii) factors in its submission for permission to clear a swap. Rather, the Commission should require a DCO only to address its ability to clear the swap at issue while continuing to comply with its Core Principles in its submission for approval to clear a swap.

The Commission's proposal would impose costs and obligations that would effectively undermine the purposes of DFA. In effect, the Commission attempts to charge a DCO that wishes to list a new swap with the obligation to collect and analyze massive amounts of information so that the Commission can perform its statutory duty of determining whether the swap that is the subject of the application and any other swap that is within the same "group, category, type, or class" should be subject to the mandatory clearing requirement. The

proposed regulation eliminates the possibility of a simple, speedy decision on whether a particular swap transaction can be cleared by a DCO — a decision that the DFA surely intended should be made quickly in the interests of customers who seek the benefits of clearing — and forces a DCO to participate in an unwieldy, unstructured and potentially endless process to determine whether mandatory clearing is required. Additionally, the Commission already has a great deal of the information necessary to address the factors relevant to the application of the mandatory clearing requirement by virtue of the extensive reporting requirements promulgated by DFA. See, DFA Sections 725(e), 727, 729.

The costs in terms of time and effort to secure and present the information required by the proposed regulation represents a massive disincentive to DCOs to undertake to clear a "new" swap. It also puts domestic DCOs at a great disadvantage to foreign DCOs. That is, foreign clearing houses will not be subject to the heavy costs of providing the extensive submissions contemplated by the proposed regulation; foreign clearing entities also will not be subject to an extensive waiting period while seeking permission to clear a swap.

Regulation Section 39.5(b)(5) starkly illustrates this outcome. No application is deemed complete until all of the information that the Commission needs to make the mandatory clearing decision has been received. The Commission is the sole judge of completion and the only test is its unfettered discretion. Only then does the 90 day period begin to run. This turns DFA on its head.

To this end, if the Commission decides, contrary to our views, to require a DCO to submit information addressing the (h)(2)(D)(ii) factors in its submission for permission to clear a swap, CME Group recommends that the Commission alter Regulation 39.5(b)(5) to limit the circumstances under which it may deem a submission incomplete. Specifically, CME Group recommends that the proposed regulation be changed to allow the Commission to deem an application to clear a swap, or any group, category, type or class of swaps, to be incomplete and thereby require a DCO to submit further information only if the application does not adequately address whether clearing the swap at issue complies with the DCO Core Principles. That is, in order to place some limit on the information a DCO is required to provide to the Commission and to expedite the clearing approval process, the Commission could not delay consideration of an application to clear a swap as incomplete on the basis that the DCO has not fully addressed the (h)(2)(D)(ii) factors.

III. Detailed Comments

Following is our detailed analysis of the defects of the proposed regulation. We have set forth the relevant provision of the proposed regulation followed by our comments.

> **§ 39.5 Review of swaps for Commission determination on clearing requirement.**
> *(a) Eligibility to clear swaps. (1) A derivatives clearing organization shall be presumed eligible to accept for clearing any swap that is within a group, category, type, or class of swaps that the derivatives clearing organization already clears. Such*

presumption of eligibility, however, is subject to review by the Commission.

Subpart (a)(1) creates significant issues that need to be corrected to clarify two points: (1) is a DCO that already clears a swap required to make any submission to the Commission and (2) what constitutes a "group, category, type, or class of swaps." The remainder of the proposed regulations depend on a determination as to whether a DCO is or is not eligible to clear a particular swap. Section 39.5 (a)(1) creates a mere presumption of eligibility, which is not equivalent to eligibility as required by statute. Subpart (a) should be revised to provide that a DCO is eligible, under defined conditions, to clear the swap subject to a subsequent decision by the Commission revoking that eligibility.

On a similar note, under DFA Section 723, "[any] swap, category, type, or class of swaps listed for clearing by a [DCO] as of the date of enactment of this subsection shall be considered submitted to the Commission." CEA §2(h)(2)(B)(ii). The Commission may not require DCOs to make any submission related to these swaps because, as the statute says, they have already been submitted. Subpart (a)(1) should be redrafted to make clear that under no circumstances may a DCO be required to file a submission with the Commission addressing a swap that it has already cleared pre-enactment. The materials submitted pre-DFA by the DCO in connection with clearing that swap are, by statute, sufficient. Requiring a new submission would violate the terms of DFA and would unduly complicate the process for implementing the clearing mandate contemplated by the DFA.

Similarly, the Commission should not require a DCO to provide submissions seeking permission to clear swaps that a DCO began clearing after enactment of DFA but before the statute's effective date. There is no reason to treat differently pre-enactment and pre-effective date cleared swaps, and Section (h)(2)(B)(ii) should be read to apply to all swaps cleared prior to the effective date of the clearing mandate in DFA, rather than the date of enactment.[1] As a corollary, the presumption set forth in Section 39.5 should apply to all swaps cleared prior to DFA's effective date. This is, for multiple reasons, the most reasonable course of action. Swaps cleared by a DCO prior to enactment and swaps cleared prior to the effective date are essentially the same because both are now being cleared under the same statutory regime — no new regulation applies to the clearing of swaps between enactment and application of the clearing requirement under DFA. Just as in the case of pre-enactment cleared swaps, the DCO should have already made a submission for pre-effective date cleared swaps. This makes particular sense in the case of CME Group. Specifically, CME Group has cleared Interest Rate Swaps after the enactment of Dodd-Frank. Prior to clearing, CME Group filed a self-certification and request for approval of clearing with the Commission. As such, CME Group has already filed materials demonstrating its compliance with the Core Principle in clearing interest rate swaps. Requiring CME Group, essentially, to refile the same information again is a waste of resources.

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[1] It is worth noting that the clearing requirement set forth by DFA does not even apply to pre-effective date swaps. Section (h)(6) specifically states that both swaps entered into before the date of enactment and swaps entered into before the effective date of the subsection are exempt from the clearing requirement if properly reported.

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Indeed, it appears that the Commission has already accepted this more reasonable interpretation in that Section 39.5 applies its presumption to "any swap that is within a group, category, type, or class of swaps that the derivatives clearing organization already clears." This assumes that the stated presumption of eligibility, and, we recommend, the exemption from filing a submission, applies to all swaps cleared before the effective date of DFA.

Last, the presumption set forth by the Commission depends on a determination as to whether a swap "is within a group, category, type, or class of swaps that the derivatives clearing organization already clears." It is not clear whether "group, category, type, or class of swaps" really refers to four different methods of categorizing swaps, each with a separate test of inclusion, or whether this is simply imprecise wording that signals an effort to be inclusive. Whatever the case, we urge the Commission to revise this language to provide clearer guidelines respecting the Commission's intent. It would be useful to provide real world examples. For example are all swaps related to petroleum products delivered or priced in the U.S. within the same "group, category, type, or class of swaps"? Are all interest rate swaps or only dollar denominated interest rate swaps? Is duration significant? The Commission needs to provide a clear statement of the purpose served by "group, category, type, or class of swaps" and the tests that would determine whether a particular swap is within or without the boundaries.

If the regulation is to provide effective guidance it must do more than mimic the statute. Promulgating a regulation represents the Commission's best opportunity to bring some clarity. A DCO needs some basis to determine whether a "new" swap is within the "class" of swaps that it is already clearing.

> *(a)(2) A derivatives clearing organization that wishes to accept for clearing any swap that is not within a group, category, type, or class of swaps that the derivatives clearing organization already clears shall request a determination by the Commission of the derivatives clearing organization's eligibility to clear such a swap before accepting the swap for clearing. The request, which shall be filed electronically with the Secretary of the Commission, shall address the derivatives clearing organization's ability, if it accepts the swap for clearing, to maintain compliance with section 5b(c)(2) of the Act, specifically:*
> *(i)The sufficiency of the derivatives clearing organization's financial resources; and*
> *(ii)The derivative clearing organization's ability to manage the risks associated with clearing the swap, especially if the Commission determines that the swap is required to be cleared.*

It is not clear how subpart (2) adds value to the existing requirements of the CEA. Section 5b(c)(2) of the CEA specifically requires DCOs "to comply with each core principle described in this paragraph and any requirement that the Commission may impose by rule or regulation pursuant to Section 8a(5)" in order to maintain registration as a DCO. Presumably the Commission is seeking some quantitative measure respecting whether the clearing of the swap requires any sort of deviation from the DCO's existing risk management metrics. The Commission should specify the measurement that will satisfy this requirement.

It is unclear why the Commission believes that swaps that are subject to the mandatory clearing requirement magnify or create additional risk management issues or how a DCO can be expected to quantify those additional risks at the time it files the application. The market for

clearing swaps is in its infancy and the overall risk profile at any DCO depends on developments in the market for swap clearing that cannot be realistically estimated at this time.

> *(b) Swap submissions. (1) A derivatives clearing organization shall submit to the Commission each swap, or any group, category, type, or class of swaps that it plans to accept for clearing. The derivatives clearing organization making the submission must be eligible under paragraph (a) of this section to accept for clearing the submitted swap, or group, category, type, or class of swaps.*

Subpart (b) is also unclear. It is presumably intended to govern the submission of any swaps that are not yet being cleared by a DCO but are within the "same group, category, type, or class of swaps" as those already being cleared. The Commission appears to be using subpart (b) as a device to make its decision as to whether a swap should be subject to the mandatory clearing requirement of DFA. As noted, subpart (b) requires that the DCO be eligible to clear the swap that it plans to accept for clearing, but subpart (a) only creates a presumption of eligibility. This must be reconciled.

> *(b)(2) A derivatives clearing organization shall submit swaps to the Commission, to the extent reasonable and practicable to do so, by group, category, type, or class of swaps. The Commission may in its reasonable discretion consolidate multiple submissions from one derivatives clearing organization or subdivide a derivatives clearing organization's submission as appropriate for review.*

It is not clear what the Commission intends to convey by requiring that swaps be submitted, "to the extent reasonable and practicable to do so, by group, category, type, or class of swaps." As noted above, there is no explanation of how the grouping is to be defined. Moreover, it is unclear what makes it reasonable or practicable to submit by means of a grouping as opposed to submitting an individual swap. For example, assume a clearing house intends to clear a "Gulf Coast ULSD (Platts) Up-Down Spread Swap." It would be convenient to characterize this as an energy swap and seek approval from the Commission for all energy swaps if the Commission agrees, but the proposed regulation offers no useful guidance.

> (b)(3) *The submission shall be filed electronically with the Secretary of the Commission and shall include:*
> *(i) A statement that the derivatives clearing organization is eligible to accept the swap, or group, category, type, or class of swaps for clearing and, if the Commission determines that the swap, or group, category, type, or class of swaps is required to be cleared, the derivatives clearing organization will be able to maintain compliance with section 5b(c)(2) of the Act;*

Subpart (b)(3) clearly illustrates the drafting issues presented by this proposed regulation. Assuming that "eligible" is properly defined and the DCO is eligible to clear the swap, it is unclear why the Commission believes that a separate showing of compliance with Section 5b(c)(2) is required if the Commission "determines that the swap, or group, category, type, or class of swaps is required to be cleared." Assume that the DCO could not demonstrate compliance with Section 5b(c)(2) if the Commission issues an order requiring mandatory clearing because the DCO could not meet the requirements if every swap in the class was brought to this DCO — that is not a reason to preclude the DCO from clearing the swap. Unless the Commission is fixed on a course of refusing to allow a DCO to control its risk by turning

away business that would cause it to exceed its risk parameter targets, this requirement makes no sense. Moreover, this obligation suggests that a DCO is not required to implement risk control processes that account for concentration and liquidity risk as part of its existing duties under the Core Principles. That assumption is incorrect and this requirement is likely to be read as weakening the existing DCO obligation.

> (b)(3)(ii) *A statement that includes, but is not limited to, information regarding the swap, or group, category, type, or class of swaps that is sufficient to provide the Commission a reasonable basis to make a quantitative and qualitative assessment of the following factors:*
> *(A) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data;*

As noted above, this request is unreasonably burdensome on DCOs, could defeat the purposes of DFA, and may ask for information that DCOs simply can not access. Many swaps are thinly traded, have no significant outstanding notional exposure and must be priced by reference to curves or other theoretical constructs. Indeed, across OTC venues, there is very little data on notional outstanding and trading liquidity of swaps except across very broad categories. Most of the nearly 1,000 contracts cleared through the ClearPort facility, if they traded as swaps, would fall within this category. However, assume the DCO has found adequate means to manage risk and clear these positions. It is not clear that any of these factors are relevant to the question of whether the contract can be cleared if the clearing house is willing and the customers seek the protection of clearing. The Commission should reconsider whether it is an inefficient use of DCO and Commission resources to require this analysis of every cleared swap that has not been previously submitted for clearing, prior to enactment. Moreover, given the extended time between submission and approval and the public notice requirement, this process creates a massive first mover **disadvantage**. The DCO that seeks to list a new swap is tasked with a massive undertaking that will give rise to free riding by every other DCO that can simply await the Commission's decision.

> (b)(3)(ii) (B) *The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded;*

This request is also unduly burdensome. A DCO substitutes itself as the buyer to the seller and the seller to the buyer. Its rules control the terms of the contracts that it clears. Clearing does not depend on the trading conventions that control trading in the OTC market or on unrelated swap exchange facilities.

> (b)(3)(ii) (C) *The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCO available to clear the contract;*

This request is again, unclear, unduly burdensome, and possibly calls for information that DCOs do not possess. We do not understand what is meant by the mitigation of systemic risk, but to the extent that the Commission is asking for information respecting whether clearing mitigates systemic risk of a particular set of swaps, it is not possible for the DCO to answer this question without complete knowledge of the existing arrangements in the OTC market respecting

collateralization and mitigation of credit exposures. The Commission has systematically asserted that mandatory clearing will mitigate systemic risk in the OTC market. It should be its obligation to substantiate its theory, not the DCOs who are prepared to clear particular swaps.

> (b)(3)(ii) (D) *The effect on competition, including appropriate fees and charges applied to clearing; and*

This request is also unclear, unduly burdensome, and asks for information that DCOs simply do not possess. This provision does not specify what competition is the subject of the inquiry and/or what sort of "appropriate" fees and charges are in question. DCOs have no basis to judge how mandatory clearing is likely to impact competition among swap dealers or major swap participants. We are at a loss to understand what Congress and the Commission mean by the phrase, "competition, including appropriate fees and charges applied to clearing." Regardless, as to reasonable fees, CME Group notes that as a DCO, it is putting large investments into developing its capabilities to support the clearing of swaps.

> (b)(3)(ii) (E) *The existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property;*

It is not appropriate for the Commission to question a DCO as to whether the Commission's regulations will prevail in the event of the insolvency of an FCM.

The remainder of Section 39.5(b)(3)(iii-xi) confirms the burden that will be placed on a DCO that simply wants to clear an innocuous, but "new" swap. Almost all of the information is sought to assist the Commission in deciding whether it should impose a mandatory clearing requirement. The Commission cannot justify requiring a DCO that wants to clear a simple swap to secure and submit "an analysis of the effect of a clearing requirement on the market for the group, category, type, or class of swaps, both domestically and globally, including the potential effect on market liquidity, trading activity, use of swaps by direct and indirect market participants, and any potential market disruption . . . ."

Subpart 39.5(c) defines the Commission's duty to review swaps on an ongoing basis more narrowly than DFA. The proposed regulation limits the Commission's review to "swaps that have not been accepted for clearing by a derivatives clearing organization," while DFA includes no such limitation. Also, the proposed regulation fails to recite the factors that DFA compels the Commission to take into account before making a finding that a swap must be cleared.

IV. Conclusion

CME Group strongly supports clearing of swaps in appropriate circumstances as contemplated by DFA. We urge the Commission to reconsider and revise its rule proposals to avoid creating undue procedural hurdles for the two types of Commission determinations affected by the proposal: what a DCO is qualified to clear a swap and whether a swap must be cleared. A DCO should submit information on the former as currently required. The latter is a Commission determination that does not as a matter of law or logic require a DCO submission. In this and

other significant respects, we request that the Commission recast its proposal before adoption in order to facilitate the clearing of swap transactions on DCOs.

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 via email at **Craig.Donohue@cmegroup.com**, or Christal Lint, Director, Associate General Counsel, at (312) 930-4527 or **Christal.Lint@cmegroup.com.**

Sincerely,

Craig S. Donohue

Craig S. Donohue

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