CME Group

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Chief Executive Officer

February 22, 2011

VIA ELECTRONIC MAIL
Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581
agswapsANPR@cftc.gov

Re: Business Conduct Standards for Swap Dealers and Major Swap Participants With Counterparties

Dear Mr. Stawick:

The Commodity Futures Trading Commission ("CFTC" or "Commission") has requested public comment on proposed swap execution standards applicable to brokers, futures commission merchants, swap dealers, and major swap participants under the Commodity Exchange Act ("CEA") as amended by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank"). *See* Proposed Rule 155.7 and Requests for Comment, 75 Fed. Reg. 80,638 (Dec. 22, 2010) (the "Proposed Rule"). CME Group appreciates the opportunity to express our views on this issue that will be of great importance to the ability of market participants to enter into intermediated swap transactions. CME Group believes that the Commission should defer development of any rules in this area, at least until it has sufficient data and experience regulating swap markets to determine first whether execution standards are necessary and, if so, to develop reasoned standards based on actual trading conditions.

CME Group is the holding company for four separate exchanges or DCMs subject to the CEA: 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"). Trading and clearing swaps may become an important part of our business upon the full implementation of clearing and trading rules under Dodd-Frank.

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Execution Standards for Commission Registrants

Proposed Rule 155.7 would create new rules that apply when a customer places an order, through a Commission registrant,[1] to enter into a swap that is available for trading on one or more designated contract markets ("DCM") or swap execution facilities ("SEF"). First, prior to execution of the swap, the Commission registrant would have to disclose to its customer the DCMs and SEFs on which

[1] "Commission registrants" is not defined in the statute or regulations. However, Part 155 applies to brokers and futures commission merchants and the preamble states that "Commission registrants" includes Swap Dealers and Major Swap Participants. 75 Fed. Reg. 80638 at note 2.

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the swap is available for trading and the DCMs and SEFs on which the registrant has trading privileges. Second, Commission registrants would be required to execute such swap on terms that have a "reasonable relationship to the best terms available." The proposal further specifies that registrants would have to use "reasonable diligence to ascertain the best terms available." The proposal contains a nonexclusive list of factors for evaluating whether a registrant exercised "reasonable diligence:" (1) the character of the market for the swap, including price, volatility, speed, certainty of execution, and liquidity; (2) the size and type of the transaction; (3) the number of markets checked; (4) accessibility of quotations; and (5) the terms and conditions of the order which results in the transaction, as communicated to the Commission registrant.

In the preamble, the CFTC stated that the Proposed Rule would apply to swaps actually executed on a DCM or SEF as well as bilateral swaps that, although available for trading on a swaps market, qualify for an end-user exemption. 75 Fed. Reg. 80648. To determine whether the terms of a swap have a "reasonable relationship" to the best available terms, the Commission believes the guiding principles should be good faith and fair dealing and the duty of loyalty. *Id.* To determine the best terms available, the Proposed Rule would require the registrant to survey DCMs and SEFs that make the applicable swap available for trading, including DCMs and SEFs on which the registrant does not have trading privileges. *Id.* Such survey should include "reviewing available bids and offers, requests for quotes, and real time reporting of trades executed within a reasonable period of time prior to execution of the order." *Id.*

The Commission Should Base Any Execution Standards on Actual Market Experience.

CME Group believes that the Commission needs to base any execution standards it might adopt on actual market experience.[2] There is no immediate need for execution standards for swaps. Virtually all swap customers are expected to be Eligible Contract Participants ("ECPs"). ECPs are sophisticated, professional investors; not retail investors. As sophisticated investors, ECPs will likely have relationships with multiple brokers and are capable of using only brokers they trust. ECPs are also in the best position to determine, by contract, a broker's obligations regarding execution of orders. ECPs ought to be allowed to weigh the protections they believe are necessary against the cost associated with such protections.

Furthermore, under Dodd-Frank and the Commission's other proposed rules, swaps would be executed in different ways and on different platforms, and some swaps will still be privately-negotiated bilateral contracts. Rules that require extensive diligence to determine "the best terms available" across multiple platforms, many of which the executing broker may not even be able to transact on, will increase transaction costs and slow down the execution of individual transactions. The burden could result in executing brokers missing the best terms available because they spent too much time trying to find the

[2] The CFTC's budgetary considerations also would counsel waiting for actual trading experience before adopting execution standards for swaps. As Commissioner O'Malia stated in his dissent to the 2012 proposed budget, "the Commission should consider relying more heavily on Self Regulatory Organizations (SROs) such as exchanges, and clearing houses. Also, the National Futures Association (NFA) can be called upon to execute defined regulatory functions necessitated by the Dodd-Frank Act. The NFA and SROs, in addition to enforcing their own rules, should be given the responsibility for registration, oversight of business conduct standards, and policing the markets for disruptive trade practices." Dissent of Commissioner Scott D. O'Malia To Fiscal Year 2012 President's Budget & Performance Plan (February 11, 2011), http://www.cftc.gov/pressroom/speechestestimony/omaliastatement021111.html.

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best terms available. The proposed rules will also create additional potential liability and regulatory risk that will increase transaction costs for market participants.

CME agrees with the Commission's premise that swap customers deserve the best efforts of their brokers. Best-execution types of rules, some which are cited in the preamble, are well-suited for securities with limited terms and conditions, such as equities, that are executed on a small number of centralized markets. Similar rules could be very difficult to apply to swap trading because swaps have many additional variables, and will likely not be transacted on a continuous market operated on a centralized facility. There is a substantial risk that a burdensome process could actually harm rather than protect customers through increased transactions costs and uncertain execution time. The omission of any cost-benefit analysis of the proposed rules demonstrates that the Commission has not fully considered the burdens the rules would impose or whether any potential benefits would justify those burdens. The absence of this required analysis is particularly troubling where the proposed rule is not required under Dodd-Frank. CME Group believes that until the Commission has sufficient data and experience with regulated swap markets to develop reasoned execution standards and conduct a meaningful analysis of the costs and benefits it should defer consideration of such standards.

Responses to each of the specific requests for comment follow:

1. For the purpose of meeting the duty to use reasonable diligence to determine whether the terms it offers are reasonably related to the best terms available for execution of a swap that is available for trading on a DCM or SEF, should the Commission prescribe a certain percentage of DCMs or SEFs that must be reviewed/considered by the Commission registrant? If so, what percentage is appropriate?

CME Group does not believe the Commission should specify a certain percentage of DCMs or SEFs that must be surveyed. Such a requirement is impractical. Dodd-Frank creates an entirely new regulatory regime for which no one can predict the landscape. Chairman Gensler has estimated that as many as 40 entities may register as DCMs or SEFs. Remarks by Chairman Gensler, Swap Execution Facility Conference (October 4, 2010).[3] Neither the Commission nor any market players has any idea how many DCMs or SEFs will ultimately register or, and even more uncertain, how many DCMs or SEFs will make available for trading any given type of swap. Thus, it is impossible to establish a reasoned threshold.

Finally, it is unknown whether Commission registrants will be able to access information from multiple DCMs and SEFs quickly and efficiently or whether and when there will be data aggregators. The Commission correctly notes in the preamble that trading on DCMs and SEFs will be undergoing a transitional phase and technological and other innovations will occur in the future. 75 Fed. Reg. 80648-49. However, until swap markets are up and running, there will be many unknowns. It is entirely possible that a survey requirement, as proposed, could be unduly time consuming and require a Commission registrant to check multiple individual DCMs and SEFs one at a time. Similarly, the proposed regulations setting forth real time reporting rules permit a fragmented reporting structure in which recent transaction data may not be available in a consolidated location. In some cases, an executing broker could miss

[3] http://www.cftc.gov/PressRoom/SpeechesTestimony/ChairmanGaryGensler/opagensler-55.html

actually executing a swap on the best terms available because the process for trying to determine the best terms available simply took too long.

2. Should the Commission define what it means for the terms of execution to have a "reasonable relationship to the best terms available"? If so, how should the Commission define the phrase?

CME Group believes a very flexible standard is necessary. "Reasonable relationship" is sufficiently flexible to accomplish the intent of the rules. However, the Commission should consider clarifying what it means by "available." The rule, as proposed, appears to contemplate that "available" means listed on *any* DCM or SEF. However, if an executing broker does not have trading privileges on a DCM or SEF, the terms listed on that DCM or SEF are not actually "available" to the executing broker. An executing broker might be able to see such terms and, therefore, might be able to consider such terms and try to use them to negotiate better terms on a platform where the broker can transact. However, the terms of the swaps on the other DCMs or SEFs are not actually "available" in the sense that the executing broker cannot respond to any offers without arranging a give up or other arrangement with an executing broker on that DCM or SEF.

3. Should the Commission require any additional disclosures to the customer, including for example, the best terms available for execution of the swap order and the different between the best terms and the terms on which the swap was executed?

Additional disclosure requirements are unnecessary, would be unduly burdensome, and would likely not provide customers better protection. Swap customers executing transactions on DCMs or SEFs will be ECPs, which will be fully capable of auditing their brokers' performance after the real-time reporting rules take effect. In many cases, the "best terms" will involve a qualitative assessment that would require an accompanying explanation every time a difference was reported. Swaps inherently have many terms that are variable and not easily quantifiable, and may or may not be "better" depending upon the situation of each individual customer. Consider the following example:

> A customer places an order for a swap that is not a swap required to be cleared. Two SEFs make the swap available for trading. The price on one SEF is less favorable but the counterparty has better credit than the counterparty for the other, more favorably-priced swap. If the customer is sensitive to credit risk, it may believe the less favorably priced swap has "better terms." If, however, the customer would rather accept more credit risk in exchange for more favorable pricing, it may believe the more favorably-priced swap has "better terms."

Whether the terms were better or worse than other terms available in this situation is a qualitative assessment. The executing broker would have to explain its assessment every time there was a difference. An executing broker can determine whether qualitative differences, such as in the example, have a "reasonable relationship to the best terms available," but reporting any such differences would require a much higher level of specificity in the execution standard.

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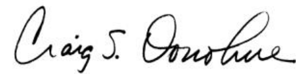
Dodd-Frank does not mandate that the Commission create a “best terms available” standard. The swap markets would be better served if the Commission refrained from creating execution standards that impose survey requirements based upon assumptions of what innovations might occur. In this case, waiting for actual market experience would allow the Commission to determine whether any rule in this area is needed and then to adopt a factually-based principled approach, rather than speculating on how the executed swap market might develop. We appreciate the opportunity to comment on this proposal and look forward to working with the Commission throughout this rulemaking process.

Sincerely,



Craig S. Donohue
Chief Executive Officer

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