CFE
CBOE FUTURES EXCHANGE

February 22, 2011

Via Electronic Submission

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

Re: Comment Letter on Proposed Rulemaking Relating to Core Principles and Other Requirements for Designated Contract Markets; RIN 3038-AD09, 75 FR 80572 (December 22, 2010)

Dear Mr. Stawick:

CBOE Futures Exchange, LLC ("CFE") appreciates the opportunity to provide its comments to the Commodity Futures Trading Commission ("CFTC") with respect to the CFTC's proposals in the above-referenced release ("Release"). The Release proposes to implement certain provisions of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") by setting forth proposed new rules and amended guidance and acceptable practices for designated contract markets ("DCMs").

DCMs Should Be Permitted to Offer Trading in Swaps in the Same Manner that SEFs May Do So

CFE strongly believes that a DCM should be allowed to offer trading in swaps in the same manner that a SEF is permitted to do so. The Dodd-Frank Act contemplates that both DCMs and SEFs may list swap contracts and thus compete with one another. Accordingly, it is crucial that there be a level playing field between both DCMs and SEFs and that there be no regulatory disparities that would make it more advantageous to list a swap on a SEF as opposed to a DCM. Otherwise, the result will be regulatory arbitrage and the goal of promoting competition between DCMs and SEFs will not be realized. Moreover, it is consistent with the public interest and the underlying intent of the Dodd-Frank Act to facilitate the trading of swaps on fully regulated exchanges. To the extent that it is easier to trade swaps on a SEF than a DCM due to more stringent trade execution requirements imposed on DCMs, trading in swaps will migrate to the lesser-regulated SEF trading venues.

CFE is not suggesting that products traded on a DCM which may not be traded on a SEF should be subject to the same trade execution requirements as those applicable to a SEF. Instead, CFE believes that a DCM should be able to offer trading in swaps on its market in the same manner that a SEF may do so. For example, CFE should be permitted to have a separate rule chapter that governs trading in swaps which contains trade execution requirements that are consistent with the SEF trade execution requirements while at the same time retaining whatever trading standards may be required by the CFTC for CFE's other products (including the futures and options on futures that trade on CFE). This separate rule chapter could be coupled with the

submission to the CFTC of a written demonstration of how CFE would fulfill its obligations with respect to swap transactions as required under Proposed § 38.8(a). CFE believes that the language of DCM Core Principle 9 under the Commodity Exchange Act regarding execution of transactions on DCMs is open to a great deal of interpretation as to how it may be satisfied. CFE urges the CFTC to interpret that language, or to permit DCMs to interpret it, in a manner that permits a DCM to compete on an equal plain with SEFs by offering the same types of trade execution procedures for swaps that SEFs may offer.

It is inefficient and would be form over substance to require a DCM to create a separate SEF in order to offer trading in swaps in the same manner that a SEF can do so instead of just permitting the DCM to adopt a separate rule chapter for the trading of swaps on the DCM consistent with the SEF trade execution requirements. A DCM should not have to create a separate entity, board, board committees, membership application and approval process, complete rule set, and all of the many overlapping processes, policies, and procedures that are required for SEFs when a DCM already has all of these components in place and can simply add any incremental additional required components for swaps. Such an approach, if it is what the CFTC intends, is burdensome, costly, without regulatory purpose, and unnecessary.

The CFTC Should Define the Term "Market Participant" as a Non-Member with the Ability to Enter Orders Directly into a DCM's Trade Matching System

The CFTC should provide that the term "market participant" as used in Proposed § 38.151 is limited to non-members of a DCM that have the ability to enter orders directly into a DCM's trade matching system for execution and does not include non-members that do not have this ability. In particular, CFE does not believe that Proposed § 38.151 should apply to customers whose orders pass through a member's system before receipt by a DCM because in that instance the customer order is being received by the DCM from the member. CFE believes that this definition is consistent with the CFTC's statement in the Release that:

> "The Commission believes that if a participant is granted the privilege of trading on a DCM, the participant should not only be required to abide by the DCM's rules, but the participant also must consent to the DCM's jurisdiction and participate in both the investigatory and disciplinary process."

Customers that submit orders through a member do not have the privilege of trading on a DCM and thus Proposed § 38.151 should not apply to them.

This same comment applies as well to the other regulations being proposed by the CFTC in the Release that utilize the term "market participant." For example, Proposed § 38.153 requires that a DCM have arrangements and resources for effective enforcement of its rules, including the authority to examine books and records kept by market participants. If the term "market participant" were to be interpreted to apply to all customers (and not just to those customers with direct electronic access to the DCM), it would greatly expand a DCM's regulatory responsibilities to those over which it has no direct relationship or connection and greatly increase the costs to DCMs without discussion or justification of this result in the Release. It would also be very difficult for a DCM to conduct the same examination responsibilities and other regulatory responsibilities that are applicable to a DCM member with respect to customers that do not have a direct relationship or connection with the DCM.

A DCM Should Be Permitted to Have Fee Differentiation Based on Factors Other than Cost

In addition to CFE's comment regarding the use of the term "market participant" in Proposed § 38.151, CFE also believes that the CFTC's proposed application of the requirement to have comparable fee structures in Proposed § 38.151(b)(2) is too narrow.

In considering this issue, it is important to keep in mind that it is in a DCM's best interest to set fees at levels that entice participation on the DCM (rather than to exclude participants) since having greater participation leads to greater contract volume and thus more transaction revenue for the DCM. Additionally, it has been CFE's experience that encouraging participation often may not be achieved through a flat fee structure.

Proposed § 38.151(b)(2) requires a DCM to have comparable fee structures for members, market participants, and independent software vendors receiving equal access to, or services from, the DCM. The CFTC states in the Release that fee structures may differ among categories of member, market participant, or independent software vendor if the fee structures are reasonably related to the cost of providing access or services to a particular category. CFE agrees that a DCM should be able to have fee structures that differ among categories but does not believe that the only permitted differentiation should be based on cost.

There are many other legitimate and justifiable reasons to differentiate among categories with respect to fees. For example, a DCM may want to incentivize member liquidity providers to provide continuous markets of a designated size and width by providing lower fees to those members. This benefits the marketplace and customers by promoting market liquidity and improving the market sizes and prices that are available for execution. A DCM may also decide to charge lower fees for member transactions than for other categories to incentivize entities and individuals to become members of the DCM. This increases member competition on a DCM's market and increases the number of dedicated participants on the DCM's market to provide liquidity, depth, and order flow to the market. Similarly, a DCM may decide to charge lower fees to trading permit holders of an affiliate exchange of the DCM which offers trading in related products to encourage those trading permit holders to submit orders to trade in the DCM's products. CFE offers trading in futures products that are related to securities products that trade on its affiliate Chicago Board Options Exchange, Incorporated ("CBOE"), and CFE's market is benefited by the additional depth and liquidity in CFE's products that are provided by CBOE trading permit holders. A DCM should be permitted to differentiate between categories of members, direct access market participants, and independent software vendors based upon these and other reasonable factors.

DCMs Should Be Allowed to Determine which Risk Controls Are Appropriate Depending Upon the Nature of the Particular Product

CFE does not take issue with the proposed requirement related to DCM risk controls set forth in the first sentence of Proposed § 38.255, which states:

> "The designated contract market must establish and maintain risk control mechanisms to reduce the potential risk of market disruptions, including but not limited to market restrictions that pause or halt trading in market conditions prescribed by the designated contract market." (emphasis added)

CFE does take issue with the following statement in the Release relating to Proposed § 38.255 to

the extent that it may be read to imply that a DCM must implement trading pauses:

> "The Commission believes that pauses and halts are effective risk management tools and must be implemented by DCMs to facilitate orderly markets."

A DCM should be permitted to determine which risk controls are appropriate depending upon the nature of the particular product. Consistent with the language of Proposed § 38.255 (which refers to restrictions that pause or halt trading), the CFTC should make clear that a DCM is not required to implement trading pauses if it determines that they are not appropriate for a particular product.

For example, CFE lists CBOE Volatility Index ("VIX") futures, Mini-VIX futures, and Weekly Options on VIX futures. Many CFE customers and trading privilege holders use these products to hedge their positions in Standard & Poor's 500 Index ("SPX") options and VIX options traded on CBOE and to seek to hedge against large market movements. SPX and VIX options do not have trading pauses and the ability to hedge those products with CFE VIX products would be inhibited if the CFE VIX products were required to pause while the related CBOE products continued trading. Additionally, the very reason why some market participants hold CFE VIX products is to seek a hedge against large market moves by taking advantage of the fact that the VIX and the Standard & Poor's 500 Index typically move inversely to one another. This purpose is defeated if CFE VIX products were required to be paused while the equities market continued to move. Accordingly, while CFE rules do require CFE VIX products to halt in the event of an equity circuit breaker halt and CFE has additional halt rules that are applicable with respect to its VIX products, CFE should not be required to implement trading pauses in these products and other products when it does not make sense to do so.

> <u>If a Minimum Centralized Market Trading Requirement for DCM Contracts Is Retained, It Should Be Based on Number of Trades Instead of Volume and Average Order Size in Comparison to Average Block Trade Size</u>

Proposed § 38.502 requires that in order for a DCM to be able to continue to list a contract, an average of 85% or greater of the total volume of the contract must be traded on the DCM's centralized market over a 12 month period. For the reasons stated above, no such test should be applied to DCMs for swaps traded on DCMs unless it is also equally applied to SEFs.

In addition, this test is far too stringent. CFE has found that it can take a long period of time to build liquidity and volume in a futures product. During that period of time, the markets available on the DCM's centralized market and the trades that take place on that market can be small in size. Because large size markets are not available, parties may need to utilize block trades for large size transactions in the product. As a result, a few large block trades can skew the percentage of volume taking place off of the DCM's centralized market even when the number of block trades is small in relation to the total number of trades that take place on the centralized market.

Accordingly, CFE believes that if a test is adopted by the CFTC for a contract to remain eligible to be listed on a DCM, it should be based on two factors: (i) the percentage of trades in the contract that take place on the DCM's centralized market (instead of the percentage of volume in the contract that is traded on the DCM's centralized market) and (ii) the average order size in the contract on the centralized market in comparison to the average block trade size in the contract. As long as there is not an inordinate percentage of block trades in the contract and the minimum block trade size is sufficiently larger than the average order size in the contract on the centralized market, the acceptable practices referenced in Proposed § 38.503(h) and the

provisions of Proposed § 38.503(b) (which are designed to ensure that block trade sizes are set at appropriate levels) should protect the integrity of the price discovery process consistent with DCM Core Principle 9.

Establishing a percentage test that is too high (as is the case with the 85% test in Proposed § 38.502) risks disqualifying a large number of futures contracts from trading on a DCM after only a year of trading, including those futures contracts which start out with minimal trading volume and ultimately become successful products with robust trading on a DCM's centralized market after they have been offered for a few years. Furthermore, maintaining an overly restrictive test will put DCMs at a competitive disadvantage to SEFs and provide SEFs with an unfair regulatory advantage over DCMs. It will also put small DCMs like CFE at a competitive disadvantage to large DCMs that are better able to compensate liquidity providers to provide depth and liquidity to their centralized markets in order to satisfy such a test. Ultimately, this will harm end users as small DCMs with new ideas are given only a limited time frame to build awareness and acceptance for innovative products.

Also, if a percentage test like the one in Proposed § 38.502 is retained, the reporting requirement under Proposed § 38.502(b)(4) should be revised so that a single filing can be made once a year for all of a DCM's products. Proposed § 38.502(b)(4) requires that a DCM calculate and file with the CFTC the centralized market trading percentage in each of its contracts within 30 days of the 12 month anniversary of the initial calculation which is tied to the initial listing date of the contract for new contracts or the effective date of Proposed § 38.502 for existing contracts. As a DCM lists more and more contracts, it will have report due dates under Proposed § 38.502(b)(4) at a potentially large number of varying dates within a year which could be in the middle of a week or month or on a weekend or holiday. This is administratively cumbersome for DCMs and it would be far more efficient if a DCM were required to conduct a test and file a report for all of its contracts prior to a single date each year (such as January 31st, which is one month following the end of the calendar year).

The CFTC Should Clarify that DCMs Should Only Be Required to Produce to Respondents Evidence to Be Introduced at a Disciplinary Hearing

The CFTC should clarify that the requirement under Proposed § 38.710(a)(2) regarding the production of documents to a respondent in advance of a disciplinary hearing only applies to books, documents, and other evidence to be introduced by the DCM at the hearing. In particular, this requirement should not apply to documents subject to the attorney-client privilege, to attorney work product, to confidential surveillance reports and methodologies, and to the identity of the complainant if the DCM does not intend to introduce this information at the hearing. It is important that this requirement not be interpreted to require a DCM to waive it legal privileges, to reveal confidential surveillance reports and methodologies that could be used by a respondent and others who obtain access to the information to reverse engineer and/or evade the DCM's surveillance techniques, or to reveal the identity of a complainant when the complainant wishes to remain anonymous (which encourages complainants to come forward and report rule violations). DCM investigation and examination reports and materials prepared by a DCM in connection with these reports or in anticipation of a disciplinary hearing should also be protected from disclosure as internal work product unless the DCM intends to introduce them at the hearing (as distinct from the underlying evidence analyzed and discussed in those reports and materials which should be available to the respondent).

The CFTC Should Clarify that the Proposed Requirement to Provide for Customer Restitution Does Not Apply When the Amount of Restitution that Should Be Provided, to Whom to Provide It, and/or How to Allocate It Is Unclear

CFE supports the goal articulated in Proposed § 38.714 that any disciplinary sanction also include full customer restitution in the event of demonstrated customer harm. However, there are often many variables relating to potential customer restitution that a DCM may not be able to ascertain. For example, it may not be possible for a DCM to determine in a particular situation the amount of customer harm, which parties may have been harmed, and/or how the harm was allocated among potentially aggrieved parties. CFE does not believe that a DCM should be required to include restitution as part of a disciplinary sanction if factors like these are unclear in a particular instance. Being able to ascertain with reasonable certainty what the restitution should be in a particular situation, to whom to provide it, and how to allocate it may be what is meant by the application of the requirement in Proposed § 38.710(a)(2) to cases of "demonstrated customer harm." In any event, CFE believes that the CFTC should clarify that the requirement to include customer restitution in a disciplinary sanction does not apply to the extent that a DCM is unable to determine with reasonable certainty what the restitution should be in a particular situation, to whom to provide restitution, and/or how to allocate restitution.

The Proposed Submission Deadlines for DCM Financial Information Should Be the Same as Public Company Financial Reporting Deadlines for DCMs with Financial Information that Is Subject to Public Company Reporting Requirements

CFE believes that the deadline for the quarterly submission to the CFTC of DCM financial information under Proposed § 38.1101(f)(4) should be revised for DCMs that are public companies or have financial statements that are consolidated with those of a public company. Specifically, CFE believes that the quarterly submission deadline for those DCMs should be the same as the filing deadline with the Securities and Exchange Commission ("SEC") for the Form 10-Q or Form 10-K (for the applicable reporting period) of the public company DCM or the public company with which the DCM's financial statements are consolidated. Public company reporting and the preparatory steps required to make Form 10-Q and Form 10-K filings are tied to these SEC deadlines and having the same CFTC deadline for finalization and submission of this information to the CFTC will avoid disruption of the current financial reporting processes. Additionally, the CFTC should make clear in Proposed § 38.1101 that a DCM may request confidential treatment of any information required to be submitted under Proposed § 38.1101 that is not publicly available.

The CFTC Should Lengthen the Time Frame for DCM Compliance with the Proposed Requirements

The Release and other CFTC releases propose a large number of new requirements applicable to DCMs under each of the 23 DCM core principles and associated regulations. In order to comply with these new requirements, CFE will need to revise and update many of its rules and policies and will need to establish a number of new procedures. The 60 day time frame proposed by the CFTC to implement all of these changes is extremely short. In addition, for all practical purposes, the actual time frame to do so with respect to the many rule changes that need to be made is even shorter. Under Proposed § 40.6(a)(3), rule changes will need to be submitted to the CFTC 10 business days in advance of their effectiveness lowering the actual time frame for completion of those rule changes to 48 days or less. In addition, CFE has found it helpful to provide the CFTC staff with drafts of significant rule certifications in advance of their formal submission in order to receive any feedback that the CFTC staff might have. Doing that in this

instance (which CFE believes would be useful) will lower the time available to complete the rule changes even further. Given the importance of all of these changes, CFE does not believe that it is in the best interest of all that will be impacted by these changes to rush their preparation and to not be able to take the time necessary to prepare all of the rule and policy changes and new procedures in a careful and considered fashion. Accordingly, CFE believes that the CFTC should amend Proposed § 38.3(g) to provide, at a minimum, that DCMs shall have 120 days to come into compliance with the new requirements.

The CFTC Should Designate a Single CFTC E-Mail Address for the Submission of All DCM Notifications and Reports to the CFTC

A number of the regulations proposed in the Release require DCMs to provide notifications and reports to the CFTC. For example, Proposed § 38.1050(e) requires a DCM to notify CFTC staff of certain events such as electronic trading halts and systems malfunctions and Proposed § 38.1101(f) requires a DCM to submit to the CFTC periodic reports containing certain financial information. However, these and other proposed regulations in the Release do not specify the manner in which required notifications and reports should be submitted to the CFTC. CFE believes that the CFTC should designate a single e-mail address at the CFTC for the submission of all DCM notifications and reports to the CFTC. The CFTC can then internally determine how best to route the information within the CFTC and can make sure it gets to the appropriate CFTC staff members. CFE believes that this is preferable to having DCMs address these submissions to particular individuals at the CFTC since it may not be clear which individuals should receive a particular submission and the individuals at the CFTC responsible for various items can change over time.

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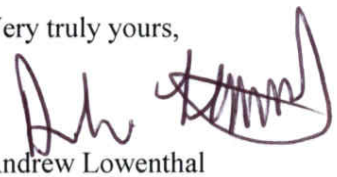
CFE is available to provide any further input desired by the CFTC regarding these issues and to work cooperatively with the CFTC to address them. Please contact Arthur Reinstein in our Legal Division at (312) 786-7570 if you have any questions regarding our comments.

Very truly yours,



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