Eris Exchange

February 22, 2011

VIA ELECTRONIC MAIL

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

Re: RIN number 3038-AD09: Federal Register Release: 75 FR 80572-Core Principles and Other Requirements for Designated Contract Markets; Proposed Rule

Dear Mr. Stawick:

Eris Exchange, LLC ("Eris Exchange") appreciates the opportunity to submit its comments to the U.S. Commodity Futures Trading Commission (the "Commission" or "CFTC") on the proposed Dodd-Frank Act rulemaking related to the Core Principles and Other Requirements for Designated Contract Markets (the "Proposal").

As discussed more fully below, Eris Exchange has serious concerns regarding a lack of flexibility in the Proposal and the CFTC's abrupt movement away from the "principles based" regulation, which has proven to be a successful regulatory approach for Designated Contract Markets ("DCM"). Specifically, the "Minimum Centralized Market Trading Percentage Requirement" (the "85% Centralized Market Requirement") will result in forcing futures contracts that historically have been traded on a DCM to either delist from a DCM or "transform" the futures contract into a swap that is then transferred to a Swap Execution Facility ("SEF"). *See* Proposal at 80588. The 85% Centralized Market Requirement will have the consequence of changing the definition or criteria of a futures contract.[1] This definitional change will, for the first time in Commission history, impose a liquidity requirement on futures contracts. This liquidity requirement will deter new product and market innovation, disrupt markets that have functioned well in the past, and limit the ability of opaque markets to evolve to transparent trading venues. Therefore, Eris Exchange does not support the Proposal due to the 85% Centralized Market Requirement.

I. Background on Eris Exchange and the Eris Interest Rate Swap Futures Contract

Eris Exchange is an Exempt Board of Trade subject to the jurisdiction of the Commission. Eris Exchange is an open platform that currently offers the trading of an interest rate swap futures contract that replicates the economics of a standard over-the-counter ("OTC") interest rate swap (the "Eris Interest Rate Swap Futures Contract" or "Contract"). The Contract is cleared by CME Clearing.

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[1] While "futures contract" is not defined in the Commodity Exchange Act, the Commission's Glossary provides general guidance on the definition:

> Futures Contract: An agreement to purchase or sell a commodity for delivery in the future: (1) at a price that is determined at initiation of the contract; (2) that obligates each party to the contract to fulfill the contract at the specified price; (3) that is used to assume or shift price risk; and (4) that may be satisfied by delivery or offset.
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> http://www.cftc.gov/ConsumerProtection/EducationCenter/CFTCGlossary/glossary_f.html

Eris Exchange was founded by five major independent liquidity providers: Chicago Trading Company; DRW Trading; GETCO; Infinium Capital Management; and, Nico Trading (the "Founders"). The Founders are principal trading firms that trade across a wide range of asset classes and have significant experience in the equity and futures markets.

The Founders created Eris Exchange to increase access to traditional OTC markets that are migrating to centrally-cleared trading venues as a result of recent U.S. financial regulatory reform. Traditionally the OTC interest rate swaps market has had a closed system of one-to-one bilateral transactions or one-to-one RFQs. This is due to historical market structure issues, as well as, the need for the sell-side to hedge the risk assumed from engaging in transactions. The OTC interest rate swaps market has historically included high barriers to entry that effectively prevented the emergence of independent liquidity providers. Recognizing the need for additional participants in the OTC interest rate swaps market and the value those participants could add to price discovery and liquidity, Eris Exchange was created as an open venue for all market participants to trade the Eris Interest Rate Swap Futures Contract.

Eris Exchange's initial product offering is due, in part, to the regulatory certainty that has existed for decades with financial futures contracts and the benefits a futures product offers participants, such as cross-margining with traditional financial futures. The Eris Interest Rate Swap Futures Contract embeds all of the economics of a standard over-the-counter interest rate swap into a single futures price. The Contract is independently marked-to-market and settled every day based on data from the overall interest rate market. The Contract does not have periodic cash flows like standard OTC swaps, but replicates the economics of accrued and expected cash flows in the futures price, resulting in cash transfers through the daily variation margin process. In other words, Eris Exchange has "futurized" an interest rate swap.

As discussed more fully below, Eris Exchange is concerned that the Proposal will disincentivize product innovation in the futures space. Specifically, Eris Exchange is in the process of applying for registration as a DCM, which would allow Eris Exchange to trade futures and swaps. Therefore, Eris Exchange will ultimately be subject to the Proposal, if finalized by the Commission. As a new entrant into the futures exchange business, Eris Exchange can provide the Commission with a unique perspective.

II. Discussion

A. Eris Exchange Opposes the 85% Centralized Market Requirement for Futures Contracts

Eris Exchange agrees with the statement in the Proposal that the "trading in the centralized market provides a price discovery function, and specifically requires that the execution of transactions be in a manner that protects the price discovery process." Proposal at 80588. However, by imposing a prescriptive percentage across all markets, products, and at all times will severely limit product innovation. In short, one size does not fit all in the case of the futures markets. The 85% Centralized Market Requirement is too crude a method for determining whether there should be a centralized market requirement in the first place. It is misguided to have the same centralized market requirement for a physically delivered contract and a financially settled contract or for an agricultural product and a swaption. The 85% Centralized Market Requirement is not flexible enough to meet the requirements of the diverse products that the futures markets have offered in the past and can continue to offer in the future. The Proposal also has the risk of forcing futures trading overseas to markets where a centralized market requirement does not exist. Therefore, the 85% Centralized Market Requirement will have a negative impact on market structure. Instead, the Commission should maintain its principles based scheme, which has allowed the futures markets to flourish in terms of product innovation, as well as, sustain the market's primary function of allowing market participants to hedge their commercial needs.

As a general matter, the 85% Centralized Market Requirement conflicts with the language of Core Principle 9, which explicitly permits off-exchange transactions, which includes block trades. *See* Proposal at 80588 (stating "The Commission notes that, while amended Core Principle 9 recognizes the primacy of trading on the centralized market for price discovery, it does not bar off exchange transactions. Congress reaffirmed that the rules of the DCM may authorize bona fide off-exchange transactions.") The 85% Centralized Market Requirement places an unnecessary prescriptive requirement on how a DCM can operate under the Act, especially where a DCM already has self-regulatory obligations related to off-exchange transactions. Nowhere in the Proposal does it state that the 85% Centralized Market Requirement is due to a pattern of fraud or manipulation in the industry. Indeed, the financial crisis demonstrated that the futures industry and the CFTC effectively oversaw and regulated the futures markets.

As noted above, Eris Exchange offers a futures contract because it believes that the product provides the market with an effective option for hedging interest rate risk, while at the same time allowing the crucial transition of interest rate products to centralized trading and clearing. In order to achieve this goal, the Eris Interest Rate Swap Futures Contract has standardized and "futurized" the interest rate swap, making the product an innovative development in the interest rate market. However, the 85% Centralized Market Requirement provides a restriction on the ability of exchanges to offer products that are innovative and take time to gain traction and to fully trade in a central limit order book. If a futures contract does not satisfy the 85% Centralized Market Requirement, the futures contract will be forced off of the DCM, converted into a swap, and required to trade on a SEF. Proposal at § 38.502. The result is that the Commission is forcing a futures contract to become a swap, which seems to be a result contrary to the clear language of the Dodd-Frank Act, which specifically excludes futures from the definition of "swap." *See* Section 721(a)(47) of the Dodd-Frank Act.

Forcing a "futurized" swap or even a swap to delist from a DCM and re-list on a SEF, due only to a liquidity requirement, results in disparate treatment for a DCM. While the Dodd-Frank Act allows a DCM to offer the trading of swaps, the 85% Centralized Market Requirement effectively overrides the Dodd-Frank Act. Applying a different standard for a DCM than a SEF, for a similar or the same product, is a poor regulatory result. In other words, the Proposal favors SEFs. Clearly, this was not the intent of the Dodd-Frank Act since swaps are specifically allowed to trade on both a DCM and a SEF. *See* Section 723(a)(3) of the Dodd-Frank Act (adding Section 2(h)(8) of the CEA to require, among other things, that execution of swaps subject to the clearing requirement of Section 2(h)(1) of the CEA must occur either on a DCM or a SEF).

The possibility of delisting adds uncertainty to the marketplace, especially for long-dated futures contracts, as the product, and its progeny, could be delisted. This possibility alone will destroy the incentive for market participants to utilize a long-dated futures contract that could serve an important commercial hedging need. The Proposal adds yet another level of uncertainty to a marketplace that is already undergoing a regulatory overhaul. Market participants are in the process of deciding how they will effectively operate in the new market structure; such a severe change to the futures market structure is simply not needed. The Proposal dis-incentivizes people from using DCMs. Delisting is a severe result with serious consequences. Instead, the Commission should consider some form of principles-based remediation by the DCM to encourage greater trading on the centralized market. Such remediation, however, should be conditioned on the failure of a contract to fulfill its price discovery function.

As noted above, Core Principle 9 permits a DCM to have rules for off-exchange transactions, such as block trades. The practical effect of the Proposal will be that block trades will have a limited time horizon on a DCM and ultimately will no longer be practical on a DCM, especially for new markets that need time to gain traction or for products that require a different market structure. The end result is that certain products will never have

an opportunity to transition to a central limit order book, which provides the greatest level of transparency, and ultimately price discovery. While the Proposal does permit a DCM to petition the Commission for a limited exemption from the 85% Centralized Market Requirement of up to 12 months in certain circumstances, including for new contracts, the limited exemption is not flexible. *See* Proposal at § 38.502. In order for the Commission to grant a petition, a DCM would have to demonstrate that at least 50% of the trading in a contract occurred in the centralized market and that the DCM expects to meet the 85% Centralized Market Requirement within the following 12 months. *Id*. Like the 85% requirement, the 50% requirement is not practical. The Commission should not restrict a DCM's flexibility to compete in the market. This is especially true for a new DCM entrant.

B. Eris Exchange Opposes the Elimination of the 90-Day Accelerated Review Process

As a general matter, Eris Exchange appreciates the new Form DCM set forth in the Proposal, but Eris Exchange opposes the elimination of the 90-day accelerated review process. The Form DCM provides a DCM applicant with a roadmap of required documentation. This Form should result in a streamlined and standardized review process by Staff.

Eris Exchange opposes the elimination of the 90-day accelerated review process. *See* Proposal at 80575. While Eris Exchange is sympathetic to the Commission's experience with "incomplete or draft applications, without adequate supporting materials" the certainty provided by the Form DCM will lead to a streamlined and standardized review process. It would seem a contradiction for the Commission to provide certainty with the Form DCM, while at the same time saying that is not enough to become a DCM in 90 days. If there is something more that the Commission believes it requires from a DCM applicant, it should provide that certainty to the marketplace in the Proposal. Any questions from the Commission that arise from an application should be capable of being answered within the 90-day time period. Otherwise, the Commission creates a burdensome process for applicants.

Importantly, Eris Exchange believes that the elimination of the 90-day accelerated review process places new entities at a competitive disadvantage because time-to-market is critical in this time of regulatory and technological evolution. The 90-day accelerated review process should remain because it balances the needs of the Commission with the needs of the marketplace. As noted above, a DCM is a self-regulatory organization with significant responsibilities to oversee and regulate its market. The Commission should allow new marketplaces to flourish to increase competition by streamlining the application approval process.

C. Specific Questions Raised in the Proposal: End-of-Day Price Reporting for Interest Rate Swaps

The Proposal seeks comments on several questions related to end-of-day price reporting for interest rate swaps. While Eris Exchange will be offering the trading of an interest rate swap future, Eris Exchange provides the guidance set forth below with regard to these questions. As an initial matter, Eris Exchange believes DCMs and SEFs should be held to the same reporting standard.

The end of day price reporting for interest rate swaps should comply with three principles. First, it is very reasonable to require a market to provide real-time, intraday prices for par swaps in standard maturities. This level of transparency is critical to ensure that market participants are receiving fair and reasonable prices. Second, daily open interest should be published publicly in a summary fashion. Open interest information should be grouped in maturity buckets based on the remaining tenor of each instrument. Third, as to end of day pricing, a clearing house will settle contracts based upon a market-driven curve. The clearing house's methodology to generate the daily settlement curve, as well as all of the inputs and components of the

settlement curve, should be made transparent to the full trading community. In addition, the clearing house should publish the specific daily settlement values applied to each cleared swap, without revealing open interest at such a granular level.

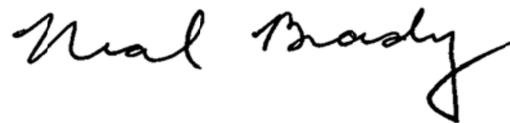
Implementation of these three principles correctly balances the need for transparency with the need to preserve the anonymity of individual customer positions. In sum, these three principles are: (i) publishing real-time, intraday trade prices for par swaps at standard maturities; (ii) publishing open interest grouped in maturity buckets based on remaining tenor; and, (iii) publishing a transparent settlement curve from the clearing house as well as the specific settlement values applied to each cleared swap. If implemented, these three principles represent a meaningful and practical end of day price reporting requirement for interest rate swaps.

III. Conclusion

Eris Exchange is fully operational today for trading and clearing of interest rate swap futures, thus incorporating the guiding principles of the Dodd-Frank Act. Eris Exchange is committed to complying with the principles of the Dodd-Frank Act, but seeks implementation in a manner that fosters competition and open access to the markets.

If you have any questions or would like to learn more about Eris Exchange, please do not hesitate to contact Stephen Humenik, General Counsel and Chief Regulatory Officer at 312-626-2681 or stephen.humenik@erisfutures.com or Neal Brady at 312-253-9056 or neal.brady@erisfutures.com.

Sincerely,



Neal Brady
Chief Executive Officer
Eris Exchange, LLC

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