



February 22, 2011

VIA ELECTRONIC SUBMISSION

Mr. David A. Stawick
Secretary
U.S. Commodity Futures Trading Commission
1155 21st Street, NW
Washington, DC 20581

Re: Core Principles and Other Requirements for Designated Contract Markets: RIN 3038-AD09; Core Principles and Other Requirements for Swap Execution Facilities: RIN 3038-AD18

Dear Mr. Stawick:

On December 22, 2010, the U.S. Commodity Futures Trading Commission (“Commission” or “CFTC”) issued a Notice of Proposed Rulemaking regarding core principles and other requirements for designated contract markets (“DCM”) in the Federal Register,¹ as required by Section 735 of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“Dodd-Frank Act” or “Act”).² Thereafter, on January 7, 2011, the Commission issued a Notice of Proposed Rulemaking regarding core principles and other requirements for swap execution facilities (“SEF”) in the Federal Register, as required by Section 733 of the Act.³ Argus Media Inc. (“Argus”) hereby submits comments on the DCM and SEF Rulemakings.⁴

Argus endorses the important goals of enhancing transparency and promoting market integrity to protect against manipulative behavior in CFTC jurisdictional markets. Consistent with these goals, Argus supports the Commission’s emphasis on ensuring the integrity of the price indices to which futures and swap contracts often are linked and against which they may be settled. Argus believes that any rules implementing the core principles should account for differences in markets and instrument types when assessing the integrity of particular price indices and when evaluating the robustness of the methodologies used by independent third parties to publish these indices. Further, Argus encourages the Commission to clarify that the

¹ *Core Principles and Other Requirements for Designated Contract Markets*, 75 Fed. Reg. 80,572 (Dec. 22, 2010) (to be codified at 17 C.F.R. Parts 1, 16, and 38) (“DCM Rulemaking”).

² Pub. L. No. 111-203 (2010) (to be codified as an amendment to the Commodity Exchange Act (“CEA”) in 7 U.S.C. ch. 1).

³ *Core Principles and Other Requirements for Swap Execution Facilities*, 76 Fed. Reg. 1214 (Jan. 7, 2011) (to be codified at 17 C.F.R. Part 37) (“SEF Rulemaking”).

⁴ Argus’ comments apply with equal force to the DCM and SEF Rulemakings.

specific criteria the Commission identifies as applicable to DCMs and SEFs when they generate their own cash settlement price series are intended to cover DCMs and SEFs, but not third party price reporting agencies. DCMs and SEFs, unlike third party price reporting agencies, have unfettered access to and control over the relevant information. Because of this, they are able to meet the heightened requirements outlined by the Commission. Finally, Argus respectfully suggests that it is inappropriate to require DCMs and SEFs to monitor the “availability and pricing of the commodity making up the index to which the contract will be settled” where the index price is generated based upon transactions that are executed off the DCM or SEF.

Argus is a leading independent provider of price information, market data and business intelligence for the global, physical petroleum, natural gas, electricity, emissions, biofuels and coal industries. Argus is incorporated in the United States as Argus Media Inc., a Delaware corporation, which is a wholly owned subsidiary of Argus Media Ltd., established in 1970.

Headquartered in London, Argus has offices in Washington, D.C., Houston, New Jersey, Moscow, Singapore, Tokyo and Beijing. Argus is owned by its employees and by the family of its founder. Argus staff adhere to a strict ethics policy that forbids them from dealing in energy and commodities or in the stock of energy or commodities companies.

I. DCM and SEF Rulemakings

Section 723 of the Dodd-Frank Act amends Section 2(h) of the CEA generally to require that all swaps must be executed on a DCM or SEF.⁵ However, this requirement does not apply if the swap is not required to be cleared, or if no DCM or SEF makes the swap available for trading.⁶ Section 733 of the Dodd-Frank Act creates new Section 5h of the CEA, which prohibits any person from operating a facility for the trading and processing of swap transactions unless the facility is registered as a DCM or SEF.⁷

The DCM Rulemaking proposes new and revised regulations, guidance and acceptable practices to implement the regulatory obligations that each DCM must meet in order to comply with the CEA, as amended by the Dodd-Frank Act.⁸ Among other things, the DCM Rulemaking proposes revisions to the Commission’s guidelines regarding Core Principle 3, which is intended to ensure that DCMs only list contracts that are not readily susceptible to manipulation.⁹ For both futures contracts settled by cash settlement and swaps contracts, these guidelines contain separate criteria for compliance with Core Principle 3, depending on whether the price index is

⁵ Dodd-Frank Act, Section 723 (CEA Section 2(h)).

⁶ *Id.* (CEA Section 2(h)(8)).

⁷ Dodd-Frank Act, Section 733 (CEA Section 5h(a)).

⁸ DCM Rulemaking at 80,574.

⁹ *See generally id.* at 80,631-35 (Proposed Part 38, Appendix C).

calculated by the DCM or by a third party. Where an independent, third party calculates the referenced price index, the DCM “should verify that the third party utilizes business practices that minimize the opportunity or incentive to manipulate the cash-settlement price series.”¹⁰ The DCM Rulemaking also amends Core Principle 4—Prevention of Market Disruption—to specify the methods and procedures DCMs must employ in satisfying their obligations under this principle. For cash-settled contracts, the regulations require that a DCM monitor: “(a) [t]he availability and pricing of the commodity making up the index to which the contract will be settled; and (2) [t]he continued appropriateness of the methodology for deriving the index.”¹¹

The SEF Rulemaking establishes a comprehensive regulatory framework for SEFs. Among other things, the SEF Rulemaking proposes regulations and guidelines regarding Core Principle 3—Swaps Not Readily Susceptible to Manipulation.¹² Similar to the DCM Rulemaking, the SEF Rulemaking contains guidelines regarding price indices on which swaps’ cash flows are based.¹³ For price indices published by a third party (as opposed to the SEF), the company should be “independent and reputable” and use a “sound, well-documented methodology that protects the index from manipulation.”¹⁴ Moreover, the SEF Rulemaking establishes guidelines for Core Principle 4—Monitoring of Trading and Trade Processing. For cash-settled swaps, a SEF must monitor the “availability and pricing of the commodity making up the index to which the contract will be settled” and the “continued appropriateness of the methodology for deriving the index.”¹⁵

II. Comments to DCM and SEF Rulemakings

A. The Commission should account for differences in markets and instrument types when assessing the integrity and robustness of a price index.

Argus shares Congress’ and the Commission’s concern about ensuring that futures and swaps are not subject to manipulation. In that regard, Argus supports the Commission’s emphasis on ensuring the integrity of price indices upon which futures and swap contracts are often based and against which such contracts may be settled. This includes indices published by

¹⁰ *Id.* at 80,633 (Proposed Part 38, Appendix C § (c)(3)(i)); *id.* at 80,635 (Proposed Part 38, Appendix C § (g)(1)(i)).

¹¹ *Id.* at 80,614 (Proposed § 38.253).

¹² SEF Rulemaking at 1,246 (Proposed §§ 37.300-301); *id.* at 1,257 (Proposed Part 37, Appendix B).

¹³ The DCM guidelines apply to swaps that are settled by physical delivery or by cash settlement. *Id.* at 1,257 (Proposed Part 37, Appendix B) (“For swaps that are settled by physical delivery or by cash settlement refer to guidance in Appendix C to Part 38—Demonstration of Compliance that a contract is not readily susceptible to manipulation, Section b(2) and Section c(5), respectively.”).

¹⁴ *Id.* at 1,227.

¹⁵ *Id.* at 1,247 (Proposed § 37.403).

DCMs, SEFs or independent third parties. To achieve this goal, the Commission's guidelines state that, where a third party publishes the price index, the DCM or SEF should ensure that the third party uses reliable methodologies that minimize the opportunity or incentive to manipulate the cash-settlement price.¹⁶ Further, "Documentation demonstrating that the settlement price index is a reliable indicator of market values and conditions and is commonly used as a reference index by industry/market agents should be provided."¹⁷ Argus endorses this verification process.

However, from Argus' perspective, it is important that any such examination of a referenced index price should recognize the differences in markets and instrument types. Under certain circumstances, the methodologies used to determine an index price may vary depending on the characteristics of the market in question. For example, the markets for physical crude oil in the United States are markedly different than the markets for other physical energy commodities, such as natural gas and electricity. Natural gas and electricity are single homogenous commodities, with prices varying according to location and timing of delivery. As a result, liquidity across delivery points may be more consistent and the methodologies used to generate index prices in these markets may be more straightforward. In contrast, crude oil markets are typically fragmented and fragile. Different regions of the country produce different grades of crude oil. These different grades of crude oil are refined into different products, and only certain refineries are capable of distilling these different grades of crude oil. Finally, these refined products are not highly fungible: gasoline specifications vary from state to state and between urban and rural regions, meaning that the same gallon of gasoline cannot be sold everywhere. Given this ongoing process to direct the oil into the products for which there is the most immediate need, and then to move these products to the regions of the country where they are to be consumed, there is a greater tendency for variations in size and liquidity from one crude oil marketplace to another. Thus, what may be considered sound and reliable for one market or instrument type may not be for another. Argus recommends that any review of the integrity of a price index should be flexible enough to account for differences in markets and instrument types.

B. The Commission should clarify that the specific criteria applicable to DCMs and SEFs that generate price indices are appropriately limited to DCMs and SEFs because of their access to and control over the relevant information.

The DCM and SEF Rulemakings contain guidelines for ensuring compliance with Core Principle 3, including a process for verifying the integrity of the price indices to which futures and swap contracts are often tied and/or against which they are settled. In both Rulemakings, the proposed guidelines appear to differ depending on whether the price index is calculated by the

¹⁶ DCM Rulemaking at 80,633 (Proposed Part 38, Appendix C § (c)(3)(i)); *id.* at 80,635 (Proposed Part 38, Appendix C § (g)(1)(i)); SEF Rulemaking at 1,227.

¹⁷ DCM Rulemaking at 80,633 (Proposed Part 38, Appendix C § (c)(2)); *id.* at 80,635 (Proposed Part 38, Appendix C § (g)(1)).

DCM/SEF itself or by a third party. Where an independent, third party publishes the referenced price index, the DCM or SEF “should verify that the third party utilizes business practices that minimize the opportunity or incentive to manipulate the cash-settlement price series.”¹⁸ The DCM or SEF should also enter into an information-sharing agreement with any such third party provider.¹⁹ However, if the DCM or SEF itself generates the cash settlement price series, the guidelines identify more specific criteria. For instance, if the index price is derived based on a survey of cash market sources, the DCM or SEF should maintain a list of all of the sources, each of which must be reputable.²⁰ The sample of sources polled should be representative of the cash market and conducted when trading in the market is active.²¹ Finally, the cash settlement survey should include at least four independent entities if these sources do not take positions in the commodity, or eight independent entities if these sources trade for their own accounts.²²

Argus recognizes the value of this approach. However, Argus also believes that the specific criteria listed above are appropriately limited to DCMs and SEFs that generate their own price indices as the proposed guidelines seem to suggest. Unlike third party price reporting agencies who rely upon the voluntary submission of price information from market participants, DCMs and SEFs are not limited in their access to the applicable transaction data. Therefore, the DCM or SEF in some instances may be able to access a larger pool of transaction data to ensure that the “sample of sources polled [is] representative of the cash market.”²³ In contrast, an independent third party is limited to the transaction data that market participants are willing to volunteer. Thus, an independent price reporting agency may not be able to satisfy a threshold requirement for the number of entities surveyed due to a lack of transactions or participants in a given market, which may be the case in the more illiquid cash markets. As a result, the imposition of these criteria on third party providers would likely reduce the number of price indices independently generated that could be used by DCMs or SEFs in pricing their contracts.

¹⁸ *Id.* at 80,633 (Proposed Part 38, Appendix C § (c)(3)(i)); *id.* at 80,635 (Proposed Part 38, Appendix C § (g)(1)(i)); *see also* SEF Rulemaking at 1,227 (“If obtained from a private third-party, the company should be independent and reputable. Moreover, the third party should use a sound, well-documented methodology that protects the index from manipulation.”).

¹⁹ DCM Rulemaking at 80,633 (Proposed Part 38, Appendix C § (c)(3)(i)); *id.* at 80,635 (Proposed Part 38, Appendix C § (g)(1)(i)).

²⁰ *Id.* at 80,633 (Proposed Part 38, Appendix C § (c)(3)(ii)); *id.* at 80,635 (Proposed Part 38, Appendix C § (g)(1)(ii)); SEF Rulemaking at 1,227.

²¹ DCM Rulemaking at 80,633 (Proposed Part 38, Appendix C § (c)(3)(ii)); *id.* at 80,635 (Proposed Part 38, Appendix C § (g)(1)(ii)); SEF Rulemaking at 1,227.

²² DCM Rulemaking at 80,633 (Proposed Part 38, Appendix C § (c)(3)(ii)); *id.* at 80,635 (Proposed Part 38, Appendix C § (g)(1)(ii)); SEF Rulemaking at 1,227.

²³ DCM Rulemaking at 80,633 (Proposed Part 38, Appendix C § (c)(3)(ii)); *id.* at 80,635 (Proposed Part 38, Appendix C § (g)(1)(ii)); SEF Rulemaking at 1,227.

Consistent with the plain language of the guidelines, Argus encourages the Commission to clarify that the heightened criteria applicable to DCMs and SEFs that generate their own price indices do not apply to indices generated by independent third parties.

C. It is not appropriate to require DCMs and SEFs to monitor the “availability and pricing of the commodity making up the index to which the contract will be settled” where the index is based on transactions executed off exchange.

The Commission also addresses the “growth in markets that are linked, for example, where the settlement price of one market is linked to the prices established in another market.”²⁴ Given the growth of these linked markets, traders may have incentives to manipulate or disrupt the prices in the reference market for the purpose of influencing the prices in the linked market. Accordingly, in the guidelines for Core Principle 4 (Monitoring Trading and Trade Processing), the Commission proposes ways for DCMs and SEFs to monitor trading in the market to which a cash-settled futures contract or swap contract may be linked.²⁵ In particular, for cash-settled contracts and swaps, the regulations *require* the DCM or SEF to monitor the “availability and pricing of the commodity making up the index to which the contract will be settled” and the “continued appropriateness of the methodology for deriving the index.”²⁶

While Argus supports the stated goal, it is concerned about the practicality of requiring DCMs and SEFs to perform this monitoring function, particularly where an index price is published based upon transactions that are executed off the DCM or SEF. Read literally, this guideline would mean that a DCM or SEF would have to monitor the “availability and pricing of the commodity” that forms the basis of the price index regardless of where and how the underlying commodity is traded. For example, a SEF that links a fuel oil swap listed on the platform to a third party’s fuel oil index price would have to monitor the availability and pricing of the physical fuel oil that forms the basis for the third party’s index. Should DCMs and SEFs be required to monitor the “availability and pricing” of the fuel oil forming the basis of a third party publisher’s index, the exchanges could simply choose not to list the contract to avoid this obligation and any associated, potential liability. This result would be particularly detrimental to the marketplace, given that there currently is no futures contract linked to this commodity. Market participants would be left with no instrument to hedge their price risk tied to fuel oil.

Moreover, it is not clear how the DCM or SEF could perform this monitoring function without requiring the third party price reporting agency to divulge confidential information. Indeed, Argus does not believe that the Commission currently performs this function. Even if the DCM or SEF were able to monitor these off-exchange markets effectively and without

²⁴ DCM Rulemaking at 80,583; SEF Rulemaking 1,228.

²⁵ DCM Rulemaking at 80,583; SEF Rulemaking 1,228.

²⁶ DCM Rulemaking at 80,614 (Proposed § 38.253); SEF Rulemaking at 1,247 (Proposed § 37.403).

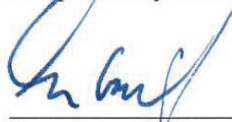
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requiring the release of confidential information, the cost to do so could be prohibitive. Accordingly, the guidelines, as currently structured, create a disincentive for a DCM or SEF to link their cash-settled futures contracts and swap contracts to commodities markets assessed by third party price reporting agencies because doing so creates an obligation for the DCM or SEF to monitor the availability and price of the underlying market. At the same time, it is unclear how this requirement would further Congress' and the Commission's goal of protecting the markets against manipulative conduct. Thus, the Commission should consider eliminating the requirement that a DCM or SEF must monitor the "availability and pricing of the commodity making up the index to which the contract will be settled" in its guidelines to account for this fact.

III. Conclusion

Argus appreciates the opportunity to provide the Commission with its perspective on the DCM and SEF Rulemakings. Argus welcomes the opportunity to discuss these issues further with the Commission and its Staff.

Respectfully submitted,



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