OneChicago

February 22, 2011

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

RE: **CORE PRINCIPLES AND OTHER REQUIREMENTS FOR DESIGNATED CONTRACT MARKETS**
RIN 3038-AD09

Dear Mr. Stawick:

OneChicago, LLC ("OCX") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or "Commission") Notice of Proposed Rulemaking ("NPRM") that was published in the Federal Register on December 22, 2010. Our comments are focused on proposed regulations §38.502, Minimum centralized market trading requirement; §38.503, Block trades on futures contracts; and §38.1101 Financial Resources.

OneChicago is the only domestic security futures exchange; we provide a marketplace for trading futures on over 1,900 individual equities. Security futures were authorized by the Commodity Futures Modernization Act of 2000 ("CMFA"), which placed security futures under the joint regulation of the Commodity Futures Trading Commission ("CFTC") and the Securities and Exchange Commission ("SEC").

Overarching Comment

While the Dodd-Frank Act (DFA) granted the CFTC the authority to adopt rules with respect to core principles it did not discuss the elimination of principles-based regulation. The prescriptive tone of this NPRM, where there is proposed requirements to multiple Core Principles, strikes us as doing just that and we do not believe that there is any evidence that this would be of any benefit.

In general, the NPRM has shoehorned the trading of security futures products ("SFP") into the trading of all other futures and swaps by using a one-size-fits all approach to regulation. The staffs and commissioners of both the SEC and the CFTC artfully crafted the regulation of SFP to comply with the intent of the CFMA. The special provisions for SFP provided in the CFMA include the joint regulation by the SEC and the CFTC, a special provision regarding the minimum margin (performance bond) for the product and the adoption of specific regulations regarding the trading of SFP found in Part 41 of the CFTC Regulations. None of the provisions regarding SFP have been amended, renumbered or repealed by Dodd-Frank, yet the CFTC has apparently decided unilaterally to adjust certain important regulations that impact SFP. We believe that only Congress, and not the CFTC, has that authority.

Proposed §38.502, the Minimum Centralized Market Trading Requirement (the "85%" rule)

Core Principle 9 calls for Designated Contract Markets ("DCM") to "provide a competitive, open and efficient market and mechanism to executing transactions that protects the price discovery process of trading in the centralized market". It also provides for the ability for DCMs to allow for Exchange for Physical, now referenced as Exchange for Derivative Related Position ("EDRP") as well as block trades.

OneChicago notes that Section 5(d)(9) of the CEA, as amended by Dodd-Frank, does not require a fixed percentage of the trading in a product be in the "centralized market of the board of trade" in order to protect the "price discovery process" as discussed in the NPRM. In this respect, we agree with dissenting statements of Commissioners O'Maila and Sommers.

We are concerned that the CFTC is inappropriately applying the proposed rules to all futures markets despite difference amongst them. As fully described below, security futures have distinct characteristics that separate it from other futures product that warrant different treatment. Consequently, security futures markets should be exempt from proposed §38.502 and §38.503 due to:

1. Security Futures are primarily an equity finance tool that reflects already discovered cash market prices

OneChicago security futures, a delta one product[1], are primarily an equity finance tool used by market participants in the same fashion as security lending transactions, equity swaps, and equity repos. Market participants use security futures as a substitute to holding the cash equity to lower their cost of acquiring or maintaining equity exposure. This holds true whether they are trading the security futures outright or as a leg of a strategy trade including EDRPs.

Price discovery does not happen in the security futures price market, price discovery happens in the deep, liquid organized cash market for the underlying equity. The security futures solely reflect the cash market price plus finance costs, including securities lending pressure[2] adjusted as

---

1 Delta One products are a class of financial derivative that have no optionality and as such have a delta of one (or very close to one) - that is a 1% move in the underlying results in very close to 1% move in the derivative.

2 . The securities lending pressure can cause the security future to be offered at significant discount to the cash offer. For instance, on January 14, the February 2011 ManKind Corporation future was offered at a 42% annualized discount to the underlying cash offer.

appropriate for distributions. The discovered cash price is a component in the futures pricing algorithm.

SFP margins are prima facie evidence that SFPs are different from other futures. CFTC and SEC set the margin at the 20% level to be consistent with equity options as required by the CFMA. Margins on other futures products are generally set by the exchanges and the clearing house.

Another difference between SFPs and other futures is related to deliveries. Unlike other futures products, the overwhelming majority of physically delivered security futures contracts are delivered and not rolled. The table below shows the percent of open interest in the deliverable contract on the first business day of the month that ultimately went through delivery.

Month	Percentage
September 2010	99%
October 2010	95%
November 2010	114%
December 2010	65%

This is a clear difference from other futures where less than 5% of open interest is delivered. It is also worth noting that OneChicago's open interest actually rises on expiration Friday as market participants use the SFP to amass positions needed to satisfy obligations in other expiring derivatives.

Why Security Futures trade away from a centralized market

OneChicago employs a market marker model such that the majority of our products enjoy continuous two-sided bid and offers which are readily available to all market participants. The market makers use algorithms that start with the underlying cash equity bid and offer, add in their cost of carry and risk premium to derive their OneChicago bid and offer. Each change in the bid/offer in the underlying stock can cause the market maker to update their bid/offer in the security futures. This direct linkage generates more than 70 million SFP quotes a day across 1,900 products for an average of more than 10 thousand two-sided bid/offer quotes per tradable instrument.

As stated above, there are quotes in the OneChicago core centralized market, however, they do not represent enough size to generally satisfy larger size orders. The market maker quotes generally reflect quantities that are tradable in the cash equity market, the less shares that are available in the cash equity market, the less the market makers will have on their bid and offer. Therefore, the OneChicago displayed liquidity in the centralized market is a direct function of the displayed liquidity in the cash market.

With a 2010 average trade size of less than 10 contracts, executing large size in the centralized market may result in hundreds of transactions, directly increasing costs for market participants.

Consequently, large size trades are unlikely to occur in the core centralized market. Rather, most large size trades are voice brokered and pre-hedged in the underlying stock prior to reporting the trade to OCX.

.
This is not unique to security futures at OneChicago. Security futures at Eurex, an exchange based in Germany, trade primarily in a bi-lateral fashion, less than 3% of Eurex's 2010 security futures volume was executed on its order book.

2. Congress, in Section 2(a)(1)(D)(i) and (vii) of the Act, and the Commission in Regulations 41.22 and 41.23 clearly provide listing standards for security futures. Proposed §38.502 poses additional listing/maintenance standards that are outside of the Congress's intent for security futures as well as Regulations 41.22 and 41.23

Security futures product listing requirements, unlike other futures listing standards, are delineated in the CEA (see §2(a)(1)(D) of the CEA and §6(h) of the Securities Act of 1934) and are subject to both CFTC and SEC jurisdiction. Based on the definitive language in the CEA, Congress clearly intended for security futures to have different listing standards than other futures products. In doing so, Congress recognized the significant differences between security futures and other futures contracts. Procedurally, the only way to change the listing standards for SFPs is through a Joint Order of both the SEC and the CFTC. The proposed rule is not the same as a Joint Order.

Further, the 85% Rule is discriminatory. The reason is if trading in a specific SFP does not meet the proposed minimum centralized market trading percentage, it must be delisted or moved to a Swap Execution Facility ("SEF"). While this alternative may work for some exchanges it is a disingenuous suggestion for OCX because SFP contracts cannot be accommodated by a SEF. We do not believe that the intent of Dodd-Frank was to amend or repeal any provisions relating to SFP. Nevertheless, this Rule, if adopted, could result in shuttering OCX, the only active exchange offering SFP, inconsistent with Congress's intent in the CFMA to provide for security futures in the US.

Finally, the underlying security will still meet the requirements for listing as dictated by the CEA and Commission Regulations Section 41 Subpart C. As such, OCX could immediately relist the security futures. Absent the Commission taking action to change the security futures listing standards in Section 41, this cycle would continue in a list and delist fashion, all consistent with the CEA and Commission regulations.

3. Pursuant to CEA §5f Notice Designated Contract Markets in Security Futures are exempt from CFTC Core Principles. Applying Proposed §38.502 to DCMs will create regulatory arbitrage

National securities exchanges or associations that are fully registered with the Securities and Exchange Commission may offer security futures upon notice registering with the Commission. These notice registered security futures markets are not subject to certain sections of the Commodity Exchange Act including Section 5, which contains the Core Principles.[3]

Absent exempting security futures from proposed §38.502 and §38.503, the Commission will cause regulatory arbitrage between the Commission and the SEC. Security futures exchanges,

[3] See Section 5f of the Act

by necessity, will then register with the SEC as national securities exchanges or associations and only notice register with the Commission. OneChicago does not believe Congress' intent in Core Principle 9 was to consolidate all security futures exchange under the SEC.

Proposed §38.503, Block Trades on Futures Contracts
OneChicago supports the Commission fully codifying the market participant requirements for block trade transactions. In fact, OneChicago's rules already mirror proposed §38.503(c) (d) and (e).

However, we are concerned with the block size requirements such that each equity listing may be subject to separate requirements. OneChicago supports a consistent minimum block size across all SFPs. Designating different block sizes for each product would be a logistical nightmare for market participants that will be sure to result in inadvertent violations.

Core Principle 21 and Proposed §38.1101 Financial Resources
OneChicago appreciates the active steps taken by Congress in Core Principle 21 to require that only financial capable entities are approved as DCMs. As one of the smaller DCMs, we have a complete understanding of the financial investments required to start a new contract market.

We note that neither the Act nor the NPRM define whether operating costs are gross or net. In any event, the number could be significant both for the large established exchanges and for the new and less active exchanges such as OCX. The Commission needs to provide further definition for operating costs.

The NPRM suggests that the DCM could use its own capital to satisfy this requirement or could "…request an informal interpretation from Commission staff on whether a particular financial resource (such as a parent or other form of guarantee) would be acceptable to the Commission." We believe that there should be some bright lines in the Rules rather than leaving this decision to the staff. Would firm commitments from owners to honor capital calls be acceptable to the commission?

An unintended consequence of proposed §38.1101 may be that it encourages a DCM to cut services to such a level as to reduce it's operational need for cash thus weakening the organization.

OneChicago thanks the Commission for the opportunity to comment on this subject. We would be happy to discuss any related issues with CFTC staff. If you have any questions, please do not hesitate to contact me at (312) 424-8512 or via email at tmccabe@onechicago.com

Sincerely,

Thomas G McCabe
Chief Operating Officer