February 22, 2011

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

RE: (RIN number 3038–AD09) Core Principles and Other Requirements for Designated Contract Markets

Dear Mr. Stawick:

Green Exchange LLC ("GreenX") welcomes the opportunity to comment on the Commission's proposed rule release regarding core principles and other requirements for designated contract markets (the "Release").[1] GreenX was approved as a designated contract market ("DCM") by the Commission on July 22, 2010. Contracts on emissions allowances and credits in CO_2, NOx, and SO_2 were listed for trading by GreenX beginning on January 24, 2011.

As the DCM most recently approved as such by the Commission, GreenX believes that it is able to offer an important perspective on the impact of the Proposed Rules specifically affecting newly formed DCMs. In addition, GreenX believes it can offer a unique perspective as its products are in new and developing markets. As to our general view concerning the Proposed Rules, GreenX supports the comments submitted by CME Group, Inc.[2]

GreenX generally supports the Commission's efforts to "codify certain requirements and practices that are commonly accepted in the industry and have been found…to represent the best practice means of complying with the core principles."[3] GreenX believes, however, that in many instances, what may be a best practice for one DCM, may not necessarily be a best practice for all DCMs, particularly for newly formed DCMs that have fewer resources, and operate in new markets, with less trading volume than long-established DCMs. GreenX is concerned that the Commission's departure from principles-based regulation to a "one size fits all" approach to regulation will stifle innovation and competition. Potential entrants will

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[1] Core Principles and Other Requirements for Designated Contract Markets, 75 Fed. Reg. 80572 (December 22, 2010).
[2] Chicago Mercantile Exchange Inc. owns an equity stake in Green Exchange Holdings LLC, GreenX's parent company and also acts as a service provider to GreenX.
[3] 75 Fed. Reg. at 80574.

be discouraged from entering the market as DCMs because the initial start-up costs will be tremendous, the ability to continue with anticipated products uncertain, and competing in the market as a DCM, with a slim chance of success in the best of circumstances, will be too difficult. Below we address provisions of specific concern to GreenX.

I. Core Principle 9 – Proposed Regulation §38.502

A. Proposed Regulation §38.502

Under proposed regulation §38.502, for each newly listed contract, a DCM would be required to determine the percentage of the total volume, in all contract months combined, that is attributable to centralized market trading for a 12 month period commencing one year following the date of a contract's initial listing on the DCM, and for each 12 month period ending on the anniversary of such contract's listing thereafter. Unless an average of 85% or greater of the total volume of such contract is traded on the DCM's centralized market, as calculated over the 12-month period ("85% requirement"), the DCM would be required to delist or liquidate the contract.

For contracts listed as of the effective date of final regulation §38.502, the DCM would be required to calculate for each contract the total volume attributable to centralized market trading within 30 days of the effective date. Unless an average of 85% or greater of the total volume of such contract is traded on the DCM's centralized market, as calculated over the prior 12-month period, trading in such contract must be for liquidation only.

The proposed regulations provide that a DCM would be able to apply to the Commission for an exemption from the delisting requirement of up to twelve months, provided that an average of 50% or greater of the total volume of such contract was traded on the DCM's centralized market.

As support for the proposed regulation, the Commission points to DCM Core Principle 9, which requires that a DCM provide "a competitive, open and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade." GreenX, however, agrees with the views of Commissioners Sommers and O'Malia described in their dissent to the proposed regulations, specifically, that off-exchange contracts do not adversely affect price discovery for contracts traded in the central market.[4] In fact, GreenX believes that off-exchange contracts ultimately support price discovery because they are the intermediate means by which uncleared over-the-counter

[4] See 75 Fed. Reg. at 80635-36.

("OTC") contracts are migrated to centrally traded contracts. GreenX believes that the Commission's narrow interpretation of Core Principle 9 and the 85% requirement will stifle competition and innovation, forcing these off-exchange contracts away from DCMs and away from Commission regulation and the safety, soundness and transparency of centralized clearing, and ultimately harm price discovery.

In the Commission's analysis of 570 contracts that had off-exchange trading volume described in the Release, the Commission stated that it did not consider 410 contracts where almost all or all of the trading over the three-month period occurred off-exchange. The Commission noted that these contracts mostly involved energy, forex and weather contracts. These are precisely the types of contracts that should be considered when evaluating potential exchange volume thresholds and other requirements under the proposed regulation. Many of these are contracts that evolved from uncleared OTC contracts in response to a demand from the marketplace and became sufficiently standardized to be listed on an exchange, but have not yet matured into contracts with volume in the centralized market. We acknowledge that some, if not many, of these contracts may never mature into contracts with substantial volume in the centralized market. However, the potential negative impact of reduced price discovery will be minimal because, in this case, there is little demand for price discovery. GreenX believes that the centralized market target volume requirement is too high, and that the target should be recalculated to take into account the 410 contracts cited above, as well as other contracts related to newer markets, such as environmental products.

B. Carbon Markets Report Discussion of Off-Exchange Contracts

The Interagency Working Group for the Study on Oversight of Carbon Markets ("Interagency Working Group") recently released its Report on the Oversight of Existing and Prospective Carbon Markets, in which the Working Group states "the ability to engage in OTC trading can be particularly important in the early years of a market. Because exchanges use multilateral trading platforms and central clearing, they generally rely on standardized contracts. The OTC market permits new transaction types to emerge, which, over time, may become sufficiently standardized and commonplace to sustain migration to an exchange platform."[5]

The Commission, as chair of the Interagency Working Group, appears to recognize the important role of off-exchange contracts as an intermediate step in the evolution of uncleared OTC contracts to contracts traded in the centralized market. Further, in providing a two-year transition period from the launch of the contract on a DCM, the Commission appears to recognize that the transition from off-exchange trading to the

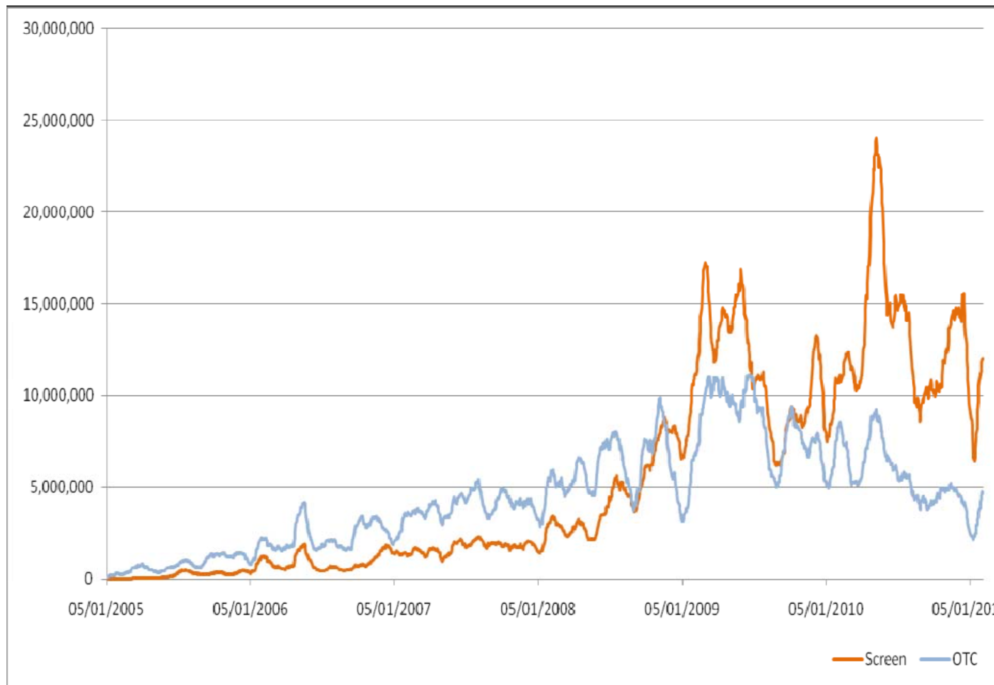
[5] "Report on the Oversight of Existing and Prospective Carbon Markets," Interagency Working Group for the Study on Oversight of Carbon Markets (January 18, 2011), at 18-19.

DCM's centralized market will take some time. As discussed in greater detail below, GreenX believes that a longer transition requirement is required given the hurdles to facilitating this transition, particularly for novel contracts, and the drastic consequences of failing to meet the proposed centralized market trading target.

The Interagency Working Group described one of the main benefits of the OTC market as that "it allows market participants to engage in transactions of customized derivative contracts that facilitate the hedging of or gaining exposure to market factors, or to otherwise meet their unique risk-management needs." In developing new products, DCMs attempt to create exchange-listed contracts that market participants may substitute for these OTC contracts. This is the first step to bring a contract towards competitive execution. Using the evolving carbon markets as an example, off-exchange carbon transactions in the European carbon market currently constitute approximately 30% of the total global exchange carbon contract volume, down from about 70% in early 2006, one year after the start of the market and launch of exchange contracts.[6] Below are graphical representations of screen versus OTC trading distribution in the European carbon market since 2005.[7]

[6] Note that this does not include un-cleared OTC transactions in the carbon market, as it is not possible to verify the number of un-cleared OTC transactions. Upon the implementation of mandatory clearing, if these formerly un-cleared OTC transactions would be migrated into clearing through off-exchange transactions effected subject to the rules of a DCM, this would further reduce the percentage of DCM volume executed in the centralized market.
[7] Source - Point Carbon (February 7, 2011).

GreenX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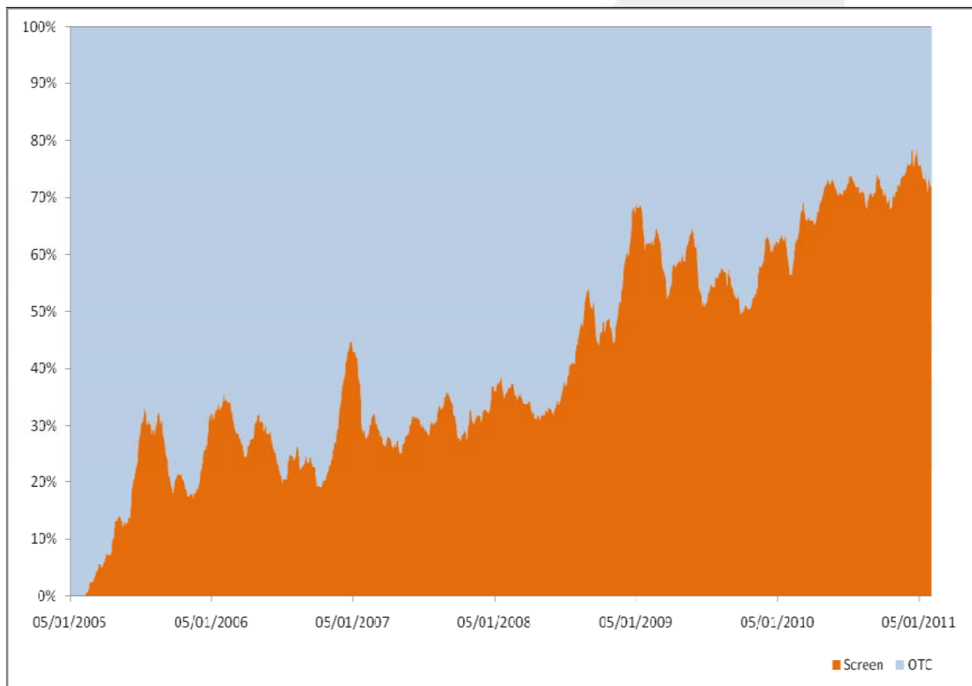
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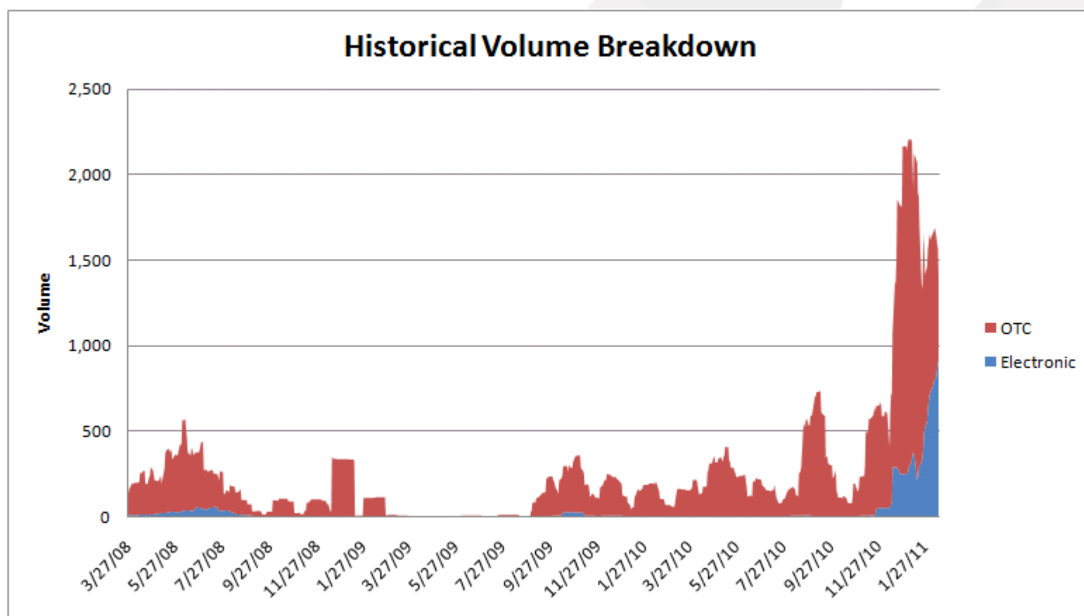
When participants do begin transacting in the DCM's contracts, the DCM's development of market share will typically start with off-exchange market transactions prior to moving to the competitive execution venue. Anecdotally, GreenX believes this evolution is a slow process because in illiquid markets, participants choose to enter the market through off-exchange transactions rather than spending hours watching a trading screen that shows little volume and liquidity, and little price discovery. Using an OTC broker is a more efficient means of negotiating the contract than using a blank trading screen. GreenX agrees with the Interagency Working Group in its belief that there is a natural evolution from off-exchange to the centralized market as volume and open interest increases, and as price discovery increases, to the point where participants choose to watch trading screens rather than execute off-exchange. In addition, there must be critical mass in order to kick-start a market, and in the nascent stages of market development that may not be the case. The 85% requirement will mean far less hedging and risk management options for those operating in developing markets.

Using GreenX's contracts as an example, the following chart shows the proportion of all GreenX futures and options contracts traded OTC (*i.e.*, off-exchange through ClearPort) to those traded in the centralized market (*i.e.*, electronically through Globex) since 2008.[8] The analysis is based on a twenty day rolling average for each series of data, starting on March 27th, 2008, and ending on February 15th, 2011.



[8] Prior to January 24, 2010, the GreenX environmental contracts were listed on NYMEX.

The below chart sets forth the total GreenX product on-screen volume compared to off-exchange volume since the environmental products first were listed.[9]

Trading Year	Globex Volume	Off-Exchange Volume
2008	7%	93%
2009	3%	97%
2010	6%	94%
2011	57%	43%

As the above diagram and chart illustrate, it takes time to move trading towards the centralized market. One or two years simply will be insufficient time for products in less mature markets to gain traction.

Almost all of the GreenX futures contracts currently trading are physically delivered with calendar year-end expirations (*e.g.*, December 2011, 2012, 2013 and 2014). After reviewing its trading data, GreenX notes that a substantial portion of this daily trading activity, approximately 72%, occurs in the nearby contract month. GreenX observes that significant trading activity and building of open interest in the next year-end calendar month typically does not occur until the nearby contract approaches expiration. For example, from January 24, 2011 to February 18, 2011, trading volume for December 2011 dated contracts was 18,993 contracts, trading volume for December 2012 dated contracts was 4,793 contracts, and trading volume for December 2013 dated contracts was 1,197 contracts. For the longer dated contracts (*e.g.*, December 2013), GreenX observed that off-exchange trading was more prevalent since there generally was less screen-based trading activity. Given this trend, the 85% requirement essentially would preclude listing contracts with extended delivery dates, as participants likely would be hesitant to trade for fear of being exposed in a contract at risk for being delisted, thus risking losing a hedge. This would create a self-fulfilling prophesy for those contracts.

In addition, the Commission should permit DCMs the flexibility to consider each expiration a separate contract for purposes of calculating the percentage of centralized market trading. Using GreenX EUA contracts as an example, where the contracts are listed by vintage year of the allowance or credit, even if GreenX achieved 90% screen trading for its 2011 EUA futures contract calculated over a 12 month period, if the 2012 and 2013 contract volumes were forced to be included in the same calculation, the EUA futures contract overall would fail the 85% requirement.

[9] *Supra* note 8.

C. Proposed Regulation §38.502 ultimately will harm participants in the centralized market

Often it can take at least six months to a year for a DCM to develop and launch a new contract. The DCM incurs significant expenses during the development and launch period, potentially including expenses related to research and analysis, testing and technology, internal and external legal review, outside consultants, marketing and sales.

When a DCM lists a new contract that competes with or is a substitute for existing contracts on another DCM or foreign market, the DCM has the challenge of convincing participants to trade its contracts over those of its competitors. It typically takes DCMs a significant amount of time and expense before it develops enough momentum to garner sustainable market share.

For a newly-formed DCM, the challenge is far greater. The newly formed DCM also must convince participants that its market offers pricing, clearing or other benefits that are superior to other markets. There also is a natural "ramp-up" period in which the newly-formed DCM is registering and connecting participants, and establishing itself as a recognized DCM.

Additionally, a DCM often must address multiple issues unrelated to the venue for contract acceptance in creating its markets and products. For example, GreenX was required to solve certain technology problems in order to provide European participants access to its markets. These types of issues could cause significant delays and could affect volume on the centralized market, even though they do not have to do with the venue for contract acceptance.

To hold DCMs to an 85% percentage target for trading contracts in the centralized market would stifle innovation and product development by DCMs, as they likely will be unwilling to invest the time and resources to develop, market and launch a new contract if there is a concern that it may be required to be delisted after just two years. This will result in fewer contracts on DCMs, more uncleared OTC contracts and a loss of transparency. This also may prevent new DCMs from registering and will make funding of a newly formed DCM much more difficult. All of these results ultimately will harm market participants.

The Commission should also not underestimate the psychological and commercial risks to market participants of a potential failure to meet the 85% requirement. Participants want to know when entering into a trade that the trade will be a viable trade over the life of the transaction, particularly where a transaction is being executed as a hedge for another transaction. The Commission's proposal could harm market participants as their positions either could be transferred to a SEF or

liquidated, regardless of whether they were traded in the centralized market or OTC. Their positions would thus be shifted from a transparent DCM to less transparent OTC markets. Dealing with this transfer could cause market participants to incur legal and other professional fees to address the transfer, divert scarce business attention to having to deal with the transfer, and otherwise raise many issues for market participants. For example, if a market participant's positions are transferred to a SEF, the market participant must first become a participant of the SEF.[10] Further, if the contract was cleared as a futures contract on the DCM, and is transferred to a swap contract on the SEF, there could be adverse tax consequences to the market participant. If the market participant's positions are liquidated, it may not be able to enter into a new contract to hedge its resulting exposure. Companies often must first gain approval internally from risk committees before trading a new exchange contract, and may be unable gain approval if the 85% requirement is enacted as written until there is a proven track record for the DCM/contract as the risk of delisting or forced migration will be too great. All of these risks would give to a well-founded fear on the part of market participants, as the Eagles sang in "Hotel California" that they "can checkout any time [they] like, But [they] can never leave!" The natural response to this fear would be to trade only on the most established, most liquid DCMs and only in the most liquid products. This would harm competition, stifle innovation, reduce risk management tools in the marketplace, serve as a significant barrier to entry and protect incumbent exchanges against upstarts, however meritorious their products might otherwise be.

D. The Application of the Proposed Rules to Existing Contracts is Burdensome and Harmful to Participants

The application of proposed regulation §38.502 to existing contracts would almost immediately force many existing DCM contracts to trading for liquidation purposes only. Using the Commission's analysis described above, the 410 contracts (where almost all or all of the trading over the three-month period occurred off-exchange) would certainly be, and many other contracts may be, required to be available for liquidation purposes only. Participants would lose the benefit of hedging using these contracts since these contracts may not be immediately available to participants on a SEF. With these proposed rules, the Commission will insert risk for exchanges and participants into the market and eliminate risk management tools.

Because of the timing considerations described above, GreenX believes that DCMs should have the same opportunity to meet centralized market trading requirements

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[10] GreenX notes that the proposed rules provide that the contract and open interest may be transferred to a SEF. GreenX does not believe that this is an acceptable solution. These proposed rules would essentially require all DCMs to register as SEFs in order to protect their proprietary interest in contracts. The registration and operation of a SEF would be costly.

for contracts that exist as of the effective date as they do for newly listed contracts. GreenX believes that imposing a target without providing sufficient opportunity to meet that target could be detrimental to DCMs and participants. It also allows no room for flexibility for differing circumstances, such as in the case of GreenX, which only began listing its contracts on its own DCM in January of this year.

E. The Proposed Rules should not apply to Options Contracts

Options contracts are primarily traded in two venues – a trading floor and off-exchange. GreenX does not have a trading floor and its option contracts generally are entered via ClearPort. Options contracts are not generally traded electronically because of the number of contract permutations out the curve for puts and calls at numerous strikes. Options trading strategies are far more complex and often include multiple legs where timing may be critical. Screen trading as of yet is insufficiently flexible for fully implementing these strategies, so it may be necessary for participants to execute off exchange. For a DCM that does not have a trading floor, proposed regulation §38.502 would have the result of preventing the DCM from listing options. The Commission should consider applying the proposed regulation §38.502 only to futures contracts listed on a DCM.

F. The Mechanics of the Annual Calculation Method are Flawed

GreenX believes that calculating the percentage of volume in the centralized market over a one year period, particularly in the context of a start-up DCM, is flawed and would have the effect of creating a hurdle that is too difficult for the DCM to overcome.

To illustrate potential flaws in the one-year 85% average requirement, assume a hypothetical instance where in the second year of a contract's trading, the DCM is able to achieve the following steady increase in trading volume in the DCM's centralized market (illustrated in the numerator), out of the total volume in the DCM (illustrated in the denominator):

Month 13	Month 14	Month 15	Month 16	Month 17	Month 18
200/1000	250/1000	300/1000	350/1000	400/1000	450/1000
Month 19	Month 20	Month 21	Month 22	Month 23	Month 24
500/1000	550/1000	600/1000	650/11000	750/1000	850/1000

As this example illustrates, due to a steady increase in trading volume over time, by the end of the second year, the DCM has achieved the Commission's proposed target of 85% of contract volume in the centralized market. It has not, however, achieved an average of 85% of contract volume in the centralized market. Indeed, in this example, the DCM has achieved only an average of 48.8% of contract volume in

the centralized market, making it ineligible for the Commission's proposed exemption. Application of the Commission's proposed rules to this fact pattern would have a result contrary to the stated intention of the proposed rules, *i.e.*, the contract would be required to be delisted, price discovery in the centralized market would be lost and the contract would be forced off the DCM, away from Commission regulations and the safety, soundness and transparency of centralized clearing.

Again, using GreenX's own data as an example, from the date that the GreenX products migrated to the GreenX DCM, January 24, 2011, through February 17, 2011, GreenX has achieved an average of 68% total volume traded on the DCM's centralized market, and an average of 32% traded off-exchange. In contrast, from February 17, 2010 through February 17, 2011, these contracts achieved an average of 21% total volume traded on the DCM's centralized market, and an average of 79% traded off-exchange. Even though GreenX's centralized market volume is steadily increasing, and increasingly so in more recent months, which is the stated goal of Core Principle 9, GreenX would fail the 85% requirement, and would fail to be eligible for an exemption as the proposal is currently drafted, particularly if GreenX had to include the months where the environmental contracts were not listed on its own DCM.

Additionally, the calculation methodology is flawed because it takes into account all transactions on the DCM. Exchanges will often try to encourage market participants holding a portfolio of uncleared positions to novate the pre-existing portfolio of uncleared positions into cleared exchange-traded products. This is usually accomplished through non-competitive off-exchange transactions because by definition it takes both parties to the open trades to agree to move the positions into clearing, and to minimize transaction costs and to avoid causing a disorderly market. GreenX believes that these transactions should be excluded from the calculation (i.e., excluded from the denominator) because these are "one-off" transactions that bring otherwise uncleared transactions and open interest into the exchange environment.

G. GreenX's Alternative Proposal

For the reasons described above, GreenX recommends that the Commission take a more pragmatic approach to the centralized market trading requirement. GreenX believes that hard numbered, inflexible rules will not work in developing markets, and will be unduly burdensome for newer DCMs, and that the Commission should instead have the flexibility to address its liquidity or transparency concerns.

GreenX recommends a tiered approach for new contracts that would require a DCM to make progress towards the desired percentage of centralized market volume (excluding certain one-time off-exchange transactions as discussed above) over a

four year period. GreenX also recommends that the review period for each target be six months and that the mandatory delisting requirement (or exemption) be triggered only if the contract failed to meet any two consecutive targets. This would have the effect of smoothing the averages during the period and would take into account seasonal fluctuations in volume that may occur in certain contracts.[11]

To provide the Commission with the greatest flexibility in the application of these proposed rules, GreenX recommends that no minimum centralized market threshold should be required to apply for an exemption from the delisting requirement and that the length of the exemption should be subject to the discretion of the Commission based on the facts and circumstances of the exemption request. As described above, there may be reasons for a contract not meeting the 85% requirement that have nothing to do with the contract's acceptance in the market, and the Commission should have the flexibility to consider all of the issues.

GreenX also suggests that the Commission implement a second exemption from the delisting requirement that automatically would be applied (i) if the DCM implements a liquidity program that is reasonably designed to increase contract volume in the centralized market, or (ii) for a DCM that already has a liquidity program in place for the contract, if the DCM provides a materially greater incentive under the liquidity program that is reasonably designed to increase contract volume in the centralized market. GreenX suggests that this exemption should apply for 2 years, after which time the delisting requirement would apply if the contract failed to meet the minimum centralized market volume requirement at the end of such period.

Also, for administrative convenience and cost savings, both on the part of DCMs and the Commission, GreenX suggests that DCMs be required to calculate and file with the Commission the trading percentage calculation as of a fixed calendar date (*e.g.*, submit the calculation as of June 30, no later than July 31 and as of December 31, no later than January 31), rather than an anniversary of the listing. The first report would be due after the first full six-month period the contract was listed. This would greatly reduce the burden on the DCM in tracking and providing this information on a piecemeal basis, and also would reduce the burden on the CFTC staff in reviewing the reports provided by the DCMs.[12]

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[11] In the hypothetical example above, under the GreenX proposal the contract would average 65% trading in the centralized market, making it eligible for the Commission's proposed exemption.

[12] For example, based on data reviewed by the Commission, there were off-exchange transactions in 570 listed DCM contracts. Rather than DCMs preparing, and the Commission receiving and reviewing, 570 different reports throughout the year, each containing information about just one contract, the Commission would receive, at most 17 reports (based on the current number of DCMs), containing information about all 570 contracts.

Based on its experience in migrating new contracts from the OTC market to the centralized market, GreenX would recommend migration targets as follows (assuming a hypothetical listing date of December 15):

Months 1-6 (June 30)	Months 7-12 (December 31)	Months 13-18 (June 30)	Months 19-24 (December 31)
0%	0%	20%	30%
Months 25-30 (June 30)	Months 31-36 (December 31)	Months 37-42 (June 30)	Months 43-48, & each June 30 and December 31 thereafter
40%	50%	60%	70%

The above timeline and percentages would be more effective and consistent and would provide new products and new DCMs with more reasonable goals and sufficient time to gauge product success.

As GreenX describes above, a primary function of DCMs is to provide a venue for participants to enter into contracts that allow them to manage their individual risk – which in turn results in a reduction of systemic risk. By imposing the 85% requirement, and potentially requiring DCMs to delist their contracts, the Commission actually is creating systemic risk. If the contracts that are listed on a DCM are required to be delisted and liquidated or transferred to a SEF, participants whose positions are liquidated will be forced to find replacement contracts in the OTC market or on an overseas exchange, or if their positions are transferred to a SEF, be forced to become a member of that SEF. Market participants will be reluctant to enter into these new contracts because of the potential uncertainty of having to liquidate these contracts prior to their expiration. This will have a particularly bad effect on potential hedgers, who will be disinclined to use long-dated contracts in new products if they run the risk of early termination due to the CFTC's proposed mandatory delisting requirement. DCMs will also be less likely to take the risk of listing innovative risk management products if they know that the threat of delisting hangs over such products. This may result in greater trading in the OTC market or on overseas exchanges and will have the consequence of moving contracts away from Commission regulation and centralized clearing.

II. Core Principle 21 – Financial Resources.

GreenX supports the Commission's goal of ensuring that DCMs have adequate financial resources to discharge their responsibilities. As noted at the outset of the letter, GreenX has considered the Commission's proposed regulations on financial resources based on its perspective as a start-up and the most recently approved

DCM. Given this perspective, GreenX believes that the Commission's proposed rules exceed the requirements set forth in the Dodd-Frank Act,[13] and could be better calibrated and clarified to obtain the Commission's desired results while minimizing the costs and burdens on DCMs such as GreenX. In particular, GreenX believes that (1) the Commission's proposed increases in the amount of "financial resources" needed and (2) restrictions on the use of debt financing would significantly impede the ability of start-ups to become (and remain) DCMs. Significant restraints on the ability of start-ups to become (and remain) DCMs would likely decrease competition and innovation in the financial marketplace, which would adversely affect all participants in the financial market.

A. "Financial Resources"

Proposed § 38.1101(a) would require a DCM to maintain at all times sufficient "financial resources" to cover its operating costs for at least one year. Proposed § 38.1101(e) states "[t]he financial resources allocated by the designated contract market to meet the requirements of paragraph (a) of this section must include unencumbered, liquid financial assets (*i.e.*, cash and/or highly liquid securities) equal to at least six months' operating costs." Although it appears at first glance that proposed §§ 38.1101(a) and § 38.1101(e) would simply require DCMs to maintain financial resources sufficient to cover one years' operating costs, at least six months of which must consist of unencumbered, liquid financial assets, GreenX understands that in fact the Commission intends that these tests be separate. The text accompanying proposed § 38.1101(e) attempts to make this clear: "[t]he Commission notes that a committed line of credit or similar facility is not listed in proposed § 38.1101(b) as a financial resource available to a DCM to satisfy the requirements of proposed § 38.1101(a)."

In other words, if a DCM uses a committed line of credit to satisfy the proposed § 38.1101(e) requirement of maintenance of six months' liquid assets, because the DCM cannot count that committed line of credit to satisfy the § 38.1101(a) requirement of maintenance of one year's "financial resources," the DCM must have other "financial resources" that will cover one year's operating costs – which when viewed together require the DCM to maintain aggregate "financial resources" (in the normal financial sense of the term) in excess of one year's operating costs. In the most extreme example, under proposed § 38.1101, a DCM would be required to maintain "financial resources" (in the normal financial sense of the term) equal to up to 18 months' operating costs (*i.e.*, the letter of credit for the six months' liquid assets

[13] The Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat. 1376 (2010).

requirement plus other “financial resources” for the one year’s “financial resources” requirement).

GreenX urges the Commission to revise proposed § 38.1101 to permit DCMs to include committed lines of credit and similar facilities as good “financial resources” for purposes of § 38.1101(a). In the ordinary business world, committed lines of credit and similar facilities are standard “financial resources,” and they assist DCMs (not to mention other kinds of entities) to operate in the ordinary course of business. Moreover, neither the Dodd-Frank Act nor the Commission’s order designating GreenX as a DCM specify that some kinds of “financial resources” should be excluded from the calculation of “financial resources” for regulatory purposes, or that such exclusions should require DCMs to maintain “financial resources” (in the normal financial sense of the term) in excess of one year’s operating costs. *See* Section 735, clause (21)(B) of the Dodd-Frank Act (“The financial resources of the board of trade shall be considered to be adequate if the value of the financial resources exceeds the total amount that would enable the contract market to cover the operating costs of the contract market for a 1-year period, as calculated on a rolling basis”) (emphasis added). The proposed requirements also exceed the requirements of the GreenX designation order, which includes a simpler test that would meet the Dodd-Frank Act requirement (“IT IS FURTHER ORDERED that [GreenX] will demonstrate to the Commission, at the end of each fiscal quarter after the date of this Order, that it has sufficient financial resources to operate in compliance with all core principles applicable to designated contract markets under Section 5(d) of the Act and the Commission’s regulations thereunder, by demonstrating that it has sufficient financial resources to cover its projected operating costs for a period of at least one year, and by demonstrating that its financial resources include unencumbered, liquid assets equal to at least six months of such projected operating costs”) (emphasis added).

Increasing the amount of standard “financial resources” that a DCM must maintain beyond one year’s operating costs has real potential to decrease competition and innovation in financial markets. The greater the amount of standard “financial resources” an applicant or an existing DCM must maintain in order to continue to qualify as a DCM, the more difficult it is to either become or to remain a DCM. In percentage terms, the increase in required “financial resources” (in the normal financial sense of the term) from one year’s to 18 month’s operating costs represents a 50% increase, which is a highly significant increase. GreenX is not aware of failures of DCMs resulting solely from inadequate capital, and, given the Commission proposal goes beyond the protections required under the Dodd-Frank Act, GreenX suggests the Commission reconsider the proposed requirements.

Revising proposed § 38.1101 to permit DCMs to include committed lines of credit and similar facilities as good “financial resources” for purposes of § 38.1101(a) also would permit DCMs to manage their financial affairs in a more efficient manner. Both

standard loans and committed lines of credit require DCMs and other entities to pay interest on amounts borrowed. However, under a committed line of credit, a DCM (or other borrower) can ensure that the lender will provide funds on an as-needed basis, even if the DCM never actually borrows those funds. There is of course a cost for this benefit (often a payment to the lender in the form of a so-called "unused commitment fee"), but this "unused commitment fee" is typically only a small portion of the interest rate payable both on standard loans and committed lines of credit. Therefore, the use of a committed line of credit actually can permit a DCM (or other borrower) to reduce its operating costs by avoiding the need to incur unnecessary interest charges, while still ensuring that it has adequate funds available to pay its operating expenses. This method of financing better suits the purposes underlying proposed § 38.1101, providing for sufficient coverage, including easily utilized liquid assets.

A second benefit of revising proposed § 38.1101 as suggested would be to eliminate certain difficulties that would otherwise likely emerge in practice. Certain debt facilities may be denominated as "lines of credit," and under the Commission's proposed rules it would be clear how those "lines of credit" should be treated for purposes of § 38.1101(a). It would not be clear, however, what the Commission might deem to be "similar facilities" or how the Commission should treat various other kinds of debt facilities that may be fungible from an economic perspective with "lines of credit," including revolving loans and loan facilities put into place but not immediately drawn down. Therefore, if the Commission adopts § 38.1101(a) as currently proposed, the Commission and DCMs/applicants would be forced to engage in discussions on an instrument-by-instrument basis to determine whether or not a particular instrument should be treated as a "line of credit [or] similar facility" (and therefore excluded from or included in "financial resources" for purposes of § 38.1101(a)). This is undesirable both from a clarity of rules perspective and a time and costs of operation perspective. While GreenX does not want to restrict the Commission's and DCM's flexibility, further clarification of the purpose and goal of the proposed rules would provide sufficient guidance to reduce unnecessary back-and-forth.

Based on conversations with Commission staff, GreenX understands that the separate requirements of one year's financial resources coverage in proposed § 38.1101(a) and the six months' unencumbered liquid assets in proposed § 38.1101(e) were designed to prevent a DCM from incurring indebtedness secured by its assets and counting both those assets and the indebtedness as part of its financial resources. GreenX believes that this concern could (and should) be directly addressed through language to this effect, which would have the added benefit of avoiding the various drawbacks with § 38.1101(a) and § 38.1101(e) as currently proposed.

GreenX also understands that one motivating factor in the Commission's proposed § 38.1101 was consistency with the Commission's treatment of designated clearing organizations ("DCOs"). *See* Proposed Rules, 75 Fed. Reg. 63113 (October 14, 2010). However, the roles played by DCMs and DCOs in financial markets are significantly different. DCMs do not guarantee or novate trades, and their capital is not at risk in the event of a failure of a counterparty to a transaction, in the way that is the case with DCOs. Rather, the role of financial resources (and letters of credit) in the DCM context is to ensure that DCMs can continue to operate in the ordinary course of business and make payments as they become due, which does not have the time sensitivity that it does in the DCO context. Particularly in light of the competitive role that start-ups provide in the financial marketplace, GreenX believes that the Commission should not adopt a one-size-fits-all approach and should not treat DCOs and DCMs in the same manner where different circumstances and different purposes support differential treatment.

For these reasons, GreenX urges the Commission to revise proposed § 38.1101 to state that a DCM is required to maintain sufficient financial resources to cover its projected operating costs for a period of at least one year, including unencumbered, liquid assets equal to at least six months of such projected operating costs, and that committed lines of credit or various debt instruments may be included in calculating those financial resources, as long as the DCM is not incurring indebtedness secured by its assets and counting both those assets and the indebtedness as part of its financial resources.

In the event, however, that the Commission is unwilling to revise proposed § 38.1101 as GreenX has suggested, GreenX urges the Commission to clearly specify that the requirements under paragraphs (a) and (e) of § 38.1101 are separate requirements, and to delete the language in paragraph (e) suggesting that it is part of the one year's required operating costs coverage.[14] In that case, GreenX also believes that the Commission should undertake a cost / benefit analysis of requiring DCMs to

[14] The following underlined language in proposed § 38.1101(e) is what creates this confusion: "The financial resources allocated by the designated contract market <u>to meet the requirements of paragraph (a) of this section</u> must include unencumbered, liquid financial assets (*i.e.*, cash and/or highly liquid securities) equal to at least six months' operating costs. <u>If any portion of such financial resources is not sufficiently liquid</u>, the designated contract market may take into account a committed line of credit or similar facility for the purpose of meeting this requirement.") As noted above, the text accompanying proposed § 38.1101(e) states that "[t]he Commission notes that a committed line of credit or similar facility is not listed in proposed § 38.1101(b) as a financial resource available to a DCM to satisfy the requirements of proposed § 38.1101(a)." Therefore, there could never be any portion of such financial resources that could be covered by the underlined language in proposed § 38.1101(e).

maintain “financial resources” (in the normal financial sense of the term) in excess of one year’s operating costs.

B. Liquidity of Financial Resources

GreenX also urges the Commission to clarify its proposed standards regarding liquidity of financial resources.

Proposed § 38.1101(e) would require a DCM to maintain “unencumbered liquid financial assets” equal to at least six months’ operating costs. GreenX believes that the Commission should clarify the meaning of the term “unencumbered.” In the normal commercial sense, “unencumbered” is often used to refer to assets that are not subject to a security interest or other adverse claims. However, commercial lenders often require borrowers to pledge all of their assets to secure repayment of a loan, although such security interests typically do not limit the ability of borrowers to use cash in the ordinary course of business. If § 38.1101(e) prohibits DCMs from borrowing funds on a secured basis, GreenX believes that the ability of DCMs to fund themselves in the ordinary course will be greatly restricted and it would again be more difficult for start-ups to become and remain DCMs. GreenX therefore suggests that the Commission clarify that a DCM’s assets will be considered “unencumbered” even if subject to security interests or adverse claims, so long as the DCM can use and expend those assets in the ordinary course without requiring consent of lenders or claimants.

Depending upon how the Commission determines to treat lines of credit and similar facilities, additional clarification regarding lines of credit and similar facilities may be appropriate. Commercial financial institutions normally extend lines of credit and similar facilities pursuant to legally binding agreements, among other reasons, to ensure that they have a legally binding right to repayment. If, by the use of the term “committed,” the Commission intends anything other than a line of credit or similar facility that has been extended pursuant to a legally binding agreement, GreenX suggests that the Commission clarify that this is what is intended. Moreover, GreenX urges the Commission to expressly state that lines of credit and similar facilities incurred from banks and other commercial financial institutions on market standard terms will presumptively qualify as good “committed lines of credits and similar facilities” for purposes of § 38.1101. Any other requirements (such as minimum permissible drawdown time requirements) applicable for lines of credit should be specified in the final regulations.

C. Clarification of Calculation of Operating Costs and Financial Resources

GreenX also urges the Commission to clarify how "operating costs" and "financial resources" are to be determined.

GreenX believes that the Commission should expressly state that "operating costs" should be determined from a cash flow statement perspective. Under U.S. generally accepted accounting principles, entities may need to include liabilities on a balance sheet that will not require cash payments within a twelve month period. Express adoption of a cash flow statement perspective for calculation of "operating costs" would provide a clear and workable method for DCMs to determine the amount of "financial resources" that they must maintain.

In addition, GreenX also believes that, while continuing to permit flexibility for DCMs, the Commission should provide specific examples of which assets can be included in the calculation of "financial resources" and how those assets should be valued for guidance. For example, presumably accounts receivable, fees owing to the DCM and other assets that are reasonably expected to result in payments to the DCM may be included as "financial resources," but GreenX believes that the Commission should affirmatively so state. Subordinated loans are also commonly used by many regulated entities, including FCMs and IBs, and GreenX suggests that the Commission include subordinated loans as permissible "financial resources."

Further, under proposed § 38.1101(d), DCMs would be required to reduce the value of assets to reflect any market or credit risk specific to such assets. U.S. generally accepted accounting principles require entities to take reserves (*i.e.*, reduce the value of assets) in specified circumstances. Without limiting other potential methods for complying with proposed § 38.1101(d), GreenX suggests that the Commission state that application of U.S. generally accepted accounting principles would satisfy the requirements of § 38.1101(d).

D. Time Periods for Filing Financial Statements

Proposed § 38.1100(f) would require a DCM to make quarterly reports on its financial resources, including computations of the value of each resource used to determine the adequacy of its operating capital, documentation explaining the methodology used to make those computations, and financial statements, in order to demonstrate that the DCM has adequate financial resources to cover its next 12 months of operating expenses. As currently proposed, these reports would be required within 17 business days of the close of each fiscal quarter, which the Commission has indicated is based on the deadline for monthly FCM reports. GreenX is proposing

that the Commission require these reports with 30 calendar days after the close of each fiscal quarter.

With a 17 business day filing deadline, the exact date on which DCMs must file these reports would vary on a month-to-month basis (as a result of the business day calculation, which would incorporate factors such as the day of the week on which the month starts and whether there are holidays in the month). By contrast, a 30-calendar day deadline for these reports would provide DCMs with a fixed deadline for reporting, which would be advantageous from a resource commitment perspective.

Moreover, the difference between 17 business days and 30 calendar days is unlikely to raise any significant policy concerns. As noted above, financial resources for DCMs serve to ensure that the DCM has sufficient capital to operate in the ordinary course of business for twelve months, and so early reporting is less critical. By contrast, earlier reporting is appropriate for FCMs to ensure that FCMs have sufficient capital to withstand customer non-payments (as well as obligations of FCMs). In any event, both the 17 business day and 30 calendar day standards are also significantly more burdensome on DCMs than the SEC imposes on national securities exchanges. See SEC Rule 6a-2(b)(1).

However, from a start-up DCM perspective, imposing a 17 business day reporting requirement as opposed to a 30 calendar day reporting requirement would increase the resources needed by a DCM to comply with this requirement. GreenX already has the processes in place to collect and file such reports on a 30 and 90 calendar day cycle consistent with SEC corporate requirements; speeding these requirements up to 17 days would require new programming and resources. A slightly extended timeline would enable smaller DCMs like GreenX to better make the required capital calculations and haircuts, and the use of audited financials in making the year-end report would greatly increase the accuracy of the calculations therein.

Finally, GreenX notes that normal year end adjustments typically require much more than 17 business days (or even 30 calendar days) to complete. Requiring financial statements within either such time period will likely result in subsequent adjustments being made to such financial statements, as part of the normal preparation of financial statements. GreenX therefore believes that additional time should be provided in connection with year-end preparation of financial statements. Public companies are granted 90 calendar days to prepare audited annual financial statements. GreenX suggests that the Commission either provide additional time for year-end calculations (e.g., at least 45 if not 90 calendar days) or otherwise state that good faith estimates of costs and resources reported 30 calendar days after year-end would meet the requirement.

III. Timing of Implementation.

The changes contemplated in the proposal are numerous and many will require significant expenditures and detailed analysis. Proposed Core Principle 21 may require DCMs to obtain new investment or financing arrangements, as the amount of financial resources DCMs are required to maintain may increase dramatically. With a number of critical elements changing simultaneously, it is difficult to predict with any certainty the amount of time DCMs may require to come into compliance with the new requirements. GreenX suggests that, given the current circumstances, an implementation period of no less than 180 days would be appropriate.

Thank you for the opportunity to provide these comments to the Commission. Should the Commission have any questions regarding GreenX's comments, please contact me at 212-299-2510 or Kari.Larsen@theGreenX.com.

Sincerely,

Kari S. Larsen
General Counsel, Chief Regulatory Officer