

March 8, 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-AD18: Federal Register Release: 76 FR 1214 - Core Principles and Other Requirements for Swap Execution Facilities; 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 Swap Execution Facilities (the “SEF Proposal”).

As discussed below, Eris Exchange believes that SEFs and Designated Contract Markets (“DCMs”) that trade swaps should be treated the same in terms of rules, price reporting, and execution methods. The SEF Proposal and the DCM Proposal evidence that the Commission will treat a DCM differently than a SEF even if it is trading the same swap product.¹ While Eris Exchange understands that SEFs are a new and unique regulated entity, certain rules should not be different. Specifically, the differences between the proposals are highlighted with the “Minimum Centralized Market Trading Percentage Requirement” for DCMs and the differences in block trading requirements.² The inconsistencies between the DCM Proposal and the SEF Proposal will result in regulatory or “execution arbitrage” to the disadvantage of a DCM. Eris Exchange proposes that the Commission harmonize the proposed DCM and SEF regulatory regimes.

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.

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

¹ See 75 FR 80572 (Core Principles and Other Requirements for Designated Contract Markets) dated December 22, 2010.

² Eris Exchange commented on the DCM Proposal and highlighted that the DCM Proposal favors the trading of swaps on a SEF; those comments are incorporated by reference to this comment letter. See Comment Letter from Eris Exchange, LLC dated February 22, 2011 (“Eris Exchange DCM Comment Letter”).

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 "faturized" an interest rate swap.

As discussed more fully below, Eris Exchange is concerned that the differences between the SEF Proposal and the DCM Proposal will result in regulatory or "execution arbitrage." 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 be subject to the DCM Proposal, if finalized by the Commission. To the extent Eris Exchange offers the trading of swaps on the DCM, it may be at a disadvantage to a SEF due to differences in the regulatory scheme proposed in the SEF Proposal.

II. Discussion

A. The SEF Proposal and DCM Proposal Will Result in "Execution Arbitrage"

The SEF Proposal and DCM Proposal demonstrate that the Commission will treat DCMs differently from SEFs even though they may offer trading in the same product. The DCM Proposal and the SEF Proposal differ in two important ways. First, only DCMs are subject to the "Minimum Centralized Market Trading Percentage Requirement." Second, the Proposals differ in terms of block trading rules. Eris Exchange appreciates that DCMs have been subject to a historic regulatory regime, however, the DCM Proposal contains unnecessary regulatory requirements for DCMs that are not being applied to SEFs. The DCM Proposal should be modified to be more of a "principles based" regulatory regime in order to coincide with the SEF Proposal, or, in the alternative, the SEF Proposal should be modified to align with the DCM Proposal in these areas.

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The “Minimum Centralized Market Trading Percentage Requirement” (the “85% Centralized Market Requirement”) in the DCM Proposal places a serious restriction on swaps traded on a DCM, with no similar liquidity restriction on a SEF. *See* 75 FR 80572, 80588. 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 Proposals favor 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). Further, the fact that a DCM can also register as a SEF is an unsatisfactory result where a DCM seeks to be a DCM trading swaps. *See* Section 733(c) of the Dodd-Frank Act.³

The 85% Centralized Market Requirement for a DCM offering the trading of a swap also has implications for the block trading of swaps on a DCM. The SEF Proposal allows greater flexibility for block trades. A SEF need only have rules related to block trades, report block trades within 15 minutes of execution and permit block trades above the minimum size as determined by Swap Data Repositories. *See* Proposed § 37.200, 76 FR 1214 at 1242 (SEFs must “Establish rules governing the operation of the facility, including rules specifying trading procedures to be used in entering and executing orders traded or posted on the facility, including block trades.”) and Proposed § 43.5(k)(2), 75 FR 76140 at 76174. While the DCM Proposal states that a DCM should follow the block trading rules applicable to SEFs, the swaps on a DCM are still subject to the 85% Centralized Market Requirement.

The SEF Proposal also foregoes an important opportunity to bring greater transparency to the markets. Eris Exchange agrees that block trades are necessary and should be permitted; however, block trading rules need to be tempered with transparency. The SEF block trading rules should require that the price of block trades coincide with market conditions. For example, the DCM Proposal states that block trades (for futures) should be at a price that is “fair and reasonable.” *See* DCM Proposal at 80630. Neither the SEF Proposal nor the Real-Time Public Reporting of Swap Transaction Data Proposed Rule (which addresses block size) touch upon this concept, which has been proposed for futures on DCMs and is commonplace in DCM rulebooks. *See* DCM Proposal at § 38.503(h) and Appendix B to part 38 (guidance on determining block size and pricing determinations). The CFTC has provided no such rule or guidance on block trade prices for SEFs. While real-time public reporting is critical, it does not take the place of requiring a similar, real-time rule for block trades in swaps. Such a rule will require block trades on SEFs to take into account all market conditions, including related products in the futures markets, in order to avoid the “off-market” transactions the Dodd-Frank Act was designed to bring to light.

Recently, Chairman Gensler testified that when the CFTC looked at the SEF rules:

Congress had said that they had to have multiple participants have the ability to execute with multiple participants, so what some people call many-to-many...we have a history, a 70 plus year history in the futures market and a statute that says that all futures have to come to an exchange – that’s not the case with swaps, there’s bilateral swaps and customized swaps...but, it

³ As discussed in Eris Exchange’s DCM Comment Letter, the other unsatisfactory result of the 85% Centralized Market Requirement is to force 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 SEF.

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was in that context that we took up this rule and we are very focused on how the SEC and [the CFTC] work to harmonize and try to be as consistent as possible, **but at the same time not undercut a futures regime in some way and have some regulatory arbitrage between futures and swaps, so there's that trade-off**, but we look forward to the public comment and we look forward to working consistently with the SEC.

Testimony of Chairman Gensler before the U.S. Senate Committee on Agriculture, Nutrition & Forestry, Washington, DC (March 3, 2011) (emphasis added).⁴

The differences between the DCM Proposal and the SEF Proposal will result in “regulatory arbitrage” to the detriment of DCMs, unless the SEF and DCM rules are better harmonized. In other words, there need not be a “trade-off” if the Commission makes the rules consistent in the two areas discussed above.

B. SEFs and DCMs Should be Held to the Same Standards for Intra-Day Price Reporting

Proposed §§ 37.900 and 37.901 of the SEF Proposal implements SEF Core Principle 9 as follows: “The swap execution facility shall make public timely information on price, trading volume, and other trading data on swaps to the extent prescribed by the Commission.” 76 FR 1214 at 1248-1249. The Commission has proposed rules related to the Real Time Public Reporting of Swap Transaction and Pricing Data. See 75 FR 76140 (December 7, 2010). Specifically, for swaps executed on a SEF or a DCM, the parties satisfy their real-time reporting obligation by executing the swap on such trading facility or platform. See Proposed § 43.3, 75 FR 76140 at 76172. The DCM or SEF is required to publicly disseminate all swap transaction and pricing data for swaps “as soon as technologically practicable” by transmitting the swap transaction information to a swap data repository or a third-party service provider. See Proposed § 43.3(b), 75 FR 76140 at 76172. Proposed § 43.5(k)(2) requires that the time delay for block trades be no later than 15 minutes after the time of execution. See 75 FR 76140 at 76174.

Eris Exchange believes that these reporting requirements should be implemented and SEFs should be strictly held to SEF Core Principle 9, just as DCMs are held to DCM Core Principle 9 to ensure the highest level of transparency. Trades below the block threshold, whether on a SEF or DCM, must be reported real-time (including instrument, price, volume). Trades above the block threshold, whether on a SEF or DCM, must have the same reporting requirements. Importantly, the Commission has proposed a 5 minute reporting time for block trades in futures on a DCM and 15 minutes for reporting block trades in swaps on a SEF or DCM. Compare Proposed § 38.503(g), 75 FR 80572 at 80617 (“Each block trade must be reported to the designated contract market within five minutes after its execution”) with Proposed § 43.5(k)(2), 75 FR 76140 at 76174 (“The block trade or large notional swap transaction and pricing data shall be reported to the public by the swap market (through a third-party service provider) or registered swap data repository that accepts and publicly disseminates such data within 15 minutes of the time of execution reflected in the data.”). For a futures contract that is economically similar to a swap, such as the Eris Interest Rate Swap Futures, the block trading

⁴ At the time of the submission of this Comment Letter, an official transcript of the hearing was not available. Eris Exchange has made every effort to accurately transcribe the statement.

rules should be the same. Any discrepancy between the reporting of swaps and similar futures will lead to the “regulatory arbitrage” discussed above.

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

Both the SEF and DCM Proposals seek 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 reasonable to require a market to report publicly each trade (including instrument, price, volume) intra-day, as soon as the trade occurs. This level of post-trade 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 settlement value applied to each cleared swap in the daily mark-to-market process, the same way that clearing houses report publicly the settlement price for each future and option today, 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 all swap trades; (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 appreciates the opportunity to comment on this matter. 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.



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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,

A handwritten signature in black ink that reads 'Neal Brady'.

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