

From: Duffy, Terry [mailto:Terry.Duffy@cmegroup.com]
Sent: Friday, April 01, 2011 1:40 PM
To: Gensler, Gary
Cc: Dunn, Michael; Chilton, Bart; Sommers, Jill; O'Malia, Scott; Donovan, Eileen A.
Subject: Process for Review of Swaps for Mandatory Clearing



The Honorable Terrence A. Duffy
Executive Chairman

Via Electronic Mail

April 1, 2011

Chairman Gary Gensler
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Re: Process for Review of Swaps for Mandatory Clearing (RIN 3038-AD00)
(Federal Register Vol. 75, No. 211, Page 667277)

Dear Chairman Gensler:

I write to follow-up on our recent discussions regarding the above-referenced notice of proposed rulemaking (the "Release"). We appreciate the Commission's attention to this important matter and your efforts to work with the industry to reach a solution to address the issues presented by the Release.

As noted in our comment letter in response to the Release, Section 723(h)(2) of the Dodd-Frank Act ("DFA") contemplates two distinct and independent determinations by the Commission regarding the clearing of swaps. The first is whether a submitting Derivatives Clearing Organization ("DCO") *may* clear a swap ("voluntary clearing determination"). The second is whether that swap will be subject to the clearing mandate ("mandatory clearing determination").

DFA establishes different procedures, considerations, and timelines for each of these determinations. As noted in our comment letter, we are concerned that the Release (including the proposed regulation contained therein) conflates these two determinations and inappropriately applies the procedures, considerations and timeline for the mandatory clearing determination to the voluntary clearing determination. We understand that this is not the Commission's intention and offer the following recommendations as a means of clarifying the final rulemaking so that the final regulation in this regard is consistent with the governing statutory text and Congressional intent.

As previously noted, DFA contemplates that a DCO may make a submission to the Commission to clear swaps that are not subject to the clearing mandate and that, if a DCO makes such a submission, the Commission will make a determination as to whether the DCO may clear the swap. To this end, DFA only requires that a DCO make a submission to the Commission regarding any swap it plans to accept for clearing and provide notice to its members of the submission. (DFA Sec. 723(h)(2)(B)(i).) Regarding the Commission's determination, DFA requires the Commission to determine the eligibility of a DCO to clear swaps (DFA Sec. 745(b)) and to consider whether

clearing the swap is consistent with the Core Principles for DCOs. (DFA Sec. 723(h)(2)(D)(i) (“in reviewing a submission made under subparagraph (B), the Commission shall review whether the submission is consistent with section 5b(c)(2)”.)

With respect to the mandatory clearing determination for any swap that a DCO seeks to permissibly clear, DFA requires that the Commission make this determination within 90 days of the submission, unless the submitting DCO agrees to an extension of this time limitation. (DFA Sec. 723(h)(2)(B)(iii); (h)(2)(C).) DFA also requires that the Commission provide at least a 30-day public comment period before making its determination. (DFA Sec. 723(h)(2)(A)(ii); (h)(2)(B)(iii)(III).) In making this determination, DFA requires that the Commission consider the following factors: (I) the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data; (II) the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded; (III) the effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the derivatives clearing organization available to clear the contract; (IV) the effect on competition, including appropriate fees and charges applied to clearing; and (V) the existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or 1 or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property. (DFA Sec. 723(H)(2)(D)(ii).) For the avoidance of doubt, these factors apply only to the mandatory clearing determination and are neither necessary nor relevant to the Commission's voluntary clearing determination.

On its face, proposed regulation 39.5, which purports to apply to the submission process for DCOs seeking to clear swaps not subject to the clearing mandate, seems to require that a DCO requesting a voluntary clearing determination consider the very factors that the Commission is required to consider when making the mandatory clearing determination and provide its analysis and underlying data to the Commission in its submission. Additionally, proposed regulation 39.5 appears to apply the 90-day time limit and the 30-day notice and comment period applicable to its mandatory clearing determination to the voluntary clearing determination. We recommend that the Commission clarify in its final rule that the 90-day time limit and the 30-day notice and comment period is applicable only to the Commission’s mandatory clearing determination. We also recommend that the Commission clarify that DCOs seeking to voluntarily clear a swap do not need to consider the factors the Commission is required to consider when making the mandatory clearing determination in conjunction with its submission.

Moreover, we recommend that the Commission clarify that proposed regulation 39.5(b) requires only (i) self-certification to voluntarily clear a swap not subject to the clearing mandate and (ii) notice to the DCO's members that it is making the requisite submission. Specifically, in making the voluntary clearing determination, DFA only requires that the Commission consider whether the DCO's request to clear the swap conforms with the core principles and that the DCO provide "notice" to its members that it will be accepting the swap at issue for clearing. (DFA Sec. 723 (h)(2)(D)(i).) In other words, so long as a DCO certifies that it will continue to comply with the applicable core principles once it begins clearing the swap, DFA permits it to clear the swap immediately upon making the submission.

Unlike the mandatory clearing determination, DFA establishes no time-related rules for the voluntary clearing determination. The self-certification process suggested above, however, is affected by the time-related rules for effectiveness of new rules or rule amendments. DFA Section 745 states that a new rule or rule amendment becomes effective “10 business days after the date on which the commission receives [self-certification of the new rule or amendment] (or on such shorter period as determined by the Commission by rule or regulation).” (DFA Sec. 745(c)(2).) In order to begin clearing a new swap, a DCO must submit a corresponding rule or rule amendment to

the Commission, and the DCO is unable to clear the swap until that rule or rule amendment is effective. As such, in order ensure the effectiveness of the self-certification process, we recommend that, in its final rule, the Commission explicitly exercise its discretion under Sec. 745(c)(2) to decrease the time period for effectiveness from 10 days to 1 day for self-certified rules and rule amendments submitted in connection with requests for a voluntary clearing determination. This will allow DCOs to begin voluntarily clearing new swaps immediately upon filing self-certification.

We further recommend that the Commission's final rule limit the amount of information that a DCO must include in its submission seeking to voluntarily clear a swap not subject to the clearing mandate. As previously noted, proposed regulation 39.5(b) requires that a DCO include in its submission, among other things, information and analyses that DFA only requires of the Commission in conjunction with the mandatory clearing determination. Much of the information required by proposed regulation 39.5(b) is information which DCOs will not have access to; other items require analyses that are not appropriate for DCOs to conduct. In fact, much of the information is relevant only to the Commission's mandatory clearing determination and has nothing to do with whether a DCO should be able to accept a swap for clearing.

More specifically, we do not possess information relevant to items (vi-vii) and (x). Moreover, subsections (b)(3)(ii)(A-E) and (viii) call for large-scale macroeconomic data and an analysis of the market as a whole, which we believe the Commission has access to (or will have access to) and is better positioned to analyze. Items (vii) and (x) relate to swap execution data, and since CME Group provides only clearing services for swaps at this time, we cannot readily access such information. Indeed, the relevant execution platforms, or swap counterparties are better sources of this information. However, in the event that we form a swap execution facility or offer swaps for trading on our designated contract markets, we would certainly provide this information to the Commission in our submissions.

We agree, however, DCOs may be in the best position to supply other data required under proposed regulation 39.5(b) to the Commission. In particular, most of the items requested under proposed regulation 39.5(b)(3)(iii-v) and (ix) are available to us and we agree that it should be included in any self-certification relating to our voluntary clearing of swaps.

Based on the foregoing, we recommend that the Commission revise proposed regulation 39.5(b)(ii)-(x) as follows:

~~(ii) A statement that includes, but is not limited to, information regarding the swap, or group, category, type, or class of swaps that is sufficient to provide the Commission a reasonable basis to make a quantitative and qualitative assessment of the following factors:~~

~~(A) The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data;~~

~~(B) The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is then traded;~~

~~(C) The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and resources of the DCO available to clear the contract;~~

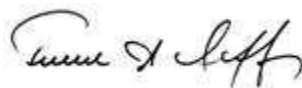
~~(D) The effect on competition, including appropriate fees and charges applied to clearing; and~~

~~(E) The existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds and property;~~

- (iii) Product specifications, including copies of any standardized legal documentation, generally accepted contract terms, standard practices for managing any life cycle events associated with the swap, and the extent to which the swap is electronically confirmable;
- (iv) Participant eligibility standards, if different from the derivatives clearing organization's general participant eligibility standards;
- (v) Pricing sources, models, and procedures, demonstrating an ability to obtain sufficient price data to measure credit exposures in a timely and accurate manner, including any agreements with clearing members to provide price data and copies of executed agreements with third-party price vendors, and information about any price reference index used, such as the name of the index, the source that calculates it, the methodology used to calculate the price reference index and how often it is calculated, and when and where it is published publicly;
- (vi) Risk management procedures, including measurement and monitoring of credit exposures, initial and variation margin methodology, methodologies for stress testing and back testing, settlement procedures, default management procedures, ~~and an independent validation of the scalability of the derivatives clearing organization's risk management policies, systems, and procedures, including the margins methodology, settlement procedures, and default management procedures;~~
- (vii) ~~Measures of market liquidity and trading activity, including information on the sources of such measures;~~
- (viii) ~~An analysis of the effect of a clearing requirement on the market for the group category, type, or class of swaps, both domestically and globally, including the potential effect on market liquidity, trading activity, use of swaps by direct and indirect market participants, and any potential market disruption;~~
- (ix) Applicable rules, manuals, policies, or procedures;
- (x) ~~Terms and trading conventions on which the swap is currently traded~~

We appreciate the opportunity to further comment on the Release and thank you for your attention to this important matter. We are available to answer any questions or provide further assistance.

Sincerely,



Cc: Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia
Eileen Donovan