CME Group

Kathleen M. Cronin
Managing Director
General Counsel and Corporate Secretary

April 18, 2011

VIA ON-LINE SUBMISSION

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

Re: Core Principles and Other Requirements for Designated Contract Markets (RIN number 3038-ADO9); (Federal Register Vol. 75, No. 245, Page 80572; Vol. 76, No. 53, Page 14825)

Dear Mr. Stawick:

CME Group Inc. ("CME Group")[1], on behalf of its four designated contract markets, appreciates the opportunity to provide additional comment on the Commodity Futures Trading Commission's (the "CFTC" or "Commission") Notice of Proposed Rulemaking ("Release") that was published in the Federal Register on December 22, 2010 as supplemented in the Federal Register on March 18, 2011 ("Supplemental Release"). Specifically, this letter addresses CME Group's continued concern with regard to proposed rule 38.502(a) under Core Principle 9 for DCMs and the Commission's reliance on the information in the "off-market data volume spreadsheet" disclosed by the Supplemental Release.

I. Background

As presented in the Release, proposed rule 38.502(a) would require that 85% or greater of the total volume of any contract listed on a DCM be traded on the DCM's centralized market, as calculated over a 12 month period (the "85% Requirement"). (Core Principles and Other Requirements for Designated Contract Markets; Proposed Rule, 75 Fed. Reg. 80572, 80588-89 (Dec. 22, 2010)). In its comment letter, dated February 22, 2011, CME Group raised multiple serious concerns with the 85% Requirement, including but not limited to, (i) the Commission's failure to adequately explain how it arrived at the 85% Requirement or how the 85% Requirement would promote price discovery; (ii) the 85% Requirement, as an arbitrary limit, would be against congressional intent; (iii) the 85% Requirement would represent an

[1] CME Group is the world's largest and most diverse derivatives marketplace. CME Group includes four separate Exchanges, including Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX"). The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. CME includes CME Clearing, one of the largest central counterparty clearing services in the world, which provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter derivatives transactions through CME ClearPort®.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930 3488 F 312 930 4556 kathleen.cronin@cmegroup.com cmegroup.com

unnecessary departure from the Commission's principle-based regulatory regime; (iv) in proposing the 85% Requirement, the Commission has overlooked multiple critical issues; (v) the 85% Requirement would likely result in several extremely negative consequences for the industry, such as hindering the development of new products; and (vi), contrary to the stated purpose of the rule, the 85% Requirement would have the unintended consequence of negatively impacting price discovery in many markets.

Many of the other public comments raised similar concerns. For example, another commenter directly challenged the Commission's legal authority and rationale for proposing to limit the contracts that may trade on DCMs to only those contracts that perform a price discovery function.[2] This commenter, as well as others, explained that the regulated futures market, under the oversight of the Commission, has grown to include not only contracts that perform a price discovery function, but those that serve the risk management needs of the public.[3] Moreover, several exchanges opined that the Commission's proposed 85% requirement would have a detrimental effect on the development of new products by DCMs.[4] As these commenters explained, new products take time to gain traction in the marketplace and often initially build open interest and gain trading momentum in off-exchange transactions.[5] Notably, not a single commenter supported the 85% Requirement or agreed that a hard limit on the percentage of off-exchange trading in a particular contract was necessary or even appropriate to ensure a DCM's compliance with Core Principle 9. Indeed, almost all noted the absence of a regulatory or public benefit from the proposed rule.[6]

---

[2] Comment letter filed by NYSE Liffe in response to the DCM Release, dated Feb. 22, 2001. The comment letter is available at http://comments.cftc.gov/PublicComments/ViewComment.aspx?id=27910&SearchText=.

[3] *Id.; see also* Comment Letters from Eris Exchange and IntercontinentalExchange, Inc.

[4] *See e.g.,* Comment letters from ELX Futures, L.P., Green Exchange LLC, Eris Exchange, LLC, NYSE Liffe US, Minneapolis Grain Exchange, Inc., and Nodal Exchange, LLC.

[5] In many instances, it takes years before trading on the centralized market becomes the predominant mode of trading. With the threat that a contract will be delisted, market participants will be deterred from trading in the contract. Customers prefer trade certainty, which they would lack if this rule is adopted. As such, the 85% Requirement – or any prescriptive rule arbitrarily limiting the amount of trading off the centralized market – would deter DCMs from investing in developing new products. As some commenters also noted, the 85% exchange-trading requirement will decrease competition in the futures industry by making it more difficult for new DCMs to enter the market. That is, a new DCM will not have the benefit of existing and well-established products; with all its products threatened by such a rule, it would be exceedingly difficult for a new DCM to even raise capital to attempt to enter the market

The commenters also discuss the potential adverse consequences of such a rule to market participants. If a contract is delisted, market participants may be required to hold existing positions to expiration, which could, under certain circumstances, have serious negative financial consequences. Even if a product is transitioned to an SEF, the transition would cause a disruption to the market, including a detrimental effect on liquidity. Significantly, market participants who were not eligible to trade on a SEF would be forced to involuntarily liquidate their positions.

[6] In fact, one major buy-side market participant expressed serious concern that the Commission's arbitrary rule would unnecessarily restrict the ability of market participants to execute block trades at a single negotiated price for bona fide business reasons. This market participant explained that limiting market participants' ability in this fashion will

20 South Wacker Drive Chicago, Illinois 60606 T 312 930 3488 F 312 930 4556 kathleen.cronin@cmegroup.com cmegroup.com

On February 25, 2011, three days after the close of the comment period, the Commission responded to a Freedom of Information Act ("FOIA") request filed by CME Group on December 10, 2010 FOIA seeking the data reviewed and analysis performed by the Commission in conjunction with the 85% Requirement. Specifically, the Commission released the off-market data volume spreadsheet, which contained off-exchange and on-exchange trading percentages for several hundred contracts listed on various futures exchanges over a three-month period of time. The Commission's response also noted that the Commission was withholding certain information pursuant to FOIA exemptions 3, 4 & 8 (5 U.S.C. §§ 552(b)(3), (b)(4) & (b)(8)). In the Supplemental Release, the Commission announced that it was making the off-market data volume spreadsheet generally available to the public on the CFTC's website and extended the comment period until March 18, 2011.

In order to understand the Commission's reasoning in reliance on the off-market data volume spreadsheet as the basis for proposing the 85% Requirement – which is not evident from the off-market data volume spreadsheet or any other material made available to the public – in a March 21, 2011 letter, CME Group requested that the Commission disclose the information that it was withholding from its February 25, 2011 FOIA response or to provide additional detail as to the nature of the withheld materials. In particular, CME Group requested the Commission to make public any analysis or study of the information in the off-market data volume spreadsheet that the Commission relied on in proposing the 85% Requirement. As of the date of this letter, the Commission has not substantively responded to CME Group's request, nor has the Commission disclosed any additional information to the public.

II. Detailed Comments

Without the benefit of the Commission's analysis of the information in the off-market data volume spreadsheet, CME Group cannot determine how the Commission arrived at the 85% Requirement based on that information or how the 85% Requirement would promote price discovery in the markets for the identified contracts or otherwise. Pursuant to the Administrative Procedures Act ("APA," 5 U.S.C. § 553), in order to provide the public a meaningful opportunity to comment on the Commission's basis for the 85% Requirement, the Commission must disclose the studies and analysis relied upon in proposing the rule. *See, e.g., Am. Radio Relay League, Inc. v. FCC*, 524 F.3d 227, 237 (D.C. Cir. 2008) (explaining that "it would appear to be a fairly obvious proposition that studies upon which an agency relies in promulgating a rule must be made available during the rulemaking in order to afford interested persons meaningful notice and an opportunity for comment"). If the Commission fails to disclose these studies or to give the public an opportunity to comment thereon, the final rule would be issued in violation of the APA and would therefore be invalid. *See, e.g., Owner-Operator Indep. Drivers Ass'n, Inc. v. Fed. Motor Carrier Safety Admin*, 494 F.3d 188, 199 (D.C. Cir. 2007) (vacating agency rule where agency failed to make available for public comment the methodology study upon which agency relied in issuing rule); *Chamber of Commerce of the U.S. v. SEC*, 443 F.3d 890, 902 (D.C. Cir. 2006) (vacating rule where agency did not disclose for public comment materials that "suppl[ied] the basic assumptions used by the Commission" in issuing rule).

"hurt the economic interests of investors in funds and beneficiaries in pension plans, among others." See Comment Letter from BlackRock, Inc. at 2.

Moreover, as it currently stands, the rulemaking record offers no rational connection between the information in the off-market data volume spreadsheet and the 85% Requirement. *See Motor Vehicle Mfrs. Ass'n of the U.S., Inc. v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 43 (1983) (explaining that to survive APA arbitrary and capricious review "the agency must examine the relevant data and articulate a satisfactory explanation for its action including a 'rational connection between the facts found and the choice made'" (quoting *Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962)). It appears as if the Commission plucked the 85% number out of thin air and then looked at the off-exchange trading percentages for a random number of contracts trading on some, but not all, DCMs.

Nor has the Commission offered any other rational explanation for the 85% Requirement, how the 85% Requirement would promote price discovery, or how the 85% Requirement would provide or be necessary to 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" as required by Core Principle 9. A spreadsheet of numbers serving as a random sample of which contacts would fail the Commission's arbitrary 85% test does not satisfy the Commission's obligations. In fact, when a DCM set block thresholds for contracts it lists for trading, the DCM is required to consider a number of factors that are intended to assess the impact that the block threshold will have on the market. Specifically, a DCM is required to consider:

1. Trading volume for the contract over the past year and average daily trading volume,
2. Average amount of open interest for the contract over the past year,
3. Average amount of liquidity in the centralized market,
4. Average amount of depth in the centralized market,
5. Typical trade size for the contract over the past year,
6. Typical order size for the contract over the past year,
7. Input from brokers and traders in the contract,
8. Block sizes on comparable swap products, and
9. Number of trades occurring equal to the block trade size level proposed and the percentage of total trading volume it represents for the past year

These factors suggest that Commission believes that a "one-size-fits-all" approach in not appropriate for DCMs when setting block thresholds; it is not clear how the Commission arrives at the opposite conclusion in this context.

Moreover, the Commission offers no explanation as to why it chose to review only a three-month period of time, particularly one which covers one of the most significant roll periods during the year. In fact, many of factors that a DCM is required to consider when setting block thresholds force the DCM to review and analyze data for *at least one year*. Before finalizing the proposed rule, the Commission must answer these and other questions raised in the public comments to the proposed rule, and provide the public opportunity to comment on those explanations. *See, e.g., La. Fed. Land Bank Ass'n, FLCA v. Farm Credit Admin.*, 336 F.3d 1075, 1080 (D.C. Cir. 2003) (remanding rule to agency for further explanation where agency failed to adequately explain basis for rule in light of comments suggesting rule was contrary to carefully constructed statutory scheme); *Fox Television Stations, Inc. v. FCC*, 280 F.3d 1027, 1043 (D.C. Cir. 2002) (remanding agency action for further explanation where agency "adduced not a single valid reason" for action).

20 South Wacker Drive Chicago, Illinois 60606 T 312 930 3488 F 312 930 4556 kathleen.cronin@cmegroup.com cmegroup.com

Finally, the 85% Requirement distinguishes a future from a swap based on liquidity. As we, and other commenters noted, such a result conflicts with the plain language of DFA.[7] Indeed, the definition of "swap" in DFA explicitly excludes futures contracts. Moreover, the Commission's position as reflected in this proposed rule cannot be reconciled with its April 6, 2010 order governing the cleared OTC account class.[8] In that order, the Commission explained that the liquidity profile of a particular contract was not a basis upon which to place a contract in the cleared OTC account class:

> Another commenter poses two questions about the definition of cleared OTC derivatives proposed in the Notice. All such questions appear related to whether the Commission may deem a contract listed for trading on a contract market (as Regulation 1.3(h) defines such term) to have been executed OTC, if such contract fails to reach a certain liquidity threshold on the contract market. The Commission believes that the definition of cleared OTC derivatives, as proposed in the Notice (*i.e.,* proposed Regulation 190.01(oo)), plainly limits such term to contracts that ''have not been entered into or traded on a contract market (as such term is defined in § 1.3(h) of this chapter) * * *.'' Regulation 1.3(h), in turn, defines ''contract market'' in terms of a board of trade's designation as a DCM, not in terms of the liquidity of any particular contract.

In that release, the Commission's position appears to be that what differentiated cleared OTC contracts from contracts that fell within the futures account class was where they were executed. That is, if the contract was executed on a DCM it was a futures contract and if executed, among other places, in the over-the-counter market the contract was in the cleared OTC account class. The Commission does not explain the basis for departing from its previous position on this issue.

* * * * *

---

[7] As we previously explained, the definition of "swap" in DFA expressly excludes futures contracts. Specifically, the definition of "swap" in DFA states "[e]xcept as provided in subparagraph (B), the term 'swap' means . . ." 7 U.S.C. § 1a(47)(A). Subparagraph (B) provides, in relevant part, "any contract of a sale of commodity for future delivery (or option on such a contract) . . . ." 7 U.S.C. § 1a(47)(B). Clearly, a contract for the sale of a commodity for future delivery, by definition, is not a swap, and by law, is required to be traded *only* on or subject to the rules of a DCM. 7 U.S.C. § 4(a). Thus, all current and future products listed as futures contracts on a DCM, by definition, are *not* swaps.

[8] Account Class, Federal Register Vol. 75, No. 65, Page 17297). The order is available at http://www.cftc.gov/ucm/groups/public/@lrfederalregister/documents/file/2010-7742a.pdf.

III. Conclusion

CME Group thanks the Commission for the opportunity to comment on this matter. We would be happy to discuss any of these issues with Commission staff. If you have any comments or questions, please feel free to contact me at (312) 930-3488 or via email at Kathleen.Cronin@cmegroup.com, or Christal Lint, Director, Associate General Counsel, at (312) 930-4527 or Christal.Lint@cmegroup.com

Sincerely,

Kathleen M. Cronin

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Bart Chilton
Commissioner Jill Sommers
Commissioner Scott O'Malia

20 South Wacker Drive Chicago, Illinois 60606 T 312 930 3488 F 312 930 4556 kathleen.cronin@cmegroup.com cmegroup.com