June 3, 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:

The undersigned exchanges (the "Exchanges") appreciate 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"). This letter addresses the Exchanges' continued concern with regard to proposed rule 38.502(a) (the "85% Requirement") under Core Principle 9 for designated contract markets ("DCMs") and the interplay between the 85% Requirement and other proposals published by the Commission for comment, including the rulemaking governing the core principles and other requirements for swap execution facilities (the "SEF Rulemaking") and the rulemaking governing product definitions (the "Definitions Rulemaking").

I. Introduction

Proposed rule 38.502 provides that no DCM "may continue to list a contract for trading unless an average of 85% or greater of the total volume of such contract is traded on the designated contract market's centralized market, as calculated over a 12 month period" (the "85% Requirement"). This proposed rule would apply to contracts that are listed as of the effective date of the rule and any products listed subsequent to the effective date of the rule. If a contract fails this test, the DCM is required to delist the contract and transfer the open positions in the contract to a swap execution facility ("SEF") (either one it operates or one operated by another) or liquidate the contract within 90-days of performing the requisite calculation.

As discussed in more detail below, the terms of Core Principle 9 do not support the 85% Requirement and the proposal is otherwise inconsistent with the Commodity Exchange Act ("CEA")." In fact, Core Principle 9 expressly permits DCMs to allow off-exchange trading without capping the amount of such trading. Trades that are executed outside the centralized market are subject to the regulatory oversight of the DCM, as well as the Commission. No evidence has been offered to suggest that these trades, which are submitted to a DCM in accordance with the DCM's rules, harm the price discovery process of the centralized market.

Furthermore, this arbitrary threshold for off-exchange trading fails to recognize that contracts and markets can have different characteristics that do not lend themselves to a “one-size-fits all” approach. A market may be naturally limited in the number of participants, the amount of trading and the nature of the trading due to the characteristics of the contract and the related cash market. A futures contract may be fulfilling an important economic purpose for one or more segments of a market, without being the primary source of price discovery for the underlying commodity or index. It does not make regulatory sense for the Commission to determine that a market which serves a legitimate purpose and that is subjected to a full and robust regulatory regime should not be permitted to exist simply because its centralized market volume does not meet some arbitrary number. On the contrary, this arbitrary rule undercuts several regulatory goals of the Dodd-Frank Act (“DFA”) and the CEA by deterring innovation in the futures market, tilting the competitive playing field in favor of SEFs and imposing costs and burdens on the market without any identified benefit. Accordingly, for the reasons discussed below and in our individual comment letters, the determination as to whether the price discovery function in the centralized market is being protected and what requirements may be necessary to protect the price discovery process, should be performed by the DCMs (subject to Commission oversight) based on a case-by-case balancing of all the qualities and features of the particular contract, the commodity involved and related markets as opposed to an unbending and potentially harmful threshold limit.

II. Detailed Comments

A. Off-Exchange Trading Is Expressly Permitted by Core Principle 9 Without Limitation

Proposed regulation 38.502(a) effectively requires that every contract listed for trading on a DCM: (i) trade in the centralized market and (ii) serve a price discovery function. This view of Core Principle 9 is inconsistent with its terms. Core Principle 9 provides that a DCM “shall provide a competitive, open and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market.” Core Principle 9, however, also expressly authorizes off-exchange futures transactions so long as those transactions are executed pursuant to DCM rules. Specifically, Core Principle 9 provides that “the rules of a board of trade may authorize … (i) transfer trades or office trades; (ii) an exchange of (I) futures in connection with a cash commodity transaction; (II) futures for cash commodities; or (III) futures for swaps; or (iii) a futures commission merchant, acting as principle or agent, to enter into or confirm the execution of a contract for the purchase or sale of a commodity for future delivery if that contract is reported, recorded, or cleared in accordance with the rules of the contract market or [DCO].” The terms of Core Principle 9 do not limit the amount of off-exchange trading that a DCM may permit in any given contract and nothing in the legislative history suggests that Congress considered setting an arbitrary limit as an appropriate means to regulate under the Core Principles.

In order to avoid having a contract delisted over an arbitrary percentage of centralized market volume, the proposed rule would force upon the exchange community the elimination of exchange for related derivatives transactions, which serve a critical cash market role in pricing of the underlying commodity in connection with the creation or exchange of futures to hedge such in the ordinary course of commercial trade. The elimination of these off-exchange transactions would only serve to penalize commercial market participants by forcing both sides of a cash exchange to independently initiate or liquidate accompanying futures hedge positions, with no guarantee of getting both futures transactions executed at the agreed upon price in connection with the cash commodity traded.

The terms of Core Principle 9 also fail to support the assertion that where transactions in a DCM contract are executed off the centralized market “there is no price discovery taking place on the DCM such that the protection of the price discovery process of trading in the centralized market is not satisfied.” With respect to block trades, a price discovery function is served by bringing together in one place the prices at which market participants are willing to buy or sell a particular contract. Core Principle 9(B) specifically contemplates the execution of trades other than through the centralized market. Although the price for a

block trade may not be the result of bids and offers submitted to a trading floor or a screen, the price for these off-exchange trades is the result of a competitive procedure and, when reported to a DCM and disseminated to the public, serve a price discovery function for all market participants, including those in the centralized marketplace. We believe that off-exchange trades contribute to the price discovery process and are not aware of any evidence that the off-exchange trades contemplated by Core Principle 9(B) have a negative impact on the price discovery process of the markets.

Core Principle 9 does not require that all contracts listed on a DCM perform a price discovery function. Rather, Core Principle 9 requires a mechanism for protecting the price discovery function for those contracts that do trade in the centralized market. That is, where a listed futures contract is being traded in the centralized market and there is sufficient liquidity for price discovery to be occurring, Core Principle 9 requires DCMs to ensure that their rules governing off-exchange transactions do not interfere with or detract from that price discovery process. Indeed, 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. The Release does not offer any basis for eliminating these valuable and effective risk management tools.

B. The Record Suggests that the 15% Threshold for Off-Exchange Trading is Completely Arbitrary

The proposed rule asserts that the 85% Requirement is necessary to "balance the goal of protecting the price discovery process of trading in the centralized market, with the goal of allowing off-exchange transactions for bona fide business purposes." 75 Fed. Reg. at 80588. The proposal, however, fails to explain how the proposed rule accomplishes the stated objective. Moreover, while the Commission collected and reviewed data related to the off-exchange and on-exchange trading percentages for several hundred contracts listed on various futures exchanges over a three-month period of time (the "Data"), neither the Data nor any other material made available to the public provides a rational basis for proposing the 85% Requirement.

The Data does not seem to consider the length that the product has been made available for trading on the DCM, how long it took the various products to achieve the relevant on-exchange trading percentages, or the trading patterns at different times in the lifecycle of the product, including intra-day liquidity fluctuations. Nor does the Commission offer any 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 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*. The snapshot of data provided by the Commission, without any additional context, seems of little value to the Commission's stated objective.

Most troubling, however, is that neither the Release, nor the Supplemental Release provides an indication that an analysis was performed as to how the price discovery process is protected where there is at least 85% trading in the centralized market and why this number, as opposed to 72% or 57% for example, works for *all* markets. Before finalizing the proposed rule, the Commission must answer this and other questions raised in the public comments to the proposed rule, and provide the public opportunity to comment on those explanations.

C. The 85% Requirement Will Have An Adverse Impact on Innovation and Competition in the Futures Market.

As each of the undersigned discussed in their individual comment letters, the 85% Requirement will significantly deter the development of new products by existing exchanges, and likewise deter any new futures exchanges from being established. Many new futures products – particularly those listed to compliment OTC contracts – are assisted in their development by off-exchange trading mechanisms like EFR, EFS and block trades. In many instances, it may take years before trading on the centralized

market becomes the predominant mode of trading. But under the 85% Requirement, before products can gain traction and have increased trading volume, even small amounts of off-exchange transactions could prove fatal to the product. As MGEX noted in its initial comment letter, the Commission is creating a chicken and egg scenario which may harm competition, innovation and legitimate risk management strategies for various market participants. Certainly the authors of DFA did not intend to see products otherwise suited for exchange trading move away from DCMs. CME Group's internal studies on new product performance revealed that, on average, it takes approximately 36 months for most new products to "achieve traction," which was defined as ADV>1,000 contracts.[1] However, the foreign exchange suite of products developed and offered by CME Group would not have met the 85% Requirement until four years after it was initially offered.[2] Other examples include CME's S&P 500 futures, NASDAQ 100 futures, S&P 400 Midcap futures, $10 Dow futures, and $25 Dow futures, which would all fail the 85% test.[3] These contracts have large notional contract sizes designed to appeal to particular customer segments, and privately negotiated transactions comprise more than 15% of the overall contract volume for these instruments. For GreenX, a newly formed DCM, none of its contracts would meet the 85% Requirement, despite a steady increase in centralized market trading volume to 57% in 2011, from 7% in 2008 when its contracts were first launched on NYMEX.

Further, the proposed rule does not appear to have taken into consideration options on futures contracts and the hedging and trading strategies employed thereon. For example, one adverse consequence of an arbitrary centralized market trading requirement is that where a listed futures contract fails the requirement and a listed option on that futures contract satisfies the requirement, both the futures contract and the option thereon would have to be delisted. Again, we fail to see any regulatory or other public benefit from such a result.

With the threat of delisting a futures contract if it fails the centralized market trading requirement threshold, customers likely will not establish new futures positions if there is any risk that in 12 months the product they were utilizing to hedge their position would no longer be available as a futures contract on a DCM. Customers prefer trade certainty, and, instead, likely will trade the same product on a SEF with a "swap" label, assuming the product is not a physically-delivered futures contract that would be ineligible to trade on a SEF. Indeed, few market participants would be willing to risk their capital or their clients' capital by holding positions and trading in a contract with the uncertainty of the long term viability of the product. Even if they were, it is unclear how the delisting requirement will affect existing open interest holders and whether such holders will face market risk, transaction costs and adverse tax consequences as a result of the arbitrary construct.

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[1] Specifically, the study showed that:

- New Ag and FX Products follow the overall trend, although their growth from months 6 to 36 is less pronounced so it takes them longer on average to achieve traction.
- Equity and Interest Rate products exhibited above-average growth and generally needed less time to achieve traction.
- Alternative investment products exhibited sporadic growth, possibly due to their reliance on seasonal factors like weather and their lack of correlation with existing successful products.

[2] Specifically, these products collectively traded 32% off-exchange when the suite was first offered in 2000; 31% off-exchange in 2001; 25% in 2002; 20% in 2003; finally moving within the 85% Requirement at 13% off-exchange in 2004; 10% in 2005; 7% in 2006; 5% in 2007; 3% in 2008; and 2% in 2009 and 2010. As this data demonstrates, permitting DCMs to seek an exemption from the Commission to allow a new contract that fails the 85% Requirement to continue trading for another 12 months if at least 50% of the contract's volume is transacted on the centralized market does not address our concerns.

[3] Clearly linked or related products should be considered together for purposes of any centralized market trading calculation.

It is additionally unclear how the public will benefit or how open and transparent markets will be successfully developed when certain futures contracts are transferred to a SEF. The consequence of that transfer is that customer participation will then be restricted only to "eligible contract participants" versus a broader base of interested customers. Additionally, swap versus future contract margining rules will potentially require 5 – versus 1-day margining – simply because a new instrument has not matured sufficiently to be identified as a futures contract versus a swap. The consequence is to hamper, rather than promote, open, transparent and efficient markets.

The imposition of an 85% exchange trading requirement would have substantial adverse effects on market participants as well. As an initial matter, the cost of executing large orders, which often-times are placed on behalf of hedgers or retail investors through pension funds, will increase and that cost will be passed down to the very group of people the proposal appears to seek to protect.

D. "Futures" Disadvantaged When Compared to "Swaps"

The 85% Requirement appears to contemplate distinguishing a future from a swap based on the liquidity profile of the contract or manner in which the contract is executed. This result conflicts with the plain language of DFA. Indeed, the definition of "swap" in DFA contains no reference whatsoever to liquidity or any other similar contract feature. In fact, the definition of "swap" arguably describes many products that are listed for trading today on DCMs as futures contract, including:

- CME Group's 3-Month Eurodollar Futures (Dec 1981)
- CME Group's S&P500 Index Futures (Apr 1982)
- CME Group's Feeder Cattle Futures (Cash Settled since Aug 1986)
- CME Group's 30-Day Fed Funds Futures (Mar 1988)
- CME Group's 1-Month Eurodollar Futures (Apr 1990)
- CME Group's S&P-Goldman Sachs Commodity Index Futures (Jul 1992)
- CME Group's Lean Hog Futures (Cash Settled since Dec 1996)
- CME Group's E-Mini NASDAQ-100 Futures (Jun 1999)
- CME Group's 10-Year Interest Rate Swap Futures (Oct 2001)
- CME Group's Henry Hub Natural Gas Swap Futures (Dec 2001)
- CME Group's Cash Settled Butter (Sep 2005)
- CME Group's New York Harbor RBOB Gasoline (Oct 2005)

Since their listing for trading, these products have been traded as futures contracts by market participants and regulated as such by the Commission because a DCM chose to offer them for trading as futures contracts rather than swaps. Congress clearly understood this market reality when enacting DFA and could have expressly precluded such products from being traded and regulated as futures. It did not do so. Instead, Congress chose to provide a regulatory framework for the previously un-regulated OTC market – much like that which existed for the regulated futures market – to ensure that *all* derivatives products and market participants were subject to regulation. Thus, the Commission should not use the rulemaking process to erode or otherwise limit the types of products that may be listed for trading as futures contracts on a DCM.

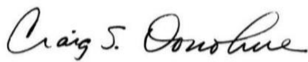
III. Conclusion

As previously noted, neither DFA nor the CEA requires DCMs to list for trading only those contracts that perform a price discovery function. The Exchanges strongly urge the Commission not to adopt the 85% Requirement, or any other arbitrary, one-size-fits all rule capping the amount of off-exchange trading in contracts listed for trading on DCMs. Instead, the Commission should adopt a position that allows DCMs (subject to Commission oversight) to continue to make the determination as to whether the price discovery function in the centralized market is being protected and what requirements may be necessary

to protect the price discovery process, based on a case-by-case balancing of all the qualities and features of the particular contract, the commodity involved and related markets, as opposed to a single-minded focus on a contract's price discovery function. The Commission has more than adequate authority under the CEA to require that a DCM make changes to its rules governing off-exchange trading where the Commission finds that such trading harms the price discovery function.

The Exchanges thank 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 any one of the undersigned.

Sincerely,



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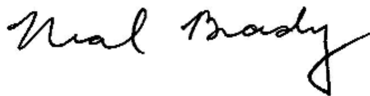

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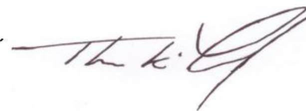

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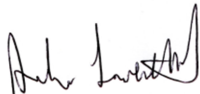

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