OneChicago

June 3, 2011

Mr. David A. Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

RE: Notice of Proposed Rulemaking: Governance Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities; Federal Register October 18, 2010 and January 6, 2011
RIN 3038-AD01

Dear Mr. Stawick:

OneChicago, LLC ("OCX") appreciates the opportunity to comment on the Commodity Futures Trading Commission's ("CFTC" or "Commission") Notices of Proposed Rulemaking ("NPRM") that were published in the Federal Register on October 18, 2010 and January 6, 2011 regarding Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities.

OneChicago is the only domestic security futures exchange; we provide a marketplace for trading futures on over 1,900 individual equities, ETFs and Narrow Based Indices. Security futures were authorized by the Commodity Futures Modernization Act of 2000 ("CMFA"), which placed security futures under the joint regulation of the CFTC and the Securities and Exchange Commission ("SEC").

Security futures are equity finance products that provide the ability to obtain and/or maintain long or short equity delta at a lower overall finance cost, which are oftentimes the largest cost borne by investors. In other words, security futures products are a delta one[1] substitute for the underlying equity. The OneChicago OCX.NoDivRisk™ exchange of derivative for related position ("EDRP") trade is an exchange traded, central counterparty cleared, economic equivalent to OTC equity swaps, OTC equity repos and OTC stock lending transactions, the very transactions that the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") has mandated move to exchange traded, central counterparty cleared transactions.

[1] **Delta One** products are a class of financial derivative that have no optionality and, as such, have a delta of one (or very close to one) – that is, a 1% move in the underlying equity results in a very close to 1% move in the derivative.

**Numerical Limits on Ownership**

We appreciate and support the Commission's drive to address and prevent conflicts that detract from the appropriate and efficient functioning of DCMs, SEFs and DCOs. However, we believe that DCMs and DCOs have adequately managed these conflicts over the years through structural governance controls, including rules, charters, operating agreements, code of ethics and conflict of interest policies. The Commission has not brought forth evidence that the current approach is ineffective in promoting the goals of the Dodd-Frank Act.

Therefore, the Commission is currently unauthorized to propose numerical limits on ownerships of DCMs, DCOs and SEFs. Section 726(b) of the Dodd-Frank Act requires the Commission to impose such limits only *after* conducting a review that *demonstrates a need* to impose such limits "to improve the governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with a swap dealer or major swap participant's conduct of business with, a DCO, SEF or DCM in which such swap dealer or major swap participant has a material debt or equity investment." As others have noted, the Commission has failed to conduct such a review. In fact, the Commission has failed to make *any* evidentiary showing that such limits are "necessary" or "appropriate" to further the expressly stated goals of the Dodd-Frank Act.

Also, the Commission has not presented any empirical evidence to demonstrate that imposing limitations on ownership or voting rights aids DCMs in balancing regulatory and commercial interests or in preventing inappropriate restrictions of access to the DCM. Besides, as acknowledged in the NPRM, directors already have a fiduciary duty to act in the best interest of the organization; such duty is more effective in ensuring the proper functioning of the marketplace than arbitrary ownership and voting restrictions.

Further, we note that customers, trade groups, competitors and regulators all exert influence on DCMs despite having no ownership interests. Clearly, the Commission agrees that non-owners can exert influence; otherwise it would not work with the industry to solicit comments and craft appropriate regulations. The comments on proposed rules undoubtedly influence the final rule issued by the Commission.

As part of the review required by the Dodd-Frank Act, the Commission should factor in the chilling effect that ownership and voting limitations may have on innovation and competition. Namely, parties may be unwilling to allocate capital and human resources in developing new DCMs, SEFs and DCOs using new and innovative trade practices or match engine technology without the ability to profit from such ventures. Entities that have an innovative method to trade or clear products will be prohibited from implementing their approaches without sharing the profit that comes from successful innovation. Further, a party may be prevented from pursuing such ventures *entirely* if it is unable to locate the arbitrary number of investors required to satisfy proposed §38.851. The possibility of such consequences runs directly counter to the Dodd-Frank Act's purpose of promoting competition. In addition, we hope the Commission recognizes OneChicago's unique position created by our relationship with the OCC (f/k/a The Options Clearing Corporation), which stands ready to clear for other entities looking to list for trading Security Futures Contracts in direct competition to our offerings.

Moreover, in deciding against proposing aggregate ownership and voting limits on DCMs, the Commission stated that "the benefits of sustained competition . . . outweigh the incremental benefit of better governance through limitations on the aggregate influence of the enumerated entities." OneChicago agrees with these concerns and believes the benefits of sustained competition also outweigh any miniscule benefit that may be achieved by the more general ownership limitations outlined in proposed §38.851.

Such concerns are especially amplified in small niche markets. Exchanges in these markets, like OneChicago, are typically established by a few market members based on their innovation and expertise. The unhindered ability of such market members to establish new DCMs and innovate the trading process leads to better trading services, increased competition and lower trading costs. On the other hand, the proposed ownership limitations would impede successful market entry by the few innovators in the field and entrench incumbents as their dominance is bolstered.

For these reasons, we believe that the discipline of the market and appropriate, well-defined governance control provide the best approach to mitigating potential conflicts of interest in DCMs. In contrast, the Commission's proposed ownership limitation is not only unlikely to achieve its desired effect, but also certain to do economic harm to current owners.

However, if, after conducting the required review, the Commission determines that numerical ownership limits are necessary and appropriate, it should consider the following:

- The Commission should set them only with respect to DCOs, SEFs and DCMs listing swaps and only for enumerated entities as these are the limited instances in which the Dodd-Frank Act delegates power to the Commission to impose such limitations. Section 726(a) of the Dodd-Frank Act explicitly states that the Commission "shall adopt rules which may include numerical limits on the control of, or the voting rights with respect to, any derivatives clearing organization that clears swaps, or swap execution facility or board of trade designated as a contract market that posts swaps or makes swaps available for trading." While we appreciate the Commission's dedication to uniformity and standardization, these limits are clearly not applicable to OneChicago. This is especially true in light of the fact that futures exchanges, such as OneChicago, played no role in causing the financial disturbances that led to the enactment of the Dodd-Frank Act. Furthermore, it would not be in OneChicago's best interests to restrict access; competitive market forces would drive orders away from our exchange and onto those of our competitors that would undoubtedly arise.

- As another alternative, the Commission should consider allowing DCMs, DCOs and SEFs to meet these requirements by limiting the exercise of voting rights on specific access and membership issues, while allowing voting rights consistent with ownership interests on all other matters.

- The Commission should allow for permanent waivers for existing DCMs in order to avoid economic waste. To require owners of existing DCMs to divest ownership interests above an arbitrary percentage will naturally depress the sale price of such 'over the threshold' ownership shares as potential buyers will certainly be aware of the owner's

dilemma. Additionally, a divestment requirement on market innovators may lead to collusion between oligopolistic market members who move into a control position with the ulterior motive of decreasing access. The Commission falsely assumes that non-diverse ownership will necessarily lead to decreased access. However, OneChicago's history of non-discriminatory access speaks to the contrary.

- Further, the Commission should also consider, as provided in Section 726(c) of the Dodd-Frank Act, the governance arrangements for the DCO or DCM when applying the standards including:

    - Allowing for waivers where membership/access standards are clearly articulated in rules approved by the Commission (Similar to the approach taken by the SEC's proposed Rules 809(c) and 811(b)). Additionally, the Commission should most certainly provide for a waiver procedure for DCMs and SEFs that can demonstrate compliance with Core Principle 16 through other means, such as governance controls.
    - Alternatively, the Commission could exempt DCMs where access is based solely on required regulatory approvals controlled by third parties. Such an approach would prevent access discrimination and eliminate the need for arbitrary ownership and voting limitations. This approach is consistent with the proposed requirement that the membership/participation committee review any applicants denied by staff.

Finally, the Commission should take judicial note that some exchanges, such as OneChicago, do not have separate membership requirements; all clearing firms that are appropriately registered with the Commission and/or the SEC and meet the OCC's membership requirements can access OneChicago markets for themselves and their customers. Thus, OneChicago's membership requirements are in line with the Dodd-Frank Act's stated purpose of promoting competition; the Commission's proposed rules, on the other hand, are not.

**<u>Governance and Fitness Standards</u>**

The Commission has proposed in §38.801(c) that each designated contract market must specify and enforce fitness standards for its members and affiliates thereof; persons with direct access to the facility; natural persons who, directly or indirectly, own greater than ten percent . . . and parties affiliated with the persons enumerated in paragraph (b) of this section. OneChicago is concerned that this proposed regulation places a large burden on DCMs in that all affiliates of member firms would need to be reviewed for fitness standards, which for some firms may include a large number of affiliates that do not conduct business at the DCM nor control an organization that does conduct business at the DCM. Further, the transition of corporate officers in and out of these organizations and the sales or purchases of their affiliates will require DCMs to conduct such reviews on an almost ongoing basis. Any benefit these reviews may confer on the industry will be immensely outweighed by the unjustified burdens they necessarily impose on it.

Moreover, the Commission has proposed in §38.801(e) that, as a condition of access, all members and non-members must agree to become subject to the jurisdiction of the designated contract markets. OneChicago agrees that all parties with direct access to the exchange should

consent to DCM jurisdiction. We do not concur, however, that all customers that are provided access through the clearing member should be required to consent to jurisdiction. The industry and DCM costs to comply eclipse the benefit of such registrations. Furthermore, as clearing members control access to the DCM, the DCM does not have an independent ability to confirm that each customer has signed consent to jurisdiction.

**Composition of Governing Boards of Contract Markets**

Proposed §38.901(c) would require that the DCM make available to the Commission and the public, a description of the process by which the DCM considers the views of its market participants. The Commission specifically requested comment on whether the proposal was appropriate to implement DCM Core Principal 17.

The Commission has taken an unprecedented step beyond the appropriate guidance and into the realm of corporate management as well as relationships with customers and end users. Core Principle 17 merely requires that a DCM's governance arrangement be designed to permit considerations of the views of market participants. The Commission's proposed §38.901 (a) and (b) provide all the necessary regulation to carry out the objectives of Core Principle 17. Thus, proposed §38.901(c) represents an unnecessary intrusion into day-to-day business practices.

**Material Relationship as Defined in Proposed §1.3(ccc)(1)(v)**

The Commission is proposing standards that are in direct opposition to other standards currently imposed by the Commission. Proposed §1.3(ccc)(1)(v) requires that members of the Regulatory Oversight Committee who are public directors do not accept, directly or indirectly, any compensatory fees from member firms, among other entities.

Other Commission standards and good business judgment call for members of a DCM's Board of Directors to have sufficient expertise. See footnote 55 and related text in the October 18, 2010 NPRM that is the subject of this comment letter.

For small DCMs, such as OneChicago, these two requirements are contradictory to each other as our public directors are likely be culled from industry experts providing consulting and/or advisory services to the trading community. Meeting both of these objectives will significantly reduce the pool and quality of potential public directors and, therefore, hinder oversight.

Furthermore, restricting all members of a director's immediate family from receiving compensation from member firms leads to a scenario where talented potential public directors are disqualified solely due to an immediate family member's employment in the financial services industry.

We suggest the Commission remove proposed §1.3(ccc)(1)(v) and support the presence of industry experts on the Board of Directors of small DCMs.

**Conclusion**
We appreciate the opportunity to provide comments on the Conflict and Governance NPRM. We believe the Commission can meet its goal of addressing conflicts of interest and good governance without imposing ownership and voting limitations, without requiring non-direct access consent and without unduly restricting the relationships that public directors may have in the financial services industry. We would be happy to discuss any related issues with CFTC staff. If you have any questions, please do not hesitate to contact me at (312) 424-8512 or via email at tmccabe@OneChicago.com.

Sincerely,

Thomas G. McCabe
Chief Operating Officer
OneChicago, LLC