

September 30, 2011

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

Re: Clearing Member Risk Management
76 Fed. Reg. 45724 (Aug. 1, 2011), RIN 3038-AD51

Dear Mr. Stawick:

CME Group Inc. (“CME Group”) appreciates the opportunity to comment on the Commodity Futures Trading Commission’s (“CFTC” or the “Commission”) notice of proposed rulemaking (“NPR”) regarding risk management requirements for futures commission merchants (“FCMs”), swap dealers (“SDs”) and major swap participants (“MSPs”) that are clearing members of a derivatives clearing organization (“DCO”). CME Group is the parent of Chicago Mercantile Exchange Inc. (“CME”). CME’s clearing house division (“CME Clearing”) offers clearing and settlement services for exchange-traded futures contracts, and for over-the-counter derivatives transactions through CME ClearPort. CME is registered with the CFTC as a DCO, and is one of the largest central counterparty clearing services in the world.

The NPR proposes two regulations: (1) Regulation 1.73, which sets forth risk-management requirements for FCMs that are clearing members of a DCO; and (2) Regulation 23.609, which sets forth risk-management requirements for SDs and MSPs that are clearing members of a DCO. In addition to requiring written procedures and maintenance of records documenting compliance, the proposed regulations would require each FCM, SD and MSP clearing member to:

- (1) Establish credit and market risk-based limits based on position size, order size, margin requirements, or similar factors;¹
- (2) Use automated means to screen orders for compliance with the risk-based limits;
- (3) Monitor for adherence to the risk-based limits intra-day and overnight;
- (4) Conduct weekly stress tests;²
- (5) Evaluate its ability to meet initial margin requirements at least once per week;
- (6) Evaluate its ability to meet variation margin requirements in cash at least once per week;

¹ For FCMs, proposed Regulation 1.73(a) (1) specifies that risk-based limits must be established “in the proprietary account and in each customer account....”

² For FCMs, proposed Regulation 1.73(a)(4) would require weekly stress tests of “all positions in the proprietary account and in each customer account that could pose material risk....” For SDs and MSPs, proposed Regulation 23.609 would require weekly stress tests of all positions.

- (7) Evaluate its ability to liquidate the positions it clears in an orderly manner, and estimate the cost of the liquidation at least once per month;³ and
- (8) Test all lines of credit at least once per quarter.

According to the NPR, the CFTC “does not intend to prescribe the particular means of fulfilling these obligations”, and “clearing members will have flexibility in developing procedures to meet their needs.”⁴ CME Group strongly supports a principles-based, non-prescriptive approach to regulations governing clearing member risk management. While the discussion in the NPR focuses on risks faced by firms that clear swaps, the proposed regulations would apply equally to clearing members that primarily, or solely, clear exchange-traded futures and/or options on futures, which present a somewhat different risk profile. Additionally, the customer base and amount and type of proprietary trading can vary dramatically from clearing member to clearing member. These and other variables, in combination, will dictate the appropriate details of suitable risk management policies and procedures for a particular firm. As the CFTC moves forward with adopting and enforcing risk management regulations, we encourage a continued emphasis on a principles-based regime and avoidance of “one size fits all” prescriptive requirements.

The CFTC has requested comment on what each DCO currently requires of its clearing members with respect to risk management policies and procedures. CME Clearing utilizes a principles-based approach for clearing member risk management. A key provision in that regard is CME Rule 982 (Risk Management), which provides as follows:

All clearing members must have written risk management policies and procedures in place to ensure they are able to perform certain basic risk and operational functions at all times. At a minimum, the following areas must be considered in the firm’s policies and procedures, depending on the firm’s size and its business and product mix:

- A. Submission and Account Monitoring. Clearing members must have procedures in place to demonstrate compliance in the following areas for trades executed through both electronic platforms and open outcry:
 1. Monitoring the credit risks of accepting trades, including give-up trades, of specific customers.
 2. Monitoring the risks associated with proprietary trading.
 3. Limiting the impact of significant market moves through the use of tools such as stress testing or position limits.
 4. Maintaining the ability to monitor account activity on an intraday basis, including overnight.
 5. Ensuring order entry systems include the ability to set automated credit controls or position limits or requiring a firm employee to enter orders.
 6. Defining sources of liquidity for increased settlement obligations.
- B. Additional and/or Alternative Requirements. Exchange or Clearing House staff may prescribe additional and/or alternative requirements in order for clearing members to comply with this Rule.

³ Proposed Regulation 1.73(a)(7) would require FCMs to evaluate their ability to liquidate, in an orderly manner, “the positions in the proprietary and customer accounts....”

⁴ 76 Fed. Reg. 45724, 45725 (Aug. 1, 2011).

Of particular importance to CME Clearing is that the Rule anticipates and provides for differences in firms' size, business and product mix, and allows CME Clearing to prescribe additional and/or alternative requirements as necessary.⁵ CME Clearing monitors compliance with Rule 982 and other risk management requirements through daily interaction with clearing members and on-site risk management reviews.

While CME Group supports the CFTC's efforts to "bolster risk management at the clearing member level",⁶ we are concerned with the proposal to require clearing members to "use automated means to screen orders for compliance with the risk-based limits." As stated in IOSCO's final report on *Principles for Direct Electronic Access to Markets*: "In an *automated* trading environment, the only controls that can effectively enforce [risk] limits are automated controls."⁷ CME Group has championed automated pre-trade controls in electronic trading environments, with a leading example being our Globex Credit Controls. We note, however, that floor-based or "open outcry" trading continues to be utilized in many of our exchange-traded markets, and automated controls are not feasible in such non-automated trading environments. We therefore urge the CFTC to revise the proposed regulations to require clearing members to "use automated or otherwise appropriate means to screen orders for compliance with the risk-based limits."

We also question the advisability of requiring clearing members to test all lines of credit every quarter. Committed lines of credit are subject to testing, but uncommitted lines generally are not. In addition, we believe that annual testing of committed lines should suffice and have seen no cost/benefit analysis that may justify quarterly testing rather than annual testing of committed lines.

Finally, we note that in January 2011, the CFTC proposed a regulation that would require each DCO to adopt rules to require clearing members to maintain written policies and procedures regarding risk management, and to "review the risk management policies, procedures, and practices of each of its clearing members on a periodic basis and document such reviews."⁸ In responding to the CFTC's request for comment on whether every DCO should be required to conduct annual risk-management reviews of each of its clearing members, we observed that many firms are members of multiple DCOs, and that "[c]ontinual on-site risk reviews by DCOs could easily become overly burdensome and distracting for clearing member firms."⁹ We understand the CFTC, and not DCOs, would be responsible for enforcing Regulations 1.73 and 23.609.¹⁰ We encourage the CFTC to coordinate with DCOs, as feasible and appropriate, in an effort to minimize the costs and burdens to all involved parties arising from any clearing member risk-management reviews the CFTC may conduct.

⁵ Other risk management rules include Rule 949 (Credit Controls), which requires clearing members to, among other things, "comply with all credit control policies developed by the Exchange for customer and proprietary transactions", and Rule 8F010, which addresses particular risk management requirements for OTC clearing members.

⁶ 76 Fed. Reg. at 45724.

⁷ Technical Committee of the International Organization of Securities Commissions, Final Report, *Principles for Direct Electronic Access*, at 4 (Aug. 2010) (emphasis added).

⁸ Proposed Regulation 39.13(h)(5). 76 Fed. Reg. 3698 (Jan. 20, 2011).

⁹ Letter from CME Group Inc. (Craig Donohue, Chief Executive Officer) to the CFTC (Mar. 21, 2011), at 9.

¹⁰ *Open Meeting on the Seventeenth Series of Proposed Rulemakings Under the Dodd-Frank Act* (July 19, 2011), at 57-59 (Statements of John Lawton, CFTC Division of Clearing and Intermediary Oversight).

Mr. David Stawick
September 30, 2011
Page 4

CME Group thanks the CFTC for the opportunity to comment on this matter. We would be happy to discuss any of these issues with the Commission and its staff. If you have any comments or questions, please feel free to contact me at (312) 930-8275 or Craig.Donohue@cmegroup.com; or Lisa Dunsky, Director and Associate General Counsel, at (312) 338-2483 or Lisa.Dunsky@cmegroup.com.

Sincerely,



Craig S. Donohue

cc: Chairman Gary Gensler (via e-mail)
Commissioner Michael Dunn (via e-mail)
Commissioner Bart Chilton (via e-mail)
Commissioner Jill Sommers (via e-mail)
Commissioner Scott O'Malia (via e-mail)
Ananda Radakrishnan (via e-mail)
John Lawton (via e-mail)
Christopher Hower (via e-mail)