Eris Exchange

Neal B. Brady
Chief Executive Officer

September 30, 2011

VIA ELECTRONIC MAIL

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

Re: RIN Number: 3038-AD51: 76 FR 45724 (Clearing Member Risk Management) and 76 FR 45730 (Customer Clearing Documentation and Timing of Acceptance for Clearing)

Dear Mr. Stawick:

Eris Exchange, LLC ("Eris Exchange" or the "Exchange")[1] appreciates the opportunity to submit its comments to the U.S. Commodity Futures Trading Commission (the "Commission" or "CFTC") on the proposed rules related to Clearing Member Risk Management and Customer Clearing Documentation and Timing of Acceptance for Clearing (collectively the "Proposed Rules").

Eris Exchange supports the Proposed Rules and believes they are necessary to promote the overall goals of the Dodd-Frank Act of reducing systemic risk and bringing greater transparency to the over-the-counter markets. Specifically, Eris Exchange believes that:

- The well-established futures model for execution and clearing (the "Futures Model") implements the goals of the Proposed Rules and therefore provides a baseline for the documentation in the cleared swaps market.
- Technology exists today to implement the execution and clearing of derivatives, indeed Eris Exchange is operational today for the execution and clearing of interest rate swap futures.
- There is no need for an execution agreement that sets up a direct legal relationship between the buyer and seller.
- The Futures Model ensures open access to any person with an account at a Futures Commission Merchant ("FCM"), including smaller buy side firms.
- The Futures Model manages risk at the customer's primary FCM and that FCM manages risk among execution venues.
- The Proposed Rule should be finalized by the Commission as soon as possible to provide certainty to the industry.

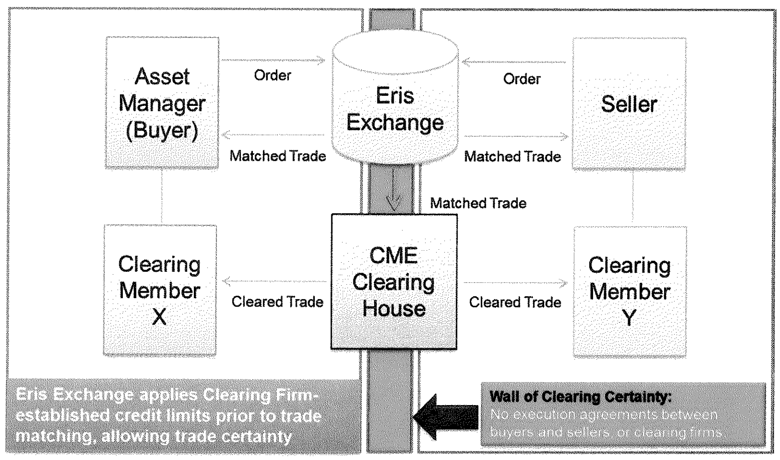
It is critical to implement the Proposed Rules for swaps that are mandated to be cleared and are made available for trading, otherwise the Commission runs the risk of relinquishing the Dodd-Frank mandate to a system that will result in a costly and burdensome documentation structure that will limit open access and stifle competition. In sum, the Proposed Rules will be a critical step toward the implementation of Dodd-Frank that has the potential to ignite a technological revolution similar to the tremendous wave of innovation experienced when the futures industry migrated from pit-based trading to screen-based trading and resulted in the emergence of the U.S.

[1] Eris Exchange is a futures exchange that has applied to the Commission to be a Designated Contract Market ("DCM"). Eris Exchange anticipates that it will be designated on October 18, 2011. As a DCM, Eris Exchange will be permitted to list both traditional financial futures, such as its interest rate swap futures contract (the "Contract"), as well as, swaps subject to the Dodd-Frank Act. As such, Eris Exchange will satisfy the Dodd-Frank execution mandate and will compete with swap execution facilities ("SEFs") in the cleared interest rate swap space.

derivatives industry as a world leader. Such a technological revolution will deliver on the real benefits of the Dodd-Frank Act.

Eris Exchange: Anonymity, Real-Time Execution and Clearing Certainty

The Futures Model is anonymous and straightforward resulting in real-time execution and clearing certainty. In order to trade futures on Eris Exchange, participants must enter into several agreements. However, as illustrated in the diagram below, these agreements never cross the line between the buyer and seller ("Wall of Clearing Certainty").



Participant anonymity is preserved in the Futures Model, thus preventing any potential interference by the counterparty or their FCM in the clearing client's execution decisions. Such interference serves no purpose other than to restrict customer's choice of executing counterparties and to permit clearing firms to limit customer's clearing and execution choice.

The separation between buyer and seller is possible given the straight-forward documentation and technological work flow necessary to trade the Eris Exchange Contract. A Participant on the Exchange must have an account at an FCM that is an Eris Exchange Clearing Firm ("Clearing Firm"). That account is governed by an agreement between the Participant and Clearing Firm, to which Eris Exchange is not a party.

In addition, the Participant and the Participant's Clearing Firm each enter into a single agreement with Eris Exchange totaling two pages, one time. The central theme of the Eris Exchange-specific documents is that Participant's Clearing Firm accepts financial responsibility for all trades.[2] Pursuant to the CME Clearing House

[2] The Clearing Firm Agreement provides as follows:

> Clearing Firm agrees that it will be <u>financially responsible</u> for (i) any transactions effected on Eris Exchange and for any use of the Eris Trading System made by Clearing Firm, Participant Firms, Authorized Traders, Broker Firms, or Authorized Brokers and (ii) all orders that are entered using User IDs assigned by Eris Exchange and for clearing any trades that are matched as a result of such orders. Clearing Firm will be <u>responsible to clear such trades</u> even if the orders received via the Eris Trading System: (a) exceeded Clearing Firm's credit parameters, (b) were entered as a result of a failure in the security controls and/or credit controls, other than due to the gross negligence of Eris Exchange, or (c) were entered by an unknown or unauthorized user.

and Eris Exchange Rulebooks, a Participant's Clearing Firm can be any of 60+ CME FCMs with $50 million in minimum capital. Importantly, the Clearing Firm is able to accept financial responsibility because it controls the Participant's credit.

Technology for Real-Time Execution and Clearing Certainty is Available Today at Eris Exchange

Through its technology, Eris Exchange assists the Clearing Firm in the control and monitoring of the Participant's credit limit. Eris Exchange applies Clearing Firm-established credit limits in real-time prior to trade matching. As such, if the Participant does not have enough credit to execute the trade, the trade will not be input into the system and consequently not matched.

Participants and Clearing Firms are able to view their real-time overall limits and status on Eris Exchange. Should a credit event occur, Eris Exchange provides the Participant and Clearing Firm with a real-time message and email notification.[3] If the credit of a Participant must be modified, the Clearing Firm can do so directly on Eris Exchange through their Clearing Firm Administrator.

As an additional risk-management feature of the Futures Model, the Clearing House, CME Clearing in the case of Eris Exchange, is responsible for monitoring and modifying the Clearing Firm's credit limits. This permits management of the overall credit exposure of the Clearing Firm.

As a result of credit controls and real-time credit monitoring, Eris Exchange trades are accepted in real-time. On Eris Exchange an executed trade is a matched and cleared trade. Trade execution and clearing are simultaneous events. Eris Exchange participants receive immediate confirmation that the trade is completed (i.e., execution and clearing certainty). Accordingly, a trade break or "fail" is avoided from the start. If a credit limit is breached by a Participant, the Participant is locked out of the trading platform. A trade does not occur if a Participant does not have sufficient credit.[4] **The result is a system in which Participants may trade with certainty even during times of stressed or volatile market conditions without regard to the credit quality of the Participant on the other side of the trade.**

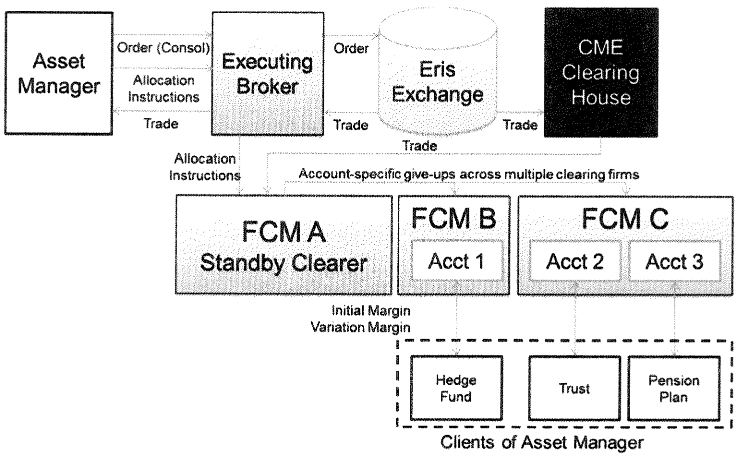
Notably, the futures industry performed flawlessly during the financial crisis. The Futures Model enabled the futures markets to respond to the risks being posed by the financial crisis by offering market participants the ability to manage risk, the stability of clearing a transaction immediately upon execution on a regulated exchange, and the ability to quickly liquidate positions. In addition, the "open" Futures Model allows for wide participation in the marketplace. This wide user base proved to be a critical factor in maintaining liquidity through the financial crisis.

[3] A "credit event" occurs when an account breaches 80% of its daily clearing firm established risk limit or when an account attempts to breach its daily clearing firm established risk limit.

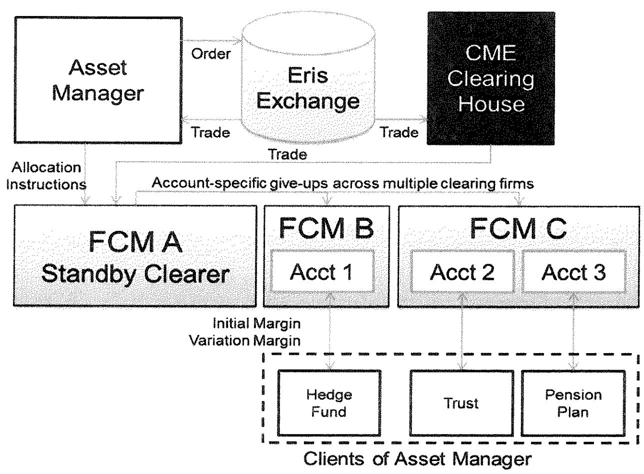
[4] In addition, if a Participant on the Exchange has made an error, there is a process in the Exchange's Rulebook for Trade Cancellations and Price Adjustments.

Give-Up Agreements Permit Best Execution with Time for Back Office Allocations

The Futures Model provides certainty for trades involving allocations by asset managers or other buy side participants. The standard futures industry give-up agreement permits a Participant, such as an asset manager, to instruct an executing broker to place a large order that can be allocated among the asset manager's accounts post-execution.[5] This overall process permits anonymity, real-time trade acceptance, and better pricing due to the ability to allocate trades post-execution. As illustrated below, this work flow is possible because of the use of a Standby Clearer that is financially responsible for the trade until it is allocated to the specific FCM accounts.



In the scenario where a Participant is directly accessing Eris Exchange, the allocation and give-up model with a Standby Clearer works the same. As illustrated in the diagram below, the same work flow is used in order to execute a bunched order at the best price in the market and to allocate the trade to various accounts post-execution:



[5] The agreement templates are available at: http://www.futuresindustry.org/giveup-agreements2.asp.

In both diagrams above, pursuant to the standard futures industry give-up agreement, the Asset Manager, on behalf of its Clients, enters into a standard futures give-up agreement with the Standby Clearer where:

- The Standby Clearer (FCM A) is responsible for determining that all orders are placed or authorized by Asset Manager.
- The Clearing Brokers (FCM B and C) are responsible for clearing all executed orders transmitted to the Clearing Broker.
- If the Asset Manager disputes any transaction, the Standby Clearer or Clearing Broker can liquidate or otherwise offset the disputed position.
- In the event that the Clearing Broker does not, for any reason, accept a trade transmitted to it by the Standby Clearer, the Standby Clearer can:
    - close out the Client's trade;
    - transfer the Client's trades to another clearing broker; or,
    - clear the Client's trade.

The give-up agreement further buttresses the "click-and-done" certainty of the Futures Model. For example, in the futures industry today, Eris Exchange understands that approximately 20% to 25% of trades at a typical futures exchange are allocated on a given day. In addition, Eris Exchange understands that at a typical active FCM, more than 200,000 allocations are performed in a day. These allocations are handled seamlessly and efficiently and do not interfere with clearing certainty.

The Futures Model of "click-and-done" and allocations can work for swaps as well. Indeed, the CFTC already has regulations regarding the allocation of futures and has proposed a similar model for the allocation of swaps, namely that there can be post-execution allocation of bunched orders.[6]

In terms of transition, the traditional bi-lateral ISDA documentation underlying existing swaps those transactions will continue to exist. In addition, until the rules are finalized and the clearing and execution mandate is effective, these documents can and will continue to be used. However, if the Proposed Rules are finalized, an elegant and well-tested solution, common in all cleared derivatives markets, will come to bear. Participants will modify existing agreements with their Clearing Firm and Participants will sign up to the SEFs on which they want to execute. The Participants will agree to be bound by these two agreements. In addition, a give-up agreement similar to the futures give-up agreement can be modified and used for swaps.

Conclusion

Eris Exchange appreciates the opportunity to comment on this matter. Eris Exchange is fully operational today for trading and clearing of interest rate swap futures, and our product and trading protocols embody the guiding principles of the Dodd-Frank Act. In implementing the Dodd-Frank Act, we believe the Commission has an historic opportunity to improve the efficiency of the swaps market, providing great benefit to end users, and ultimately reduce transaction costs while also reducing systemic risk. The key to successful implementation, however, is to move forward with efficient documentation, which the Futures Model provides a baseline to design the real-time clearing of swaps.

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[6] *See* Adaptation of Regulations to Incorporate Swaps, 76 Fed. Reg. 33066, 33091 (proposed June 7, 2011) (to be codified at 75 Fed. Reg. § 1.35(b)(5)).

If you have any questions or would like to learn more about Eris Exchange, please do not hesitate to contact Stephen Humenik, General Counsel and Chief Regulatory Officer at 312-626-2681 or stephen.humenik@erisfutures.com or Neal Brady at 312-253-9056 or neal.brady@erisfutures.com.

Sincerely,

Neal Brady

Neal Brady
Chief Executive Officer
Eris Exchange, LLC

cc: The Hon. Gary Gensler, Commission Chairman
The Hon. Michael V. Dunn, Commission Commissioner
The Hon. Jill E. Sommers, Commission Commissioner
The Hon. Bart Chilton, Commission Commissioner
The Hon. Scott D. O'Malia, Commission Commissioner