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The Honorable Gary Gensler
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Dear Chairman Gensler:

The Depository Trust & Clearing Corporation ("DTCC") submits this letter to the Commodity Futures Trading Commission ("CFTC" or "Commission") in response to The Chicago Mercantile Exchange Inc. ("CME") Submission # 12-391, which requests the expedited review and approval by the CFTC of a new Chapter 10 and Rule 1001 ("Regulatory Reporting of Swap Data") of CME's Swap Data Repository ("SDR") Rulebook.[1]

The language and spirit of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") promote U.S. financial stability by improving accountability and transparency in the financial system and protecting consumers from abusive financial services practices.[2] DTCC, which provides clearing, settlement and information services through its subsidiaries,[3] recognizes the significance of these goals and the Commission's implementation of the same. As such, DTCC opposes CME's proposed rule change and its potential implications under the letter of the law.

The Commission should not approve CME's proposed rule change because:

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[1] The CME Rule Filings, http://www.cmegroup.com/market-regulation/files/cftc-rule-filings_201211112.pdf [hereinafter CME Rule Filing].

[2] *See* Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"), Pub. L. 111–203, 124 Stat. 1376 (2010).

[3] The DTCC Data Repository (U.S.) LLC ("DDR"), a DTCC subsidiary, is provisionally registered to operate an SDR pursuant to Part 49 of the Commission's regulations for interest rate, credit, equity, and foreign exchange asset classes. On September 26, 2012, DDR submitted an amended Form SDR, which is pending before the Commission, to serve the other commodity asset class. On October 12, 2012, the DDR began to receive trades from market participants pursuant to Part 45 of the Commission's regulations. DTCC is not a registered DCO.

(1) As a threshold matter, CME's proposed rule change is procedurally deficient. CME's designation as a systemically important financial market utility, and resultant status as a systemically important derivative clearing organization ("SIDCO"), creates important procedural safeguards that must be honored. SIDCOs are subject to heightened regulation and supervision to ensure that they are operated in a safe and sound manner.[4]

a. Given CME's status as a SIDCO, federal regulations require CME to provide 60 days advance notice to the Commission before proposing a material change to its rules, procedures, or operations.[5] The Commission's rules establish that a change is material when there is a *reasonable possibility* that such change could affect the performance of essential clearing and settlement functions or the overall nature or level of risk presented by the SIDCO (in this case, by CME).[6] There is more than a reasonable possibility that CME's implementation of its proposed Rule 1001 will create additional risk to the system.

b. Further, because CME's proposed rule change "raises novel or complex issues"[7] an additional 60-day review period is required.

Under no circumstance may CME's proposed rule change be considered on an expedited basis by the Commission.

(2) Substantively, CME's proposed rule change is contrary to the governing law and, if approved, would effectively reverse the Commission's rules and published interpretations. The Commodity Exchange Act ("CEA") requires DCOs to comply with certain core principles, which are further implemented through the Commission's regulations. These statutory core principles provide in relevant part that "[t]he participation and membership requirements of each derivatives clearing organization shall – (I) be objective; (II) be publicly disclosed; and (III) *permit fair and open access*."[8] The principle of fair and open access is violated if a DCO member or participant is unable to use a clearing platform without ceding to the clearer the right to dictate how the member or participant carries on unrelated

[4] *See* section 805(a)(2) of the Dodd-Frank Act*; see also* 17 C.F.R. § 40.10.

[5] *See* 17 C.F.R. § 40.10(a).

[6] *See id.* at § 40.10(a) and (b) (emphasis added).

[7] *Id.* at § 40.10(f).

[8] CEA section 5b(c)(2)(C)(iii), as amended by the Dodd-Frank Act (emphasis added).

business and compliance activities. But, this is exactly what CME's proposed Rule 1001 would accomplish.[9]

Additionally, Commission regulations provide, "[c]onsistent with the principles of open access . . . a registered swap data repository shall not tie or bundle the offering of mandated regulatory services with other ancillary services that a swap data repository may provide to market participants."[10] Therefore, an entity offering SDR services cannot tie those SDR services together with non-SDR services it also offers as the CME proposes in its Rule 1001. Commission interpretations, stated consistently over the last twelve months in public meetings and in response to Congressional inquiry,[11] correctly affirm this application of the fair and open access principle in practice.

(3) Under the Administrative Procedure Act ("APA"), reversing the Commission's established anti-bundling provisions in the context of approving CME Rule 1001 would be declared arbitrary and capricious and otherwise contrary to law, as it would be a clear instance of an agency that has given its rule a definitive interpretation and later seeks to change that interpretation without engaging in formal rulemaking. The judicial precedents on this point are clear.[12] At a minimum, the Commission, if it is to seriously consider CME's request, should initiate a rulemaking proceeding, providing ample opportunity for market participants and other

[9] The first sentence of CME's proposed Rule 1001 provides: "For all swaps cleared by the Clearing House, and resulting positions, creation and continuation data shall be reported to CME's swap data repository for *purposes of complying with applicable CFTC rules governing the regulatory reporting of swaps*" (emphasis added). *See* Appendix A of Letter from Tim Elliott, CME to Sauntia Warfield, CFTC (Nov. 9, 2012) *available at* http://www.cftc.gov/stellent/groups/public/@rulesandproducts/documents/ifdocs/rul110912cme005.pdf.

[10] 17 C.F.R. § 49.27(a)(2).

[11] *See* Commodity Futures Trading Commission (CFTC), Open Meeting to Discuss a Final Rule on Derivatives Clearing Organization General Provisions and Core Principles; a Final Rule on Position Limits for Futures and Swaps; and a Notice of Proposed Amendment to Effective Date for Swap Regulation (Oct. 18, 2011) (colloquy between The Honorable Bart Chilton and Mr. Ananda Radhakrishnan); *see also Continuing Oversight of the Wall Street Reform and Consumer Protection Act: Hearing Before the Senate Comm. on Agriculture, Nutrition, and Forestry*, 112th Cong. 74 (2011).

[12] *See Alaska Professional Hunters Ass'n, Inc. v. FAA*, 177 F.3d 1030, 1034 (D.C. Cir. 1999) ("When an agency has given its regulation a definitive interpretation, and later significantly revises that interpretation, the agency has in effect amended its rule, something it may not accomplish without notice and comment."); *see also Paralyzed Veterans of Am. v. D.C. Arena*, 117 F.3d 579, 586 (D.C. Cir. 1997) ("[o]nce an agency gives its regulation an interpretation, it can only change that interpretation as it would formally modify the regulation itself: through the process of notice and comment rulemaking").

regulators to comment on, and appropriate time for the Commission to address, the proposal of such a significant policy revision.[13]

I. The CFTC May Not Give Expedited Consideration to CME's Submission # 12-391 Because CME Failed to Provide Advance Notice to the CFTC for Such Rule Change, As Required under the Code of Federal Regulations

On November 10, 2012, CME submitted to the Commission its request for expedited review and approval of a new Chapter 10 and Rule 1001 of CME's Rulebook. CME's submission did not comply with the Code of Federal Regulations ("CFR"), which requires special certification procedures for submission of rules by SIDCOs.[14] As such, DTCC respectfully requests that the Commission reject CME's proposed rule change.

A. SIDCO Provisions Govern CME's Proposed Rule Change, Requiring at Least 60 Days Advance Notice

In accordance with the CFR, a financial market utility that is a derivatives clearing organization ("DCO") registered with the CFTC that has been designated by the Financial Stability Oversight Council ("FSOC") as systemically important is classified as a SIDCO and must follow certain "special certification procedures for submission of rules."[15]

Specifically, because CME is a SIDCO, the CFR requires CME to give 60 days advance notice to the Commission before proposing a material change to its rules, procedures, or operations.[16] Pursuant to Commission's rules, a change is material when there is a *reasonable possibility* such change could affect the performance of essential clearing and settlement functions or the overall nature or level of risk presented by the SIDCO.[17] Additionally, in such circumstances, CME is required to

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[13] *See id*. For further discussion of the arguments presented by CME, including reliance on preamble language in 17 C.F.R. § 49.27, please see the discussion located in section II(A).

[14] *See* 17 CFR § 40.10.

[15] Under Part 39 of the C.F.R., CME, which was designated a systemically important financial market utility on July 18, 2012, would qualify as a SIDCO. 17 C.F.R. § 39.2, *available at* http://www.gpo.gov/fdsys/pkg/CFR-2012-title17-vol1/pdf/CFR-2012-title17-vol1-part39.pdf (stating, "[s]ystemically important derivatives clearing organization means a financial market utility that is a derivatives clearing organization registered under section 5b of the Act, which has been designated by the Financial Stability Oversight Council to be systemically important and for which the Commission acts as the Supervisory Agency pursuant to section 803(8) of the Dodd-Frank Wall Street Reform and Consumer Protection Act."); *see also* Department of Treasury, Financial Stability Oversight Council - Designations, *available at* http://www.treasury.gov/initiatives/fsoc/designations/Pages/defa ult.aspx.

[16] *See* 17 CFR § 40.10(a).

[17] *See id.* at § 40.10(a) and (b).

give the Board of Governors of the Federal Reserve System a copy of the notice of the proposed rule change.[18]

The Commission's rules note that the Commission, "in its discretion, may expedite the review on the grounds that the change would materially decrease risk."[19] However, as detailed herein, there is a *reasonable possibility* that CME's proposed rule change will, in fact, increase overall risk and thus, does not qualify for expedited review.[20]

B. CME's Proposed Rule Change Could Affect the Overall Nature or Level of Risk that CME Presents

CME's proposed rule change requires advance notice to the Commission given the *reasonable possibility* that CME's proposed rule change could affect the overall nature or level of risk presented by CME. There is considerably more than a *reasonable possibility* that the rule change proposed by CME has the potential to materially impact participant eligibility, risk management efforts, and systemic risk oversight.[21]

Although the Dodd-Frank Act created a competitive SDR environment, there is no question that systemic risk management will be stymied if the cleared trade data of large, systemically important financial institutions is required to be reported to a DCO's captive SDR, inevitably dispersing and fragmenting market data. In general, large, systemically important financial institutions have global reporting obligations, clear at multiple clearinghouses, and engage in significant bilateral trading. It is significantly more efficient for these institutions to have a single control and reconciliation point for regulatory reporting. And, most institutions have spent significant time, effort, and expense, in preparation for satisfying anticipated reporting obligations through such a single control and reconciliation point. Utilizing a single control and reconciliation point is most efficient for reporting institutions and best assures the accuracy and completeness of reported information, without the potential for double counting. It is worth emphasizing that the increased risks noted do not derive from the absence of a single repository for all reporting; rather, such risk arises from forcing large, systemically important institutions to send their mandated trade reporting obligations to multiple repositories against their

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[18] *See id.* at § 40.10(a)(2).

[19] *Id.*

[20] We likewise note that CME's proposed rule change would not qualify as an "emergency change" under the CFR. Indeed, the Commission adopted the final rule on swap data recordkeeping and reporting requirements ("Part 45 Rules") over 10 months ago, and CME's SDR application, submitted on June 7, 2012, makes the assumption that "the DCO that accepts a swap for clearing will select the SDR to which the reports on the two new swaps resulting from clearing will be made." This application evidences CME's intent to request this rule change for at least the past five months.

[21] *See* 17 CFR § 40.10(b).

wishes and contrary to the best internal control processes for ensuring accurate and complete reporting (regardless of whether any particular institution would choose to report to one repository rather than another).

The opportunities for misreporting and misunderstanding the import of reported information are myriad. For this reason, the Commission, in Part 45, has emphasized the need for a complete audit trail following all reported trades over their life-cycles, including when they are novated and replaced by new, economically equivalent trades.[22] Failure to carefully follow this audit trail will lead not only to failure to detect potentially dangerous market manipulation, but will likewise very easily lead to double counting, as there will be difficulty in linking the novation of old trades with the creation of economically equivalent new trades.

Audit trail issues aside, the process of constructing true exposures of large, systemically important institutions from reports to multiple repositories introduces two additional points of failure that would not be present where a large financial institution reports all of its trades to a single repository of its choosing: (1) reconciliation and control by the reporting parties, who would have to reconcile the positions resident in multiple repositories to their own books and records, rather than just the positions held by one; and (2) the reconstruction by the relevant regulatory authorities of the true exposures of these institutions from multiple repository reports. These two potential failure points are likely to be mutually amplifying as misreported trades can also be misaggregated. In this regard, the Commission and other regulators have not yet developed consistent reporting standards for SDRs, resulting in an increased aggregation burden on market regulators.

Further, public reports of aggregate open interest, based only on those positions that a particular SDR captures from a particular large, systemically important firm, rather than on all of the positions of that firm, will systematically overstate market sizes and exposures because the full effect of position netting will not be taken into account.

Accurate public and regulatory reporting of market exposures cannot be achieved when large, systemically important firms are required to report to multiple SDRs, as such a requirement would result in the introduction of additional points of failure and other risks in an already complicated system. Such a rule would force institutions to create risk to the system *against their wishes*[23] by adding additional points of failure to the reporting process. The more than *reasonable possibility* of

[22] *See* 17 C.F.R. § 45.3.

[23] A spokeswoman for the International Swaps and Derivatives Association recently reiterated swap counterparties' desires to report cleared swap transaction data from various DCOs to an unaffiliated SDR when she said in a statement, "[p]roliferation of swap data repositories and fragmentation of market data can be harmful to regulatory transparency." Douwe Miedema & Ann Saphir, *CME Lawsuit Opens New Front Against US Finance Watchdogs*, REUTERS, Nov. 9, 2012, http://www.reuters.com/article/2012/11/09/cme-swaps-lawsuit-idUSL5E8M9FHL20121109.

such a result alone clearly triggers the 60-day advance notice required under the SIDCO rules.

There is, however, an additional consideration. In planning to comply with the Commission's Part 45 Rules, entities expecting to register as swap dealers have, for months, taken necessary steps to utilize their preferred SDR. These preparations have included developing and testing reconciliations with SDR data output formats, real-time messaging of submissions (to all parties) and scheduled full portfolio reports. Further to this point, these entities have also established ongoing valuation reporting processes with single data feeds for trades where they are the reporting party. Any last-minute changes to the Commission's rules and interpretive guidance risks jeopardizing reporting parties' ability to provide valuation and other reports in accordance with the Commissions announced timelines.

The relationship between unnecessarily restrictive participation criteria and risk also has been noted by over-the-counter markets derivatives regulators, who have recognized that participation requirements limiting access on grounds other than risk should be avoided.[24]

Clearly, for the host of reasons detailed above, there is more than a reasonable possibility CME's implementation of its proposed Rule 1001 will create additional risk to the system.

C. The Proposed Rule's Procedural Deficiencies are Magnified by the Complexity and Novelty of CME's Proposed Rule Change

CME's proposed rule change "raises novel or complex issues" and as such, provides the Commission sufficient grounds to extend the review period.[25] The principal novelty lies in the proposal by a SIDCO to substantially change the swaps reporting regime established by the Dodd-Frank Act; a reporting regime implemented by the Commission and built and tested by obligated reporting parties in reliance on rule finalized 10 months ago. CME's proposed rule change is also novel and complex because of the uncertainty it creates regarding how it will operate in practice. CME's proposed rule change is limited to two sentences and does not provide any additional insight regarding CME's suggested fee structure, operational structure, or

[24] Both the preamble of the Proposed Rule on Risk Management Requirements for Derivatives Clearing Organizations, as well as a November 2004 IOSCO Report titled "Recommendations for Central Counterparties" provide that "a CCP's participation requirements should be objective, publicly disclosed, and permit fair and open access [...] to avoid discriminating against classes of participants and introducing competitive distortions, participation requirements should be objective and avoid limiting competition through unnecessarily restrictive criteria, thereby permitting fair and open access within the scope of services offered by the CCP. Participation requirements that limit access on grounds other than risks should be avoided." Risk Management Requirements for Derivatives Clearing Organizations, 76 Fed Reg. 3,698-701 n.21 (Jan. 20, 2011) (citing *Recommendations for Central Counterparties*, CPSS Publ'n No. 64 (Nov. 2004), *available at* http://www.bis.org/publ/cpss64.pdf) [hereinafter Risk Management Requirements for DCOs].

[25] 17 C.F.R. § 40.10(f).

practical functionality. Additionally, CME's proposed rule change does not include any information regarding the expected effects of the rule or the way in which CME plans to manage any potential risks that the proposed rule change may present, as required by the Commission's rules.[26]

CME's proposed rule change states that "no substantive opposing views were expressed to CME regarding this proposal."[27] This simply does not comport with the history of the development of these policies and issues. Even though the industry did not have a formal opportunity to review CME's proposed rule change prior to its submission to the Commission on November 10, 2012, CME has participated in various calls with the Commission and the International Swaps and Derivatives Association ("ISDA"), in which the SDR selection was intensely debated with CME and the IntercontinentalExchange, Inc. ("ICE"). During these calls, CME and ICE customers expressed a different perspective than the one presented by CME in its proposed rule change. And, in fact, on September 24, 2012, in response to CME's SDR application, DTCC submitted formal comments to the Commission objecting to the very practice that would be accomplished by CME's rule change.[28] CME was provided a copy of DTCC's September 24, 2012 letter on that same day.

Given the novelty and complexity of CME's proposed rule change and the uncertainty surrounding the industry's views on the same, CME's proposed rule change should be rejected as procedurally deficient because it does not allow for an extended review period so the Commission can receive and review the industry's views regarding CME's proposed rule change and the potential risks and challenges it presents.

II. Procedural Deficiencies Aside, CME's Proposed Rule Change Should be Rejected as Inconsistent with the CEA, the CFTC's Regulations, and the Commission's Interpretations

In its proposed rule change, CME notes that "none of the Commission's regulations need to be amended and no sections of the CEA or the Commission's regulations need to be interpreted in order to approve these rule amendments."[29] We strongly disagree. In fact, adoption of a change at the magnitude proposed by CME would undermine the goals of the Dodd-Frank Act, the CEA, and Commission rules and published interpretations.

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[26] *See id.* at § 40.10(a).

[27] CME Rule Filing, *supra* note 1.

[28] *See supra* note 20*; see also* Letter from Larry Thompson, DTCC to David A. Stawick, CFTC (Sept. 24, 2012) (on file with author).

[29] *Supra* note 20.

The Dodd-Frank Act, the CEA, and Commission rules and published interpretations strive to ensure that: (i) a competitive market structure and environment in the swaps market exists; (ii) regulated entities do not abuse the important positions they have been granted in that marketplace to inhibit competition; and (iii) registered entities, which are so fundamental to the operation of the new regulatory regime, operate in compliance with core principles related to open access and antitrust considerations.

CME's proposed rule change would require, as a condition precedent to utilizing CME's clearing services, all participants to agree that for all trades cleared through CME's DCO the required data be reported to CME's own captive SDR. As such, CME's new rule would ignore the swap data reporting regime established under the Dodd-Frank Act, promulgated by the Part 45 Rules, and recently clarified in the October 11, 2012 Frequently Asked Questions ("FAQs") on the Reporting of Cleared Swaps.

CME's proposed rule change is not only inconsistent with the language and intent established by the Dodd-Frank Act, but it would also have a negative impact on many market participants who have relied on the Part 49 (approved by the CFTC on August 4, 2011) and Part 45 rules (approved by the CFTC on December 20, 2011), spending an entire year planning and investing hundreds of millions of dollars to comply with the CFTC requirements. In preparation for compliance with the swap data recordkeeping and reporting rules, market participants have invested significant amounts of human and financial resources to ensure a smooth transition to the new regulatory regime, including technology investments, software testing, employee training, and compliance program development.

The scope of change contemplated by CME's proposed rule change would require appropriate rulemaking procedures by the CFTC, as provided under the APA.[30] For these reasons, CME's proposed rule change cannot be adopted as proposed and presented to the Commission.

A. CME's Proposed Rule Change Allows the Bundling of Clearing and SDR Services – Contrary to the Commission's Rules and Interpretations

The CEA mandates fair and open access to clearing services.[31] Similarly, in the provision related to SDR core principles, the CEA mandates that an SDR "shall not [a]dopt any rule or take any action that results in any unreasonable restraint of trade; or [i]mpose any material anticompetitive burden on the trading, clearing, or

[30] *See* 177 F.3d 1030; 117 F.3d 579, 586.

[31] *See* CEA § 5b(c)(2)(C)(iii).

reporting of transactions."[32] Further, the Commission has emphasized the importance of these principles in promoting competitive markets.[33]

CME's proposed rule is anti-competitive as it seeks to require as a condition precedent to the use of clearing services the use of its own captive SDR services by providing that "[f]or all swaps cleared by the Clearing House, and resulting positions, creation and continuation data shall be reported to CME's swap data repository for purposes of complying with applicable CFTC rules governing the regulatory reporting of swaps."[34] The Federal Trade Commission ("FTC") analyzed the practice of a monopolist using forced buying, or "tying." The FTC found that this practice "may limit consumer choice for buyers wanting to purchase one ("tying") product by forcing them to also buy a second ("tied") product as well. Typically, the "tied" product may be a less desirable one that the buyer might not purchase unless required to do so, or may prefer to get from a different seller. If the seller offering the tied products has sufficient market power in the "tying" product, these arrangements can violate the antitrust laws."[35]

CME may not use forced buying, or "tie-in" sales, with its clearing services to gain sales in the SDR market (where it is not dominant) and to make it more difficult for rivals in those markets to obtain sales. This is especially true in the present situation, where the "tied" product may be a less desirable one that market participants might not purchase unless required to do so, or may prefer to get from a different vendor.[36] Because CME's proposed rule change would allow bundling by requiring as a condition precedent to the use of clearing services the use of the clearinghouse's SDR services, DTCC submits that such proposed rule change goes directly against the CEA and the Commission's regulations regarding fair and open access to clearing and swap data reporting services, as well as the anti-competitive core principles applicable to DCOs and SDRs.[37]

Section 49.27 of the Commission's regulations provides that, "[c]onsistent with the principles of open access . . . a registered swap data repository shall not tie or bundle the offering of mandated regulatory services with other ancillary services that a swap data repository may provide to market participants."[38] DTCC acknowledges that an errant sentence in the preamble to Part 49 does not

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[32] CEA § 21(f)(1).

[33] Risk Management Requirements for DCOs, *supra* note 24.

[34] CME Rule Filing, *supra* note 1.

[35] An FTC Guide to the Antitrust Laws: Exclusionary or Predatory Acts: Tying the Sale of Two Products, *available at* http://www.ftc.gov/bc/antitrust/tying_sale.shtm [hereinafter FTC Guide].

[36] In the present case, many market participants have expressed a preference for using an SDR other than CME's.

[37] *See* CEA § 5b(c)(2)(N); *see also* 17 C.F.R. 39.23; CEA § 21(f)(1).

[38] 17 C.F.R. § 49.27(a).

preclude counterparties or registered entities from choosing to report to existing DCOs as registered SDRs, or to SDRs chosen by DCOs, if they so choose for business or cost benefit reasons.[39] But to suggest, as CME apparently has in its proposed rule filing, that the preamble to the Part 49 rules allows a DCO to act in an anti-competitive manner, ignores statutorily mandated core principles, the relevant rule language, as well as subsequent authoritative statements by the Commission. In fact, the preamble to Part 49 goes on to reference that "the reporting of swap transaction data to SDRs is adequately addressed in proposed part 45 of the Commission's Regulations and section 4r(3) of the CEA."[40] The Part 45 rules, which govern counterparty reporting obligations, specifically reject the view that DCOs can designate reporting to affiliated captive SDRs for their cleared swaps and leaves the choice of SDR to the counterparty "for business or cost benefit reasons."

Further, these apparent ambiguities were definitively resolved in favor of the "market forces" view by the Commission both in public meetings and in response to Congressional inquiry. On October 11, 2011, at a CFTC open meeting, the Commission staff affirmed to Commissioner Bart Chilton that "a registered SDR, consistent with the principles of open access, shall not tie or bundle the offering of mandated regulatory services with other ancillary services that an SDR may provide to market participants."[41]

And, again, in connection with a December 1, 2011 hearing of the Senate Committee on Agriculture, Nutrition, and Forestry, Committee Chairman Debbie Stabenow (D-MI) noted, with regard to SDR and DCO bundling, that "Congress was clear about its support for competition in the swaps marketplace," expressing "concerns that the rules for [DCOs] may not incorporate this same dedication to competition particularly as it pertains to bundling."[42] Chairman Stabenow went on to ask Chairman Gary Gensler about the CFTC's treatment of SDRs and DCOs "on the bundling issue."[43] In a written response provided on May 1, 2012, Chairman Gensler explained that "[f]or DCOs that also choose to register and serve as SDRs, the anti-bundling provisions in the SDR final rule will apply."[44]

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[39] *See* Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2,136, 2,184 (Jan. 13, 2012) (emphasis added).

[40] Swap Data Repositories: Registration, Standards, Duties and Core Principles, 76 Fed. Reg. 54,538, 54,569 (Sept. 1, 2011).

[41] Commodity Futures Trading Commission (CFTC), *Open Meeting to Discuss a Final Rule on Derivatives Clearing Organization General Provisions and Core Principles; a Final Rule on Position Limits for Futures and Swaps; and a Notice of Proposed Amendment to Effective Date for Swap Regulation* (Oct. 18, 2011) (colloquy between The Honorable Bart Chilton and Mr. Ananda Radhakrishnan).

[42] *Continuing Oversight of the Wall Street Reform and Consumer Protection Act: Hearing Before the Senate Comm. on Agriculture, Nutrition, and Forestry*, 112th Cong. 74 (2011).

[43] *Id.*

[44] *Id.*

On December 20, 2011, when the final Part 45 Rules were published, the Commission explicitly stated that "requiring that all cleared swaps be reported only to DCOs registered as SDRs or to SDRs chosen by a DCO would create a non-level playing field for competition between DCO-SDRs and non-DCO SDRs."[45] In determining to not, by rule, mandate how the SDR is chosen in all situations, the Commission expressed its belief "that the rule as proposed favors market competition, avoids injecting the Commission into a market decision, and leaves the choice of SDR to be influenced by market forces and possible market innovations."[46]

Most recently, this position was affirmed in FAQs on the Reporting of Cleared Swaps, indicating that "[m]arket participants may choose to use a DCM's, SEF's or DCO's SDR for reporting swap transactions, but a DCM, SEF or DCO as part of its offering of trading or clearing services cannot require that market participants use its affiliated or 'captive' SDR for reporting. Such a result would be inconsistent with the intent of sections 21 and 49.27(a) of the Commission's Regulations relating to the reporting of transactions."[47]

Repeatedly, the Commission has affirmed for market participants the importance of the anti-tying and anti-bundling principles set forth in the Dodd-Frank Act and the Commission's implementing regulations. Nonetheless, CME, through this rule proposal, seeks to take advantage of its significant market position as a clearinghouse to force market participants to also use its own SDR services.[48] Such a requirement runs directly counter to the CEA's core principles of fair and open access and the Commission's implementing regulations.

Further, under Section 49.17(g), a condition of registration as an SDR is that "[s]wap data accepted and maintained by the swap data repository generally may not be used for commercial or business purposes by the swap data repository or any of its affiliated entities."[49] As noted by the Commission, the statutory basis for section 49.17(g) of the Commission's regulations is established in sections 21(c)(6)

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[45] Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. at 2,149. The Commission goes on to indicate that "it would make DCOs collectively, and could in time make a single DCO-SDR, the sole recipient of data reported concerning cleared swaps." *Id.*

[46] *Id.*

[47] CFTC, Frequently Asked Questions on the Reporting of Cleared Swaps (Oct. 11, 2012) [hereinafter CFTC FAQs], *available at* http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/clearedswapreporting_faq_final.pdf.

[48] CME Rule Filing, *supra* note 1.

[49] 17 C.F.R. § 49.17(g).

and 21(f)(3) of the CEA.[50] Section 21(f)(3) of the CEA requires each SDR to establish and enforce rules to mitigate conflicts of interest. As explained by the Commission, "[b]ecause of the inherent conflicts in connection with maintaining swap data and SDR operations (*e.g.*, the incentive to develop ancillary services using swap data), the Commission proposed that 'commercial use' of any data submitted and maintained by an SDR must be severely restricted."[51]

The Commission's commercial use prohibition provides an exception that "[t]he swap dealer, counterparty or any other registered entity that submits the swap data maintained by the registered swap data repository may permit the commercial or business use of that data by express written consent."[52] However, SDRs may not "as a condition of the reporting of swap transaction data require a reporting party to consent to the use of any reported data for commercial or business purposes."[53] The Commission notes its concern "that an SDR may attempt to use this limited 'commercial use' exception as a precondition for accepting non-SD/non-MSP, SD and/or MSP swap transactions. Accordingly, [the Commission] proposed § 49.27 requir[ing] registered SDRs to provide fair, open and equal access to its services and must not discriminate against submitters of data regardless of whether such a submitter has agreed to any 'commercial use' of its data."[54]

Should CME, which regularly commercializes its clearing house data, be allowed to subvert the Commission's prohibition on the commercialization of data by providing the required consent for commercialization to its own captive SDR, the very purpose of the conflicts of interest core principle will be thwarted and the careful construct of the Commission's commercialization prohibition negated.

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[50] *See* Swap Data Repositories: Registration Standards, Duties and Core Principles, 76 Fed. Reg. at 54,555.

[51] *Id.*

[52] 17 C.F.R. § 49.17(g)(2)(A).

[53] *Id.* at § 49.17(g)(2)(B).

[54] *Id.*

Thus, CME incorrectly asserts that "none of the Commission's regulations need to be amended and no sections of the CEA or the Commission's regulations need to be interpreted in order to approve these rule amendments."[55] Approval of CME's proposed rule change would require both amendments to the Commission's regulations and an overturning of the FAQs on the Reporting of Cleared Swaps, protections.

B. *CME May Not Disregard or Frustrate the Counterparty's Right to Select the SDR*

Pursuant to the Dodd-Frank Act, the counterparties to a trade bear the reporting responsibility for a derivatives transaction.[56] Market participants have been clear that, along with this responsibility, counterparties want to select the SDR to which data is reported.

While the final rules do not preclude counterparties or registered entities from choosing to report to existing DCOs as registered SDRs,[57] a DCO should not be allowed to use its central market position as a clearing organization to dictate, as a condition precedent to the use of a clearinghouse, where a cleared swap is reported. Rather, only in the absence of contrary instruction by the counterparties to the trade may a DCO determine to report to its own captive SDR, instead of a centralized unaffiliated SDR designated for reporting by the counterparties. The FAQs on the Reporting of Cleared Swaps, consistent with the Dodd-Frank Act and the Commission's regulations, correctly affirm that "(unless otherwise agreed to by the counterparties and the DCO) the selection of the particular SDR to which the swap data is reported for the resulting swaps due to clearing is to be determined by the counterparties to the original swap."[58]

By contrast, CME's proposed rule provides that "[f]or all swaps cleared by the Clearing House, and resulting positions, creation and continuation data shall be reported to CME's swap data repository for purposes of complying with applicable CFTC rules governing the regulatory reporting of swaps."[59] While the rule also states that "the Clearing House shall provide the same creation and continuation data to a swap data repository selected by the counterparty as the Clearing House

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[55] *Id.*

[56] The Dodd-Frank Act requires the parties to each swap (whether cleared or uncleared) to report certain information to an SDR. *See* CEA § 2(a)(13)(G) (stating, "[e]ach swap (whether cleared or uncleared) shall be reported to a registered swap data repository"); *see also* CEA § 2(a)(13)(F) (noting, "[p]arties to a swap (including agents of the parties to a swap) shall be responsible for reporting swap transaction information to the appropriate registered entity in a timely manner as may be prescribed by the Commission.").

[57] Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. at 2,184.

[58] CFTC FAQs, *supra* note 35.

[59] CME Rule Filing, *supra* note 1.

provided to CME's swap data repository,"[60] by first dictating where the initial trade data is reported for the purposes of complying with applicable CFTC rules, CME's proposed rule change completely upends the language on clearing services in a manner contrary to the CEA and the Commission's regulations.

Moreover, while CME's purports to mitigate the damaging impact of preventing counterparty choice by agreeing to provide a copy of the data to the counterparty's chosen SDR, the lack of any detail provided by CME in its proposed rule change makes it impossible to gauge whether, in practice, the rule will work to thwart counterparty choice and frustrate risk management and oversight. As discussed above, CME's proposed rule change is limited to two sentences and does not offer any specific information regarding CME's potential fee structure, operational structure, or practical functionality. Given such limited information, it is difficult to know whether the overall pricing regime under CME's proposed rule change would be fair and reasonable and not predatory or discriminatory. Similarly, it is impossible to determine whether CME will make it operationally impracticable for counterparties to report to the requested SDR. Either through discriminatory fees or burdensome operations, there is a reasonable possibility that CME's proposed rule change could result in unlawful tying or bundling practices.[61]

In rejecting counterparty reporting instructions, CME also subverts the intent of the Commission's regulation requiring all swap data for a given swap to be reported to a single SDR.[62] For purposes of market oversight (*e.g.*, prevention of market manipulation, price distortion, and disruptions of the delivery or cash settlement process) and prudential regulation (*e.g.*, ensuring adequate capital and margin for transaction and monitoring position limits), it is critical that swap data be reported to and maintained by one SDR throughout the life of the contract.

As detailed in section I(B) above, if, against counterparty wishes, swap data is fragmented, it presents the risk that the market size will be captured inaccurately, misleading regulators and frustrating the ability to conduct effective market oversight. Moreover, by preventing market forces from using available avenues to centrally report swap data the proposed rule risks inhibiting the development of a precise audit trail to the public's benefit. Thus, CME's proposed rule change threatens the intended operation of the Dodd-Frank Act's comprehensive transparency regime.

Conclusion: The CFTC Should Not Approve CME's Proposed Rule Change and Should Require Any Rule Change Proposed by CME to Comply with the Commission's Procedural Requirements and the Substantive Rules and Regulations Imposed by the Dodd-Frank Act and the Commission

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[60] *Id.*

[61] FTC Guide, *supra* note 29.

[62] 17 C.F.R § 45.10.

CME's proposed rule change cannot be adopted.

CME's proposed rule change is procedurally flawed. Further, CME's proposed rule change is inconsistent with the language and intent established by the Dodd-Frank Act and will have a negative impact on many market participants who have relied on the Part 49 and Part 45 rules, spending an entire year planning and investing hundreds of millions of dollars to comply with the CFTC's requirements. Commission approval of CME's proposed rule change would constitute a reversal of existing rule interpretations – something that the Commission may not accomplish without notice and comment under the APA.[63]

As such, DTCC requests that the Commission deny CME's proposed rule change because the application is procedurally deficient and the proposed rule change is contrary to the CEA, published Commission regulations, and interpretations.

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Thank you for your consideration. We appreciate the opportunity to comment on this matter.

Sincerely yours,

Larry E. Thompson

Larry E. Thompson
General Counsel

Cc: The Honorable Jill Sommers
The Honorable Scott O'Malia
The Honorable Bart Chilton
The Honorable Mark Wetjen
Dan Berkovitz
Richard Shilts
Jonathan Marcus
Susan Nathan
Eric Juzenas
Nancy Markowitz

[63] *See* 177 F.3d 1030; 117 F.3d 579, 586.