



January 14, 2013

Ms. Sauntia S. Warfield
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

**RE: Regulation 40.5 Request for Approval: Chicago Mercantile Exchange Inc.
Submission # 12-391RC: Adoption of new Chapter 10 ("Regulatory Reporting of Swap Data") and Rule 1001 ("Regulatory Reporting of Swap Data")**

Dear Ms. Warfield:

I submit these comments respecting of the complexity of the issues before you and the CFTC. It is my belief that the global swaps market that is currently being structurally reframed and risk adjusted is yet to be observed against the reality of the financial system being a complex of globally interconnected information processing and communications systems.

The CFTC would benefit from placing the CME's current application and the comment letters it attracted in context of federated vs. centralized technology solutions. Federated technology can resolve design concepts where now swaps data reporting for systemic risk analysis is only expected to be placed in but a few swaps data repository (SDR) concentration points.

Federated technology advances have not been considered in solutions that have been proposed by the CFTC nor by those both for and against the CME application. This is so even though a companion project for all global swaps data reporting needs, the G20's Financial Stability Board's (FSB's) Legal Entity Identifier (LEI) initiative is deploying federated technology.¹

More importantly the LEI initiative is intended as the globally unique identifier code for any and all swaps counterparties. The use of the LEI will make the aggregation of swaps data for risk assessment much easier if left in place as the CME wishes and as others, both domestically and globally bring on board their own SDRs.

The substantive arguments are that the CMEs application may increase systemic risk (DTCC and its supporters' arguments) because there are no central points for consolidating swaps data and that duplicate reporting will prevail. The CME and its supporters argue on the basis of efficiency and lower costs to existing clients by reporting data to an allied SDR. Both sides see restraint of competition in their different approaches but arising from different circumstances.

¹ Financial Stability Board, **A Global Legal Entity Identifier for Financial Markets**, Recommendation 7, FEDERATED NATURE OF THE LEI SYSTEM, http://www.financialstabilityboard.org/publications/r_120608.pdf, June 8 2012, at page 34

Background of Centralization of Swaps Creation and Consolidation Data in SDRs

In order to observe risk in global swaps activity the CFTC presumed on an approach that requires concentration of swaps creation and continuation data in a single SDR at least here in the US. There were few SDR-like facilities at the time of CFTC's first drafting of its Swaps Data and Reporting rules, one run by Tri-Optima and the other by DTCC.

DTCC was winning bids from others, particularly ISDA and LCH.Clearnet to be a central concentration point for swaps transaction data as industry members themselves wished to understand their risk exposures in these products. At the time the large derivatives dealers thought that a single point of concentration of data in a global swaps data repository (SDR) was necessary and supported DTCC over Tri-Optima.

The CFTC presumably picked up on the momentum of this centralization approach and saw it as a reasonable approach where they could look to one facility to observe global swaps counterparty risk. Subsequently, new CFTC regulations presented opportunities for others to enter the swaps market, as SEFs (Swaps Execution Facilities), as Derivatives Clearing Organizations (DCOs), as Major Swaps Dealers (MSDs) and as SDRs.

Competition in establishing multiple SDRs has won out over the earlier notion of singularity of a global SDR that all would participate in. We argue that circumstances have changed such that concentration of swaps creation and continuation data is not necessary. It would engender more risk in the system by concentrating data in a facility that can be a single point of failure, certainly in contrast to a federated approach which has no single point of failure.

Now with competition increased in all aspects of the swaps markets, the idea of concentration, especially in a US facility such as DTCC has received significant push back by foreign regulators and financial institutions. This is also, in part, due to the presumption of extraterritorial reach of the CFTC's rule making.

The CFTC's view of centralization is shared by DTCC. DTCC set itself up as a central point of consolidated data and aspired to collect swaps transaction data globally in its own SDR. It was and still is attempting to fulfill the regulatory requirements of the CFTC's earlier interests.

Those interests have apparently changed as indicated by the exemptive relief and no-action letters that the CFTC authored in the last two weeks of this past year. Those letters postponed the CFTC's mandate for foreign entities to register with the CFTC and thus relieved them of a duty to send data to any US based SDR.²

² Federal Register, Final Exemptive Order Regarding Compliance With Certain Swap Regulations, [78 FR 858](#) // [PDF Version](#), Jan 7, 2013

Federal Register Chapter, Exemptive Order Regarding Compliance With Certain Swap Regulations, [77 FR 41110](#) // [PDF Version](#), July 12, 2012

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The Companion Federated Model of the G20's Financial Stability Board

In a closely allied activity, DTCC also set itself up as the global central point of creation, assignment, distribution and maintenance of the evolving global identification system for counterparties to swaps transactions (the LEI). Their good intention was to fulfill US regulated mandates. This too has been superseded, this time by the G20 to accommodate global regulatory needs.

Legal Entity Identifiers (LEIs) are required to be used by swaps counterparties to report data to each SDR. At this moment DTCC has been given temporary status by the CFTC to assign such identifiers through their CICI (CFTC Interim Compliant Identifier) Utility but only to be used by US counterparties.

The CFTC has obligated itself to wait for the “the establishment of the Global LEI system” as stated in their Order before finalizing the CICI as the LEI³. This temporary status is due to the parallel activity of the G20s Financial Stability Board creating a global identification system for the same function. It is also due, in part, to the CFTC's recent postponement of its rule making covering non-US counterparties.

This FSB's project, known as GLEIS, the Global Legal Entity Identification System, has not been designed in a centralized fashion where one entity or one sovereign jurisdiction or one single point of concentration prevails. Rather it has been designed as a federated networked model. Federation is the modern technology version of inter-operability, a concept that had previously been used, and still remains, for accommodating fragmentation. Both DTCC and CME are well versed in these later concepts.

DTCC evolved from the competitive leeway that the SEC's 1975 National Market System regulations allowed for interoperability of clearing, settlement and depository facilities. At the time there were many such facilities in the US, now just one, the DTCC.

DTCC grew by competitive forces that drove many financial market utilities to sell their facilities to DTCC. The stock exchanges in the US still work as an interconnected system with standard rules around interoperability. The Options Clearing Corporation (OCC) collects data from multiple options trading venues, each operating in an interconnected way amongst themselves, but centralizing options clearing and settlement – that was done by agreement at inception of the OCC.

Similarly, the CME had developed cross-margining relations with the Singapore Monetary Exchange (SIMEX). It stands today as the singular example of interoperability between US and international derivatives exchanges. It is my opinion that this is due to the different nature of contract markets, where proprietary interests in unique contract design drives these markets.

³ Commodity Futures Trading Commission, **Supplemental CICI Utility Designation**, http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/cici_factsheet.pdf, July 23, 2012
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Federation of these separate entities would be a way to achieve interoperability without protracted negotiations amongst competitors impinging on their competitive and innovative natures.

The GLEIS federated model parallels how the federated World Wide Web functions over the Internet. The global system is to be approved at month's end (January, 2013) by the G20's Financial Stability Board and later in March, 2013 by the G20 itself. The expectation is that both the CFTC and DTCC will yield to the FSB's prescribed federated model and its legal entity identification standard.⁴

Retaining At-Source Provenance over Data

Each regulator in each sovereign jurisdiction in the GLEIS (there are currently 45 members and 15 others with observer status)⁵ will assign and retain its own data for registering counterparties as legal identities. The data will contain such information as the globally unique number (the LEI) assigned uniquely to every counterparty, its name and address, its parent entity, etc. Each regulator will allow the data to be left in place in the local jurisdiction of its creation. The creator of the LEI can transfer it to another LEI registry of its choosing.

This data will be used to report swaps creation and continuation data to multiple SDRs. The set of globally distributed LEI registries will be viewed as a contiguous set of data, not centrally controlled but rather as a federated virtual data base

This federated approach is being followed by the FSB after arguing against centralization. The FSB saw a centralized solution, originally proposed by DTCC, as a single point of concentration of risk. The FSB favored competition and the reduction of risk through a networked solution that has no single point of failure. It is also an elegant solution and counterpoint to any concern of any one regulator or entity exercising extraterritorial overreach.

This non-centralized approach is favored by the CME and its supporters. However, the CME has not sought to electronically federate other SDRs with its SDR, rather simply leave the data in place at the Derivatives Clearing Organization (DCO) the CME operates. The CME wishes to extend the current access the CFTC already has by statute to its DCO's data to its SDR's data. Thus, the CME wishes to leave the SDR data in place and not send it, or compel its clients, to send it to the DTCC's SDR. Multiple presentations of the data in multiple SDRs will not be of concern in a federated approach.

⁴ Financial Stability Board, **A Global Legal Entity Identifier for Financial Markets**, Recommendation 11, STANDARDS FOR THE LEI SYSTEM, http://www.financialstabilityboard.org/publications/r_120608.pdf, June 8 2012, at page 37

⁵ Financial Stability Board, **The Regulatory Oversight Committee for the Global Legal Entity Identifier (LEI) System**, http://www.financialstabilityboard.org/publications/r_130111.pdf, Jan 11, 2013
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The CFTC Decision Rests on Consideration of Events Unfolding

It would be a reasonable next step for the CFTC to follow the FSB's lead and create a public-private entity, a non-profit foundation as the FSB is doing for its GLEIS, to own and operate an electronic network to federate multiple SDR data bases.⁶ The capability of such a federated network to aggregate data seamlessly is enabled by each unique counterparty being required to have the same unique identifier. This obtains even though they are represented in different SDRs.

The money spent for a centralized global solution needs to be placed in context of these alternatives not considered. US rule making did not fully consider implications to the ecosystem of foreign regulators interests and the competitive nature of existing market participants. It did not contemplate using the most advanced commercially available federated network, the Internet, to overlay a secure private network to federate SDRs as we have advised to both the CFTC and the FSB in their Legal Entity Identification initiatives. We have also advised regulators and private sector swaps market participants in academic papers and the trade press on this approach.⁷

Financial institutions, financial market utilities and regulators, all with good intentions jumped ahead of considerations of the federated model. This model would be the lowest cost global solution, especially if considered alongside the FSB's GLEIS implementation.

The globally unique identification of swaps market participants allows a different concept for aggregating data from disparate and geographically disbursed data bases. Disjointed and non-standard data that would first have to be normalized in a central data warehouse for aggregation and analysis can now be seamlessly viewed as a single, virtual data base without collecting the data centrally.

The available technology and example of the FSB's LEI initiative should be taken into account by the CFTC in the CMEs application to leave in place the SDR data it wishes to have its members create.

Sincerely,



Allan D. Grody
President

⁶ Financial Stability Board, **Fifth progress note on the Global LEI Initiative, June 11, 2013**, http://www.financialstabilityboard.org/publications/r_130111a.pdf at page 1

⁷ Grody, A. D., **A Second Report on the Global Identification of Counterparties and Other Financial Market Participants**, Dec. 20, 2012, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2192324,
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