

Jefferies

Jefferies Bache, LLC
520 Madison Avenue
New York, NY 10022
tel 212.284.2300
JefferiesBache.com

October 25, 2013

Via Electronic Submission

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

Re: Request from CME Group to Amend Rule 538 (Exchange for Related Positions), IF 13-003

Dear Ms. Jurgens:

Jefferies Bache, LLC (“Jefferies Bache”) welcomes the opportunity to submit this letter in response to the Commodity Futures Trading Commission’s request for comments on the proposal of the Chicago Mercantile Exchange to amend its Rule 538 and issue a “FAQ Related to Rule 538.” Among other things, this rule proposes to eliminate entirely the authority to use transitory Exchange for Related Position Transactions in connection with all CME futures and options products except in connection with certain inventory finance activities, as well as to enhance certain recordkeeping and other compliance obligations relating to non-transitory EFRPs.

As background, Jefferies Bache is a wholly owned subsidiary of Jefferies Group LLC, (“Jefferies Group”) a global securities and investment banking firm that has served its investors for over 50 years. Jefferies Group has a market capitalization of approximately \$3.6 Billion and annual revenues of \$3.0 billion (fiscal year ended November 30, 2012), and as of March 1, 2013, is a wholly owned subsidiary of Leucadia National Corporation, a publicly traded company (NYSE: LUK). Jefferies Group currently employs over 3,800 people in offices in more than 30 cities worldwide, and our approximately 1,500 sales and trading professionals transact business with and on behalf of thousands of institutional investors in most major markets in the world today.

In general, we support the effort of the CME to clarify certain recordkeeping and other compliance obligations relating to non-transitory EFRPs. However we do not believe that it is in the public interest for the CME to eliminate current authority to conduct transitory EFRPs in NYMEX energy and metals products, COMEX metals products, or CME foreign exchange products. We also believe that certain of the proposed clarifications may require further specificity.

As a result of this view, we support most of the positions taken by the Futures Industry Association in its comment letter dated October 25, 2013, regarding the CME’s proposal, and

Jefferies

incorporate the FIA's arguments by reference.¹ Accordingly we will not repeat arguments made in that letter here, except to reiterate the importance that, at a minimum, the CFTC defer consideration of the CME's proposal to amend CME Rule 538 and its related FAQ until after the CFTC issues regulations implementing Designated Contract Market Core Principle 9, and any proposed Commission rules that might apply to block futures trades or EFRPs executed on such facilities. Failing that, the CFTC should require the CME to phase-in any changes to its historic recognition of certain transitory EFRPs.

However, if notwithstanding the FIA's arguments, the CFTC is still inclined to approve the CME's proposed rule amendment to prohibit all transitory EFRPs, we respectfully request that the CFTC consider a carve-out for transitory EFRPs involving FX. This is because of the unique nature of the worldwide FX markets and the detrimental impact elimination of the ability to engage in transitory EFRPs involving CME FX products would have for end-users and other institutional participants.

As the US Department of the Treasury acknowledged in November 2012 in exempting FX swaps and FX forwards from the trade execution, mandatory clearing and margin requirements under Dodd Frank, the market for these products is "markedly different" than markets for other asset classes.² According to Department of Treasury,

"This market plays an important role in helping businesses manage their everyday funding and investment needs throughout the world, and disruptions in its operations could have serious negative consequences"³

This same principle holds true for the use of transitory EFRPs involving FX products traded on CME, as well as its competitor, ICE Futures US⁴: institutional users of this mechanism – particularly those who are prohibited by their enabling documents to carry non-cleared derivatives such as forwards or swaps -- have found it more efficient and economic to utilize the highly liquid spot FX markets in the first instance, and then to transform these products into forward derivatives (principally relying on prevailing interest rates), utilizing the CME or ICE transitory EFRP process. This is particularly the case, where the bid ask spread on currency pairs quoted on CME or ICE platforms are often less favorable than the corresponding spread available from trading spot FX in the first instance.

Indeed, it is at the initiative of many of our FX clients that we are submitting this letter because they believe that (1) that they receive superior pricing of CME FX futures as a result of entering into such transactions through EFRPs emanating from the more liquid spot FX

¹ Unlike FIA, we do not believe that block trades are an acceptable alternative to transitory EFRP transactions, particularly in connection with establishing or liquidating FX futures positions.

² See US Department of Treasury, "Fact Sheet: Final Determination on Foreign Exchange Swaps and Forwards" (November 16, 2012).

³ Id.

⁴ ICE Futures is not proposing at this time to eliminate the use of transitory EFRPs in connection with its FX futures.

Indeed, it just recently adopted New Rule 4.06 effective August 20, 2012 confirming permission to use transitory EFRPs in foreign currency. See ICE Futures Exchange Notice, "New Rule 4.06 Exchange for Related Positions" (August 13, 2012).

Jefferies

market, and (2) are concerned that an FX transaction that could be executed seamlessly through a transitory EFRP mechanism, could have a disruptive impact if entered directly through the CME electronic platform because of the deeper liquidity in the spot FX market.

Although it is potentially the case that appropriate block trade levels might permit users of energy and metals products to establish or liquidate equivalent futures positions consistent with their ultimate objectives, this would not necessarily be the case for FX market participants. This is because it is far more common to work orders in the FX space using the more liquid FX spot market, and this ability would be severely restricted by requiring orders to conform to block trade execution requirements. Moreover, some institutional end users might desire quantities of FX futures below block thresholds, and should not be disadvantaged from the price and execution advantages of obtaining or liquidating their cleared FX position through the transitory EFRP process.

Although the CFTC has raised concerns regarding the bona-fides of transitory EFRPs, it has acknowledged and accepted that they are legitimate provided a determination can be made that "...the cash transfer is commercially appropriate and severable from the EFRP." This is the case where "...the terms and structure of the transfer are substantially the same in all material respects as other cash transactions executed by the participants and other cash transactions executed in that cash market."⁵ According to the CFTC, this determination should consider the following indicia:

- (a) Whether the price of the cash commodity is determined in the same manner for any other sale of the cash commodity in transactions not involving (or followed by) an EFP;
- (b) The level of capital (creditworthiness) required of the initial cash buyer or seller;
- (c) Whether the initial cash buyer has acquired title to the cash commodity;
- (d) Documentation of the transaction;
- (e) The form of the contract and its terms; and
- (f) The buyer's ability to take delivery and the seller's ability to make delivery.

Indeed, even in proposing its Core Principals and Other Requirements for Designated Contract Markets during December 2010, the Commission acknowledged that certain transitory EFRPs are "bona fide ...if the offsetting transactions results in an actual transfer of ownership and demonstrates other indicia of being a bona fide transaction and the offsetting transaction is able to stand on its own as a commercially appropriate transaction..."⁶

In connection with transitory EFRPs involving FX, the legitimacy of the cash transaction is assured by the documentation between them, such as cash confirmation statements. The price of the cash component reflects the prevailing price in the cash markets, and the broker

⁵ See Report of the Division of Trading and Markets: Exchanges of Futures for Physicals (October 1987), at p. 196.

⁶ See Federal Register, Volume 75 No. 245 at 80593. In the same paragraph that the CFTC acknowledges and appears to reaffirm its longstanding position that at least some transitory EFRPs can be bona fide, it proposes a seemingly contradictory rule §38.505(c) that would prohibit all contingent EFRPs where the exchange of the derivative for the related position is contingent upon an offsetting transaction, including potentially transitory EFRPs. This provision has not been adopted and should not be adopted for the same reasons that the CME should not prohibit all transitory EFRPs.

Jefferies

clearing its customer's futures leg makes an assessment of the customer's credit worthiness. Moreover, all EFRP transactions, including transitory EFRP transactions are reported to DCMs promptly after execution in accordance with exchange time frames, and the CFTC has proposed to reduce this time of reporting further to five minutes (a proposal that we support for EFRPs transacted during ordinary business hours).⁷ DCMs are also required to report publicly for each day the total quantity of EFRP transactions ensuring further transparency.

The CME's proposed action implies that all transitory EFRPs (other than for financing) are problematic. This is an incorrect supposition, and historically has not been the Commission's view.

Again, we believe that all transitory EFRPs that are currently authorized by the CME should continue to be authorized. However, because of the distinct differences between FX, on the one hand, and energy and metals markets, on the other hand, as recognized by the US Department of Treasury, and because of the significant benefits to end users of obtaining or liquidating FX derivatives transactions through transitory EFRPs, we respectfully request that the CFTC at least reject the CME's proposal to ban transitory EFRPs involving FX.

We appreciate the opportunity to provide our comments on this important matter. If you have any questions, do not hesitate to contact the undersigned at (212) 708-2709 or at pblanc@jefferies.com.

Very truly yours,

Jefferies Bache, LLC

A handwritten signature in black ink that reads "Patrice Blanc" with a circular stamp containing the letters "BSO" to the right of the name.

Patrice Blanc

President and Chief Executive Officer

⁷ See Federal Register, Volume 75 No. 245 at 80593.