Terrence A. Duffy
Executive Chairman & President

Petal Walker
Chief Counsel to Commissioner Bowen
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581
MRAC_Comments@cftc.gov

December 3, 2014

Re: Market Risk Advisory Committee

Dear Ms. Walker:

CME Group Inc. ("CME Group"), on behalf of its clearinghouse and four designated contract markets ("Exchanges" or "DCMs")[1], appreciates the opportunity to provide Commissioner Bowen and the Commodity Futures Trading Commission ("CFTC" or "Commission") with its with its suggestion for topics of importance for the Market Risk Advisory Committee ("MRAC") and nominate a CME Group representative to membership on MRAC.

CME Group has a valuable perspective on how the Commission might work to improve market structure and mitigate risk -- particularly systemic risk-- to support the mission we share with the Commission: ensuring the integrity of the derivatives markets and monitoring and managing systemic risk. Below we have outlined several key policy issues for MRAC's consideration, each of which are within the scope of MRAC's purpose of conducting meetings and submitting reports and recommendations to the Commission on matters of public concern to clearinghouses, exchanges, intermediaries, market makers, end-users and the Commission regarding systemic issues that threaten the stability of the derivatives markets and other financial markets, and assisting the Commission in identifying and understanding the

[1] CME Group is the parent of four U-S based derivative exchanges: Chicago Mercantile Exchange, Inc. ("CME"), Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange, Inc. ("COMEX"). These Exchanges offer a wide range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, and agricultural commodities. CME Group's Exchanges serve the hedging, risk management and trading needs of our global customer base by facilitating transactions through the CME Globex® electronic trading platform, our open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions. CME also includes CME Clearing, which provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter derivatives transactions.

impact and implications of an evolving market structure and the movement of risk across clearinghouses, intermediaries, market makers and end-users.

1. **Concentration of risk in fewer clearing firms:** Certain proposed or newly adopted regulations are placing unnecessary pressure on the business model of futures commission merchants in the US and abroad. One that stands out in this regard is the position of the Basel Committee on Banking Supervision ("BCBS") on leverage ratio for cleared derivatives. Specifically, the BCBS's current policy on the leverage ratio overstates leverage in two material respects: (i) it does not account for the exposure-reducing effect of appropriately segregated margin passed through to a clearing house or held by a clearing member in a segregated account and (ii) it applies a calculation method that does not appropriately differentiate between cleared and uncleared derivatives. This policy ignores the CFTC's segregation regime, imposes capital requirements on clearing members that are entirely out of proportion with the systemic risks posed by their business and unnecessarily drives up costs and further squeezes client clearing capacity for cleared derivatives into a smaller group of clearing firms. We recommend the MRAC consider how further concentration of risk among clearing firms as a result of policies like those described above impact systemic risk, including the impacts on portability in the case of a clearing member default.

2. **Evaluating Risks Presented by Participants and CCPs:** As the Commission knows, other than in the extremely rare event of a clearing member default, as the buyer to every seller and the seller to every buyer, central counterparties ("CCPs") are risk neutral, with no market exposure and a matched book. Moreover, CCPs' risk management frameworks are structured to withstand clearing member defaults with little or no impact to other participants or the system as a whole. The backbone of a CCP like CME Inc.'s risk management framework is its margining policy, which is designed to ensure that risk presented by its clearing members is covered with liquid collateral in real-time. Further, a CCP's waterfall, including its default fund, is carefully structured to appropriately incentivize measured and balanced risk taking by its clearing members and instill confidence in its margining policies by putting its own capital in line behind that of a defaulting clearing member. We recommend the MRAC consider how changes to CCPs' risk management framework being advocated by certain large and systemically important financial institutions, such as increasing a CCP's capital exposure in the mutualized risk pool and increasing the initial margin requirements of end customers, could create incentives for those clearing members to increase their risk taking because such action is subsidized in part by CCPs.

3. **Better Alignment of Regulation with G20 Objectives**: Following the 2008 financial crisis, the G20 and Congress recognized the need to better position the market and market participants to manage risk. Regulated CCPs performed exceedingly well during the 2008 financial crisis, without a bailout from the taxpayers, and a cornerstone of this new global regulatory regime for derivatives is mitigating systemic risk through centralized clearing of standardized derivatives. As regulators and policymakers in the US and abroad continue to implement G20 reforms and work towards global harmonization of regulations for CCPs, we recommend the MRAC evaluate the impact of regulatory

20 South Wacker Drive Chicago, Illinois 60606 T 312 930.2000 F 312 930.2040 terry.duffy@cmegroup.com cmegroup.com

initiatives that could increase risk in the system, such as forced linkages between markets (whether between CCPs, trading venues, or CCPs to trading venues) and capital and margining policies that drive participants away from centralized clearing.

4. **Examining Regulatory Impacts to End-Users:** The US and global regulatory implementation of new regulations for derivatives transactions involving end-users could have a detrimental impact on the cost of hedging for end-users and ultimately have a trickle-down effect into commodity prices for consumers. The CFTC particularly understands such potential unintended adverse consequences of global regulatory reform and has recently proposed revisions to certain CFTC regulations -- including eliminating CFTC regulation 1.35 for these users and deleting the residual interest sunset provision for FCMs -- that will ease regulatory burdens and costs for commercial end-users. We applaud the Commission for taking action and leading on this front. We recommend the MRAC consider further action by the Commission in this regard such as (i) BCBS's position on leverage ratio – which would make agricultural products two times more expensive from a capital perspective than credit default swaps and makes hedging more expensive from a capital perspective than speculative trading, and (ii) certain provisions of the Commission's pending position limits rulemaking, including bona fide hedge exemptions and the proposed exemption to spot-month limits for cash-settled contracts that are linked to physically-settled contracts, *i.e.,* conditional limits. This spot-month limit exemption would allow a trader to hold positions up to five-times the spot month limit for cash-settled futures and swap positions in a commodity as well as unlimited physical supply of the underlying commodity. We are concerned that the potential effects of such holdings could lead to price distortions or worse in the physically-delivered contract, which is the primary price discovery market for the underlying physical commodities.

5. **Cybersecurity and System Reliability:** As the derivatives industry continues to globalize and evolve, those connected to the industry are faced with the challenge of supporting that growth in a manner that is safe and secure from cyber intrusions and other technology risks. We look forward to working with the MRAC and the Commission as you explore the regulatory and policy issues attendant to ensuring efficient and effective cybersecurity protection for the marketplace.

6. **Impact of Cross-Border Regulatory Differences on Market Structure and Competiveness of US Markets:** Harmonization of regulatory regimes and mutual recognition for G20 markets is critical to preserving and building global pools of liquidity, ensuring the US derivatives and financial markets remain the safest and most efficient in the world, and are able to compete in a global marketplace. We applaud the Commission's efforts on this front and are encouraged by the progress Chairman Massad and his global counterparts have made in recent months towards an agreed upon framework for mutual recognition. CME Group believes the lack of a harmonized approach has created uncertainty in the markets and, in some instances, has driven customers away from US venues. We are concerned that as more time passes without global consensus, regulation will artificially influence liquidity, price discovery and risk management, and competitively disadvantage US markets in an increasingly competitive global marketplace. We recommend the MRAC consider

the potential near-term and long-term impacts of the policy positions being taken by global regulators in the cross border context on the evolving market structure and competitiveness of US financial markets.

NOMINATION FOR MEMBERSHIP ON MRAC

CME Group respectfully nominates Kim Taylor for membership to MRAC. Kim Taylor has served as President, Global Operations, Technology & Risk of CME Group since 2014. She is responsible for leading all of the company's operational functions globally, including Clearing, Operations, Technology and Platform Development. She is also charged with bringing new trading and clearing products and services to market. Taylor previously served as President, CME Clearing since 2004. She led CME's efforts to establish its historic clearing agreement with Chicago Board of Trade (CBOT) in 2003 and to complete integration of NYMEX clearing systems in 2009, following CME Group's 2008 acquisition of NYMEX. She also has been instrumental in developing the expansion of CME's over-the-counter clearing services. Since joining CME in 1989, Taylor has held roles of increasing responsibility in the Clearing House Division including Managing Director, Risk Management, Vice President and Senior Director

****

CME Group thanks the Commissioner Bowen and the Commission for the opportunity to comment on this matter. We would be happy to discuss any of these issues with Commissioner Bowen or her staff. If you have any comments or questions, please feel free to contact me at (312) 930-8492 or **Terry.Duffy@cmegroup.com**, Kim Taylor, President, Global Operations, Technology & Risk, at (312) 930-3156, or **Kim.Taylor@cmegroup.com**.

Sincerely,

cc: Chairman Timothy Massad
Commissioner Sharon Bowen
Commissioner Christopher Giancarlo
Commissioner Mark Wetjen