CME Group

Sunil Cutinho
President
CME Clearing

July 1, 2016

via eRulemaking Portal

Christopher Kirkpatrick
Secretary of the Commission
U.S. Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, D.C. 20581

Re: Notice of Proposed Order and Request for Comment on a Proposal To Exempt, Pursuant to the Authority in Section 4(c) of the Commodity Exchange Act, the Federal Reserve Banks From Sections 4d and 22 of the Commodity Exchange Act[1]

Dear Mr. Kirkpatrick:

CME Group Inc. ("CME Group"), on behalf of the clearing house division ("CME Clearing") of Chicago Mercantile Exchange Inc. ("CME Inc.") appreciates the opportunity to submit the following comments ***strongly in support of the Proposal***. We believe that the Proposal represents an important and necessary step toward allowing CME Clearing to utilize accounts and services at the Chicago Federal Reserve Bank ("Chicago FRB") pursuant to Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the "Dodd-Frank Act"). However, additional work remains to be done to allow CME Clearing to move forward with the opening of accounts, including customer accounts, at the Chicago FRB. We look forward to working with the Commission and the Chicago FRB to move forward with account opening at the Chicago FRB as expeditiously as possible, while continuing to satisfy our obligations under the Commodity Exchange Act ("CEA") and Commission rules.

About CME Group

CME Group is the parent of four U.S.-based designated contract markets: CME Inc., Board of Trade of the City of Chicago, Inc., New York Mercantile Exchange, Inc. and the Commodity Exchange, Inc. (collectively, the "Exchanges"). The Exchanges offer a wide range of products available across all major asset classes, including: futures and options based on interest rates,

[1] 81 Fed. Reg. 35337 (June 2, 2016) (the "Proposal").

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equity indexes, foreign exchange, energy, metals and agricultural commodities. The 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 Group also operates a swap execution facility. CME Clearing is registered as a derivatives clearing organization ("DCO") under the CEA, and provides clearing and settlement services for exchange-traded and over-the-counter derivatives transactions. CME Clearing is also a designated financial market utility ("DFMU") under Section 804 of the Dodd-Frank Act and, as the Commission is the Supervisory Agency for CME Clearing under Title VIII of the Dodd-Frank Act, CME Clearing is also a "systemically important derivatives clearing organization" or "SIDCO."

The Importance of Segregation

We believe it is important to set forth the context in which the Commission has introduced the Proposal. The Commission has put in place a world-class customer protection regime under the CEA. That regime requires the safeguarding of money, securities and other property deposited by futures and swaps customers and has set the global standard for customer protection. The segregation of customer funds pursuant to Section 4d of the CEA and Commission rules thereunder is the central feature of that regime. DCOs, such as CME Clearing, play a key role in ensuring that customer funds remain segregated at the DCO's depositories.

The Proposal

Section 806(a) of the Dodd-Frank Act authorizes a Federal Reserve Bank, such as the Chicago FRB, to establish and maintain an account for, and provide certain services to, a DFMU. We fully support the goals of Section 806(a) of the Dodd-Frank Act. Enabling CME Clearing to have access to accounts and services at the Chicago FRB may advance a number of objectives of macro-prudential policy, including the mitigation of systemic risk in the clearing and settlement system. Migrating a portion of the eligible assets that CME Clearing has on deposit from clearing members to meet their initial margin and guaranty fund requirements to the Chicago FRB may have a number of positive impacts for our clearing members and their customers. Further, maintaining deposits at central banks is encouraged under the Principles for Financial Market Infrastructures, as published by the Committee on Payments and Market Infrastructures (formerly the Committee on Payment and Settlement Systems) and the Technical Committee of the International Organization of Securities Commissions.[2]

We strongly support the Proposal. Sections 4d and 22 of the CEA were not developed with a particular focus on Federal Reserve Banks and we agree that it is appropriate to exempt the Federal Reserve Banks from those provisions of the CEA with respect to accounts opened for SIDCOs, subject to the conditions described in the Proposal.

While the Proposal would exempt the Federal Reserve Banks themselves from Section 4d of the CEA, it would not provide relief to DCOs from Section 4d or any other provision of the CEA or Commission rules. A DCO, such as CME Clearing, would remain subject to the same

[2] April 2012; *available at* http://www.bis.org/cpmi/publ/d101a.pdf.

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requirements under the CEA and Commission rules for its accounts with a Federal Reserve Bank as would apply to its customer accounts at commercial depositories. This presents several challenges and requires more discussion between the DCOs, the Commission and the Federal Reserve Banks before DCOs will be able to move forward with the opening of accounts, including customer accounts, at the Federal Reserve Banks.

Inconsistencies in Rule 1.20

A DCO would remain subject to Commission Rule 1.20(g)(4)(ii), which requires each DCO, prior to or contemporaneously with the opening of a futures customer account at a Federal Reserve Bank to obtain a written acknowledgment from the bank that "(A) The Federal Reserve Bank was informed that the customer funds deposited therein are those of customers who trade commodities, options, swaps, and other products and are ***being held in accordance with the provisions of section 4d of the Act*** and Commission regulations thereunder; and (B) The Federal Reserve Bank agrees to reply promptly and directly to any request from the director of the Division of Clearing and Risk or the ***director of the Division of Swap Dealer and Intermediary Oversight***, or any successor divisions, or such directors' designees, for confirmation of account balances or provision of any other information regarding or related to an account."[3] There are two inconsistencies between Commission Rule 1.20(g)(4)(ii) and the Proposal. First, a Federal Reserve Bank would, pursuant to the Proposal, not be subject to Section 4d of the CEA with respect to a customer account. However, the depositing DCO would be required to obtain an acknowledgment from the Federal Reserve Bank that the customer funds in the account are "being held in accordance with the provisions of section 4d of the [CEA.]" Second, there is an inconsistency between the Proposal and Commission Rule 1.20(g)(4)(ii)(B) in that the Proposal requires that the Federal Reserve Bank provide information only to the director of the Division of Clearing and Risk (and successor divisions), while Commission Rule 1.20(g)(4)(ii)(B) requires the Federal Reserve Bank to acknowledge that it will provide information to both the director of the Division of Clearing and Risk (and successor divisions) ***and*** the director of the Division of Swap Dealer and Intermediary Oversight (and successors thereto).

There are a number of ways that the Commission could resolve these inconsistencies, including (1) eliminating the acknowledgment requirement under Commission Rule 1.20(g)(4)(ii) entirely for accounts of SIDCOs at Federal Reserve Banks; (2) amending Commission Rule 1.20(g)(4)(ii) to make it consistent with the Proposal; or (3) harmonizing the Proposal with Rule 1.20(g)(4)(ii). We would be happy to discuss these or other alternatives to resolving the inconsistencies noted above.

CME's Need for Multiple Federal Reserve Bank Accounts

CME Clearing has a long-standing and time-tested model of using commercial banks for payment, settlement, securities safekeeping and other services. This model proved robust during the financial crisis and we expect to continue using key elements of this established model going forward. CME Clearing expects to utilize accounts and services at the Chicago FRB as a supplement to, and not a replacement of, its existing commercial arrangements. DCOs have

[3] 17 C.F.R. § 1.20(g)(4)(ii) (emphases added).

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operating models, risk profiles and regulatory requirements that differ substantially from those of the depository institutions that are the typical accountholders at Federal Reserve Banks. As such, some flexibility by Federal Reserve Banks will be required to allow DFMUs that are DCOs to realize the full benefits of Federal Reserve Bank accounts and services.

While the Proposal would exempt Federal Reserve Banks from Section 4d of the CEA, it would do so subject to the condition that money, securities and property deposited into a customer account established at the Federal Reserve Bank must be "separately accounted for and segregated from the money, securities, and property deposited into a proprietary account . . . and from the money, securities, and property deposited into the account of any person other than the customers for whom the money, securities, or property is held."[4] As we have indicated, the segregation of customer accounts is a central feature of the CEA customer protection regime. As long as there is a segregation requirement for customer accounts, CME Clearing will not be able to hold both customer funds and non-customer funds in the same Master Account at the Chicago FRB. In order to comply with customer protection and segregation requirements under the CEA and Commission regulations, a DCO may require multiple Master Accounts at a Federal Reserve Bank.[5] This may require a Federal Reserve Bank to exercise its existing discretion under its standard policies and operating circulars to open multiple Master Accounts for a DCO, in order to allow the DCO to achieve the full benefits of Federal Reserve Bank accounts.[6]

Terms and Account Structures

Further, in order to provide the necessary comfort to clearing members and customers that their margin deposits are "bankruptcy remote" from the DCO under applicable bank capital requirements of the Board of Governors of the Federal Reserve System (the "Board") and other Federal banking regulators (such as the Basel III risk-based capital requirements[7], the Basel single counterparty exposure limits[8], and the Basel III Net Stable Funding Ratio[9]), a Federal

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[4] *Id.* at 35345.

[5] DCOs are required by the CEA and Commission regulations to strictly segregate futures customer funds and cleared swaps customer funds from other funds.

[6] Federal Reserve Bank Operating Circular 1 provides that a financial institution may maintain only one Master Account with its Administrative Reserve Bank. Federal Reserve Banks Operating Circular 1, Account Relationships, Effective February 1, 2013, p. 3; *available at* https://www.frbservices.org/files/regulations/pdf/operating_circular_1_02012013.pdf. However, Operating Circular 1 also specifically states that "an Administrative Reserve Bank ***may, in its discretion, allow multiple Master Accounts*** in other situations." (emphasis added) *Id.* at p 4.

[7] *See* Basel Committee on Banking Supervision, April 2014, "Capital requirements for exposures to central counterparties" requiring bank-affiliated clearing members and customers to hold capital against their exposures to CCPs; *available at* http://www.bis.org/publ/bcbs282.pdf.

[8] *See* Basel Committee on Banking Supervision, April 2014, "Supervisory framework for measuring and controlling large exposures - final standard" requiring bank-affiliated clearing members to account for non-bankruptcy remote initial margin as an exposure to a CCPs; *available at* http://www.bis.org/publ/bcbs283.pdf.

[9] *See* Basel Committee on Banking Supervision, Oct 2014, "Basel III: the net stable funding ratio" potentially requiring bank-affiliated clearing members to hold net stable funding against collateral deposits; *available at* http://www.bis.org/bcbs/publ/d295.pdf.

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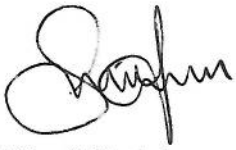
Reserve Bank may need to tailor the agreements governing the accounts of a DCO in a manner different from the agreements entered into with depository institutions.[10] There are other regulatory and operational considerations for a DCO in how it structures its account relationships with its banks that may require flexibility from the applicable Federal Reserve Bank, including the use of multiple Master Accounts. For example, different types of assets held by a DCO may be available to the DCO in different situations and a DCO's interest in those assets may differ. For example, a DCO may hold a substantial amount of its own assets in depositories, as well as substantial amounts of "house" margin contributed by clearing members for their own and their affiliates' accounts, and various pools of assets that constitute a DCO's clearing fund or funds. None of these pools of assets are subject to the segregation requirements in Section 4d of the CEA, but DCOs nonetheless maintain these assets in separate unencumbered accounts without liens or set-off rights for operational clarity, risk management, legal certainty and other reasons. We look forward to continued discussions with the Commission and the Chicago FRB to achieve account structures at the Chicago FRB that are mutually agreeable and that allow CME Clearing to continue to fulfill its obligations as a DCO, DFMU and SIDCO.

Conclusion

We appreciate the opportunity to provide these comments. We would be happy to further discuss and clarify the issues described herein with Commission staff and we encourage Commission staff to continue to work closely with the Chicago FRB and the Board to facilitate CME Clearing opening appropriate accounts at the Chicago FRB. We look forward to working with you toward that end.

If you have questions regarding this letter, please feel free to contact me at (312) 634-1592 or sunil.cutinho@cmegroup.com.

Sincerely,



/s/ Sunil Cutinho
President, CME Clearing

[10] For example, it may be difficult or impossible to include certain set-off rights and liens in favor of the Federal Reserve Bank in an agreement governing certain DCO accounts, but such provisions are typically included in agreements between the Federal Reserve Banks and depository institution accountholders.

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