CME Group

Kathleen Cronin
Senior Managing Director, General Counsel
Legal Department

September 29, 2017

VIA ONLINE SUBMISSION
Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Request for Public Input on Simplification and Modernization of Rules (Project KISS) -- RIN 3038-AD52

Dear Mr. Kirkpatrick:

CME Group Inc. ("CME Group") appreciates this opportunity to provide comments on the Commodity Futures Trading Commission's ("CFTC" or "Commission") request for public input on simplification and modernization of the Commission's rules, otherwise known as Project KISS. We applaud Chairman Giancarlo and the Commission in undertaking this initiative to take a fresh look at the regulatory framework with an eye towards making the application of the rules more operationally efficient and cost effective for all market participants without undermining the integrity of our markets.

CME Group is the parent of four U.S.-based designated contract markets ("DCMs"): Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX"), and the Commodity Exchange, Inc. ("COMEX") (collectively, the "CME Group Exchanges" or "Exchanges"). These Exchanges offer a wide range of products available across all major asset classes, including: futures and options based on interest rates, equity indexes, foreign exchange, energy, metals and agricultural commodities. The CME Group 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 facility in Chicago, as well as through privately negotiated transactions. CME Group also includes the clearinghouse division of CME ("CME Clearing"), a derivatives clearing organization ("DCO") which provides clearing and settlement services for exchange-traded and over-the-counter derivatives transactions, as well as a swap data repository ("SDR").

CME Group continues to believe that the U.S. principles-based regulatory structure overseen by the Commission is a superior framework which has enabled the U.S. markets to thrive and grow within the context of strong and balanced regulatory oversight. This framework has enabled CME Group to bring innovative new risk management products and solutions to the global marketplace. As the Commission undertakes this review and prepares for future rulemakings, we urge you to preserve this framework to continue to promote innovation while maintaining essential regulatory safeguards.

20 South Wacker Drive Chicago, Illinois 60606 T 312-930-3488 Kathleen.Cronin@cmegroup.com

In this letter, CME Group provides a series of recommendations for the Commission to consider to simplify the regulatory requirements and other practices applicable to exchanges and clearing houses. CME Group's comments are grouped in accordance with the topics set forth in the Commission's request for input: (1) Executing (Trading and Execution), (2) Clearing, (3) Reporting, (4) Registration and (5) Miscellaneous areas for comment, particularly in the self-regulatory and other operational areas.

I. Executing -- Trading and Execution

Project KISS is primarily directed towards reviewing existing rules for ways in which they might be simplified or modernized; however, we believe it is relevant to address two proposed rulemakings pending before the Commission – Regulation AT ("Reg AT") and position limits. We believe these pending rulemakings should be simplified and rationalized in a way consistent with the goals of Project KISS and the principles-based regulatory framework. We look forward to working with the Commission and staff when these pending proposals are finalized.

a. Reg AT – Consider Effectiveness of Existing Structure and, If Necessary, Implement Principles-Based Regulation

As detailed in our prior comment letters on the topic, CME Group believes that the existing proposal on Reg AT contains flaws that make it unworkable. CME Group and the Commission share the same goal: to protect the market from potential disturbances or aberrations that may result from algorithmic trading. The Commission's proposals have not provided a clear justification for why additional federal regulation is necessary or appropriate to accomplish this goal or how the proposed new rules meet that objective in a pragmatic manner. Participants in the futures industry – exchanges, clearing members, industry organizations, and other market participants – have already created and continue to develop extensive tools and controls for algorithmic trading driven by the collective desire of all concerned to build resilient, workable and cost-effective systems to protect market integrity.[1]

If the Commission nevertheless decides to proceed with Reg AT, CME Group believes that any new federal regulations should be principles-based. In our most recent comment letter, we set forth a logical and effective framework for federal regulations governing algorithmic trading with dramatically lower costs and complexity than those that would be incurred under the current proposal.

This alternative outlines broad market integrity objectives to be accomplished through risk controls and other measures without prescribing precisely *how* one must comply with these core principles. We expect the specific method of compliance by market participants would vary, based on the different roles, business operations and risk management obligations of DCMs and algorithmic traders. By articulating broad, flexible principles, our proposal would complement the significant work the industry has already done in addressing the risks presented by algorithmic trading.

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[1] *See* Letter from CME Group to CFTC re Notice of Proposed Rulemaking on Regulation Automated Trading (RIN 3038-AD 52), Section II.D, dated Mar. 16, 2016 (describing CME Group risk controls) *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60765&SearchText=CME%20Group.

20 South Wacker Drive Chicago, Illinois 60606 T 312-930-3488 Kathleen.Cronin@cmegroup.com

This principles-based regulatory framework would enable innovation in risk management and would keep pace with changes in technology and electronic trading. Its flexibility will further empower CME Group and incentivize other market participants to continue to act proactively and develop cutting edge technologies and risk systems that promote market integrity.[2]

b. Reconsider Position Limits Proposal

CME Group has provided detailed comments on the proposed position limits rule as well as prior versions of the rule. We continue to have serious concerns about the pending proposal. At a minimum, if the Commission proceeds with a rule, the proposal should be amended to address the following critical issues:

- Spot-month limit parity should be adopted as the standard for all physically-delivered benchmark contracts and their cash-settled counterparts. The Commission should not allow either a much higher conditional spot-month limit for cash-settled Natural Gas or higher, exchange-imposed conditional spot-month limits for non-referenced cash-settled contract markets. Such an imbalanced structure would undermine market integrity and fair competition.
- The five-day rule, which results in limiting the use of physically-delivered contracts in the spot month, should be eliminated; this would avoid arbitrary favorable treatment for cash-settled contracts over physically-delivered contracts that contravenes market integrity and fair competition.
- The general definition of bona fide hedging and the list of enumerated hedging categories must be broadened to ensure that commercials and other market participants will be able to conduct their customary hedging activities with certainty and without interruption.
- The provisions allowing DCMs and swap execution facilities ("SEFs") to grant non-enumerated hedge exemptions must be clarified to facilitate the processing of such exemptions and effectuate fully the benefits of empowering exchanges to provide this service to market participants.
- Any federal spot-month limits should be set at levels recommended by the exchange listing the physically-delivered benchmark contract, including (but not limited to) CME Group's recommended spot-month limit levels in Gasoline, Crude Oil, and Heating Oil.
- Federal non-spot-month limits should not be included in any new federal position limit regime that the Commission implements; rather, the Commission should first determine the effectiveness

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[2] *See* CME Group's most recent comment letters on proposed Reg AT: (1) Letter from CME Group to CFTC dated Mar. 16, 2016 *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=60765&SearchText=CME%20Group and (2) Letter from CME Group to the CFTC dated May 1, 2017 *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61181&SearchText=CME%20Group.

20 South Wacker Drive Chicago, Illinois 60606 T 312-930-3488 Kathleen.Cronin@cmegroup.com

of (i) any federal limits imposed in the spot month and (ii) the exchanges' non-spot-month accountability levels before considering whether to adopt federal non-spot month limits.

We look forward to having further discussions with the Commission regarding the re-proposal.[3]

II. Clearing

a. Qualifying Liquidity Resources Should Include U.S. Treasury Securities

CFTC Regulation 39.33(c) ("§39.33(c)") defines a list of resources that qualify as permissible to meet the liquidity requirements of a systemically important derivatives clearing organization's ("SIDCO") – referred to as "qualifying liquidity resources." Qualifying liquidity resources include:

- Cash in the currency of the obligation;
- Committed lines of credit;
- Committed foreign exchange swaps;
- Committed repurchase agreements; and
- Highly marketable collateral that is readily available and convertible into cash pursuant to prearranged and highly reliable funding arrangements.

CME Group is concerned that under the current test for qualifying liquidity resources, U.S. Treasury securities are not considered qualifying unless supported by prearranged and highly reliable funding arrangements. The implication is that if U.S. Treasury securities are not supported by prearranged and highly reliable funding arrangement, their value is effectively zero from a liquidity risk management planning perspective, and such securities could not be relied on in an actual liquidity event. This implied "zero value" contravenes how CME Clearing would expect to respond in an actual liquidity event; CME Clearing would expect to liquidate available U.S. Treasury securities through market action. This misperception creates unnecessary complexities; this could have a negative impact on the ability of a SIDCO to manage liquidity in a stress environment. SIDCOs should be permitted to treat U.S. Treasury securities as qualifying liquidity resources *prima facie*; this would align market participants and liquidity providers understanding of a SIDCO's approach to managing a liquidity event and reflect the reality of the market for U.S. Treasury securities in times of stress as described below.

The liquidity of U.S. Treasury securities in times of stress is supported by the facts in previous stress events. In such events, U.S. Treasury securities have solidified their standing as flight-to-quality assets. At times during the 2008 financial crisis, trading activity increased to $800 billion per day. We have observed that if there has been any negative impact on U.S. Treasury liquidity during past crises, it

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[3] *See* CME Group's most recent comment letter on the CFTC's re-proposal regarding "Position Limits for Derivatives" [RIN 3030-AD99], Letter from CME Group to CFTC dated Feb. 28, 2016 *available at* https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=61100&SearchText=CME%20Group.

20 South Wacker Drive Chicago, Illinois 60606 T 312-930-3488 Kathleen.Cronin@cmegroup.com

is because of lack of supply rather than any reduced demand for these flight-to-quality instruments. CME Clearing's experience is that it is easily able to liquidate U.S. Treasury securities on a same-day basis well within our established haircut levels. The liquidity of U.S. Treasury securities during times of market stress and CME Clearing's experience are evidence that U.S. Treasury securities are *prima facie* qualifying liquid resources. §39.33(c) should be revised accordingly.

Requiring pre-arranged liquidity arrangements places an unnecessary and avoidable drain on liquidity providers, absorbing resources that could be providing liquidity to other areas of the financial system, with a greater need of liquidity during a market stress event. Requiring pre-arranged liquidity arrangements is inappropriately expensive to the marketplace. Because of the Basel III capital and liquidity framework, it is critical that liquidity be used in the most reasonable and efficient way possible.

Moreover, CME Group believes that §39.33(c) is inconsistent within the overall U.S. regulatory framework. SIDCOs cannot treat U.S. Treasury securities as liquid *prima facie*, but banks may do so. U.S. banking regulations allow banks to treat high-quality obligations of sovereign nations, including U.S. Treasury securities, as Level 1 assets. Banks can use them without limit in building their stock of high-quality liquid assets and count them at fair value. Further, certain non-U.S. jurisdictions have allowed central counterparties ("CCPs") to treat high-quality obligations of sovereign nations, including the U.S., as qualifying liquidity resources without prearranged and highly reliable funding arrangements. Consequently, U.S. SIDCOs are at a financial disadvantage compared to foreign CCPs with no commensurate risk management benefit. Additionally, the U.S. appears to have greater skepticism than those jurisdictions of the liquidity of U.S. Treasury securities, potentially increasing borrowing costs for the U.S. Treasury and negatively impacting the primacy of U.S Treasury securities as the most liquid store of value in the global financial markets.

We urge the CFTC to revise §39.33(c) by changing the test from requiring prearranged and highly reliable funding arrangements to demonstrating access to liquidity via the secondary or repo markets for U.S. Treasury securities. This would ensure that a CCP has confirmed the liquidity of U.S. Treasury securities held by CCPs without creating unnecessary complexity or imposing unnecessary costs. We respectfully suggest revising §39.33(c) to clarify that "Qualifying liquidity resources" specifically include "U.S. Treasury securities that are readily available and convertible into cash" and that they not be subject to the limitation of §39.33(c)(3)(E)(2) requiring they be supported by prearranged and highly reliable funding arrangements.

b. Withdrawal of Money Market Funds Interpretation

Futures commission merchants ("FCMs") and DCOs are restricted in their ability to hold or invest in certain safe and liquid money market funds ("MMFs"). These restrictions were imposed through CFTC

staff's issuance of two letters, an interpretation ("MMF Interpretation")[4] and a letter granting no-action relief.[5]

Beyond the direct negative impact of these restrictions on MMFs, we are concerned about the method used to impose these restrictions. The process employed by CFTC staff exceeded its interpretive authority and has created legal uncertainty by attempting to rewrite, not interpret, CFTC regulations through staff interpretations and no-action relief. For example, definitions of "minimal" and "minimize" were essentially written into Part 39 of CFTC Regulations via the MMF Interpretation. In the MMF Interpretation, CFTC staff elected to read "minimal" as "least possible" regarding the use of the phrase "minimal credit, market and liquidity risk" and elected to read "minimizes" as "to make…as small as possible" regarding the use of the phrase "in a manner which minimizes the risk of loss or of delay."[6] We do not believe the definitions are consistent with CFTC regulations that foster diversity of acceptable collateral and investments in a risk prudent manner for a DCO. Independent of the substantive error, our primary concern is that creating these limiting definitions exceeded staffs' authority. If the Commission believed it was appropriate to adopt these new definitions, it should have done so through a transparent rulemaking process, providing market participants an opportunity to comment.

We respectfully request that the CFTC withdraw the MMF Interpretation or, at a minimum, withdraw the section of the MMF Interpretation in which CFTC staff defines the terms "minimal" and "minimize."

c. Expansion of Permitted Investments for Customer Collateral

FCMs and DCOs are permitted to invest customer funds in the instruments outlined under CFTC Regulation 1.25. We fully support the objective of CFTC regulations applicable to FCMs and DCOs to preserve principal and maintain liquidity in managing their investments. Considering this objective and for the reasons we discuss below, we respectfully request that the CFTC permit FCMs and DCOs to invest customer funds in certain securities issued by, or unconditionally guaranteed by foreign sovereign nations, assuming they meet the general terms and conditions for permitted investments under CFTC regulations. At a minimum, the CFTC should consider adding the ability to invest customer funds in certain securities issued, or unconditionally guaranteed by the following foreign sovereign nations: Australia, Canada, France, Germany, Japan, Sweden and the United Kingdom. We have identified this

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4 Commodity Futures Trading Commission, *CFTC Letter No 16-69 Re: Staff Interpretation Regarding CFTC Part 39 In Light Of Revised SEC Rule 2a-7* (Aug 8, 2016), *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-69.pdf.

5 Commodity Futures Trading Commission, *CFTC Letter No. 16-68 Re: No-Action Relief With Respect to CFTC Regulation 1.25 Regarding Money Market Funds* (Aug 8, 2016), *available at* http://www.cftc.gov/idc/groups/public/@lrlettergeneral/documents/letter/16-68.pdf.

6 *MMF Interpretation* at p. 3.

list of sovereign debt carefully accounting for the composition of customer cash on deposit and the credit quality of the sovereign issuer.[7]

The safety and soundness of securities issued by or unconditionally guaranteed by foreign sovereign nations is not consistently recognized by U.S. banks, DCOs and FCMs. The recognition of the quality of the obligations of certain foreign nations is demonstrated by the fact that they can be treated as Level 1 assets by a U.S. bank, which means they can be used without limit in building the bank's stock of high-quality liquid assets and counted at fair value. To be consistent within the U.S. regulatory framework, the obligations of foreign nations should be treated consistently by regulators across banks, CCPs and FCMs. For example, it seems misguided that the bank-affiliate of an FCM may recognize the quality of obligations of foreign sovereign nations, but the FCM may not do the same in its investment portfolio for customer funds. This inconsistency provides limited or no risk management benefit and overly complicates regulatory requirements; the characteristics of these assets are the same, regardless of an entity's reason for using them.

Further, the ability of DCOs and FCMs to invest in these assets would promote effective management of liquidity risk in two ways – by aligning collateral types with potential liquidity obligation and by diversifying risk in the investment portfolio. In addition, the ability to reinvest customer cash into the sovereign debt of the issuing jurisdiction will eliminate the potential exchange rate losses that would exist where customer cash is secured by reinvesting it in a security denominated in a different currency.[8] Diversification is a key tool to managing risk and providing FCMs and DCOs the ability to diversify their exposures in a risk prudent way makes sense, particularly given the treatment of obligations of foreign sovereign nations under other areas of the U.S. regulatory framework.

Additionally, it is now more important than ever to allow FCMs flexibility – where, of course, prudent from a risk standpoint – in selecting investment instruments. The concentration of entities acting as FCMs, in combination with an extended period of low interest rates and the economic challenges of clearing, makes it critical that current FCMs have flexibility in their investment decisions to avoid further concentrations.

d. Expansion of Permitted Depositories for Customer Collateral

Consistent with CFTC Regulation 1.49, FCMs and DCOs typically only deposit customer funds at depositories located in money center countries and in the U.S., which effectively means customer funds are deposited in G7 countries. The current list of countries in which customer funds can be held was established in 2003. At that time, electronic trading was in its infancy and derivatives markets were far less global than they are today. Today, electronic trading dominates the marketplace as the preferred venue of execution. At the CME Group Exchanges, nearly nine out of ten trades are executed on CME Globex. With the expansion of electronic trading, our markets are accessed by market participants across

[7] While CME maintains its own proprietary credit rating system, we note the following Moody's ratings (in parentheses) for the listed jurisdictions: Australia (Aaa), Canada (Aaa), France (Aa2), Germany (Aaa), Japan (A1), Sweden (Aaa) and the UK (Aa2) with the lowest A1 being prime investment grade.

[8] By way of example, if customer GBP was used to purchase U.S. Treasury Securities denominated in USD.

the globe, including in Europe and Asia. European and Asian participants provide liquidity throughout the day and overnight trading sessions. With the globalization of derivatives markets, additional region-specific products have been launched at out-of-region clearing houses. Additionally, CCPs began clearing standardized OTC interest rate swaps and other OTC swaps as the G20 clearing mandates were implemented. It is logical that the list of money center countries should be representative of this growth and globalization. More broadly, the list of money center countries warrants a re-assessment because economies of different countries change and evolve over almost a 15-year period. At a minimum, the CFTC should consider the inclusion of Australia, Hong Kong and Singapore as additional money center countries. This proposed expansion is reflective of the shifting weight of the global economy towards the Asia-Pacific region which in 2016 represented 29.8% of the global economy versus 22.1% in 2003. More specifically, based on the size of Australia, Hong Kong and Singapore measured in GDP in 2016 versus 2003 these countries have grown by a factor of 2-3 times.[9] In light of the global nature of the derivatives markets, we believe it is appropriate for the CFTC to reevaluate the jurisdictions which may serve as money center countries.

An expansion of the list of money center countries would not only reflect the growth and the globalization of the U.S. derivatives markets, but would allow FCMs and DCOs to diversify their exposures to depository institutions. Increasing the pool of available depository institutions is also important in light of regulations implementing the Basel III capital and liquidity framework making some banks less willing to act as depositories.

In addition, we believe that the Commission should consider whether to expand the scope of permitted depositories to include International Central Securities Depositories ("ICSDs"). Currently, under Commission Regulation 1.49(d)(3)(i), a depository located outside of the United States must be a bank or trust company that has more than $1 billion in regulatory capital. To provide greater flexibility, CCPs should be able to hold collateral directly at ICSDs as they represent a different risk profile than a traditional bank. This would enable CCPs to offer flexible and efficient collateral management solutions to clearing firms with a global presence. Providing this flexibility is essential to account for an evolving market structure in which ICSDs are heavily relied upon by global market participants for collateral protection and management.

e. <u>The Commission Should Adopt the Model Part 190 Rules Recommended by the ABA Business Law Section</u>

There has been a coordinated effort organized by a subcommittee of the Business Law Section of the American Bar Association to reform Part 190 of the CFTC regulations relating to, among other things, the liquidation of an FCM or a DCO. These rules were adopted over three decades ago and are sorely in need of modernization. The proposed changes, which are separately detailed in a letter by the ABA Subcommittee in response to the Project KISS effort, are an attempt to provide clarity incorporating lessons learned from significant FCM bankruptcies taking into account the significant changes to the

[9] *See* https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?end=2016&locations=US-CA-FR-IT-DE-JP-GB-HK-SG-AU&start=2003&year_high_desc=false.

marketplace and operative regulations over the past three decades. CME Group supports the positions in the ABA's comment letter and urges the Commission to adopt the model Part 190 rules as set forth in that letter.

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Apart from the specific recommendations contained above, there has been an ongoing dialogue between market participants, regulators and CCPs around the scope of risks presented by CCPs, particularly with respect to the size of a CCPs capital contribution ("skin in the game") and CCP liability for non-default losses, such as losses related to bank and custodian failures.

CME Group is a strong supporter of sound risk management underpinned by the belief that market participants must be incentivized to manage the risks they create. A CCP's core function is risk management. CCPs are market risk neutral and do not engage in trading, lending or any other market creating activities. CCPs serve a critical market function to ensure that market participants and clearing firms have sufficient "skin in the game" to support their activities and manage concentration risk among their largest participants. Suggestions that CCP contributions be sized using arbitrary percentages or dollar amounts are not supported by any empirical evidence and fail to consider the role and risk profile of CCPs or the systemic risk reduction benefits they bring to the market. Most significantly, such proposals ignore the negative incentive effects resulting from excessively large CCP contributions, which would result in CCPs subsidizing their participants' risks. This subsidization would undermine default management and may increase systemic risk by reducing incentives for clearing members to manage the risks they create.

Attached as Appendix A is a document entitled "Balancing CCP and Member Contributions with Exposures" which further details our thoughts on the role of a CCP, the default management waterfall and the importance of maintaining the appropriate incentives among market participants through proper allocation of "skin in the game."

With respect to non-default losses, there has been an industry focus on the management of initial margin collateral losses associated with bank and custodian failures. Placing any obligation on CCPs to guarantee these losses would be contrary to current financial industry and regulatory practice. Regulators have not required entities relying on third-party banks and custodians to protect assets that have been posted to them to accept liability for the failure of those third-party entities. This has led to these parties disclaiming liability for this failure of third parties in their legal arrangements with customers. This practice is consistent across the FCM clearing member/customer relationship, the custodian/customer relationship and the bank/customer relationship. In each case, if a clearing member, bank or custodian decides to utilize a third-party entity to hold their customer's collateral (which is a standard practice), they do not guarantee the customers against the failure of that entity, even though, in the case of custodians and banks, the protection of these assets is part of their core service offering. The Commission should avoid placing any requirement for CCPs to effectively provide such a guarantee to the custody/banking system in whole or in part where such guarantees are not required by other regulators or generally offered by entities providing custodial or banking services. The shifting of this responsibility to CCPs is inappropriate based on both financial market practice and the role that CCPs play in creating safer financial markets.

20 South Wacker Drive Chicago, Illinois 60606 T 312-930-3488 Kathleen.Cronin@cmegroup.com

We look forward to continued dialogue with the Commission on these important issues.

III. Reporting

a. The Commission Should Amend Current Reporting Requirements to Assign all Reporting Obligations for Swaps that are Intended to be Cleared to the DCO that Accepts any such Swap for Clearing.

CME Group believes that there is a straight forward way to achieve the Commission's goals to improve cleared swaps reporting and to obtain better data. To streamline current reporting flows, reduce message traffic, and right-size the number of required data elements for reporting, we urge the Commission to consider amending current reporting requirements to assign all reporting obligations for swaps that are intended to be cleared to the DCO that accepts such swap for clearing. This approach would significantly simplify reporting requirements and would leverage a mature data quality control infrastructure and is the best way to give the Commission access to high quality cleared swaps data.[10] A swap that is intended to be cleared when executed must be accepted for clearing by a DCO – if it is not accepted for clearing, it is void. Given this legal reality, swaps that are intended to be cleared should not be reported and subsequently publicly disseminated until they are accepted for clearing and thus legally binding. The DCO that accepts a swap that is intended to be cleared when executed has all the necessary details related to such "alpha" swap which can continue to be represented as a separate record of the data added to the cleared swaps. This same DCO will also be the only entity that possesses all relevant data elements regarding the novation of that "alpha" swap and the subsequent existence of the resulting "beta" and "gamma" cleared swaps.

We firmly believe the Commission would receive the highest quality data for cleared swaps under our recommended approach because the data would come from the single definitive source for cleared data – the clearinghouse. Also, this approach would eliminate the possibility that a swap is reported to the public immediately after execution but before acceptance for clearing, and is later declared void.[11] Further, we believe this approach would simplify reporting flows for the industry – hundreds of reporting counterparties that are currently tasked with reporting intended to be cleared "alpha" swaps would be reduced to a limited number of DCOs reporting cleared swaps to SDRs, which would streamline and simplify the reporting obligation and would improve the relevance of the reported data. If the DCO

[10] *See*, e.g., CME Group comment letter to original proposal of Part 45 and Part 43 dated February 7, 2011; review of cleared swap reporting requirements dated May 27, 2014; proposed amendments to swap data recordkeeping and reporting requirements for cleared swaps dated October 30, 2015; Division of Market Oversight ("DMO") Swap Data Reporting Review and associated "Roadmap to Achieve High Quality Swaps Data" dated August 21, 2017 *available at* https://comments.cftc.gov/PublicComments/CommentList.aspx?id=1824.

[11] Under current Commission guidance and requirements, the time that elapses between the execution of a swap that is intended to be cleared and the time that same swap must be submitted for clearing is relatively brief. In our view, moving alpha reports for intended to be cleared swaps from the point of execution to the point of acceptance for clearing would not diminish the value of reports for either the public or the Commission.

reported all legs of swaps that are intended to be cleared, the rest of the industry would not have to expend resources on unnecessary and redundant reporting chores. Long term cost savings to the industry from such a rule change could be significant.

b. The Commission Should Adopt and Align Reporting Standards by Using a T+1 Approach

CME Group is a proponent of replacing the Commission's current "real-time" approach to more closely align reporting requirements with other regulatory reporting regimes for derivatives that require reports on a T + 1 basis. This would harmonize reporting timelines with global regulatory standards, lead to improved data accuracy and reduce reporting complexity. This approach would allow time for errors or omissions in swap transactions to be corrected through the confirmation process prior to public dissemination. The current real-time reporting requirement has led to inferior data quality at higher cost to market participants. Harmonizing timelines to the global T+1 standards will provide an immediate improvement in quality and cost reduction.

c. A Materiality Standard Should be Added to the SDR Reporting Standards for System Safeguards

Section § 49.24(g) of the Commission's regulations require an SDR notify the Commission promptly of all system malfunctions, regardless of their severity. CME Group, particularly the CME SDR, requests that the Commission add a "materiality" threshold to the notification requirements of § 49.24(g) applied to system malfunctions. This would harmonize the notification requirements with those applicable to other CFTC registrants.[12] An SDR is the only registration category subject to System Safeguards which does not have a materiality threshold.

IV. Registration

a. The Commission Should Adopt Amendments to CFTC Regulation 3.10(c)

In August of 2016, the CFTC published a notice of proposed rulemaking to amend the exemption from registration in CFTC Regulation 3.10(c) ("§3.10 Proposed Rulemaking") for non-U.S. persons acting as FCMs and other intermediaries for transactions on behalf of non-U.S. persons.[13] We believe the proposed changes to CFTC Regulation 3.10(c) would improve market efficiency and increase liquidity by eliminating unnecessary regulatory burdens associated with accessing the U.S. derivatives markets. We therefore respectfully urge the Commission to finalize the §3.10(c) Proposed Rulemaking.

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[12] For SEFs, § 37.1401(e)(1) requires that a SEF must notify the Commission of all "[e]lectronic trading halts and material system malfunctions." Similarly, for designated contract markets ("DCM"), § 38.1051(e)(1) requires that a DCM notify the Commission of all "[e]lectronic trading halts and material system malfunctions." Finally, § 39.18(g)(1) requires that a DCO notify the Commission of "[a]ny hardware or software malfunction, security incident, or targeted threat that materially impairs, or creates a significant likelihood of material impairment, of automated system operation, reliability, security or capacity."

[13] 81 Fed. Reg. 51824 (Aug 5, 2016).

The §3.10 Proposed Rulemaking is consistent with the principle of outcomes based mutual recognition, a stated goal of the Commission's Part 30 exemption program and a consistent theme of Chairman Giancarlo's recent public statements on deference.[14] We agree with the Commission's "longstanding policy" that was highlighted in the §3.10 Proposed Rulemaking to "focus its customer protection activities upon domestic firms and upon firms soliciting or accepting orders from domestic participants."[15] Additionally, we commend the Commission for recognizing that "[w]here a Foreign Intermediary's customers are located outside the U.S., . . . the jurisdiction where the customer is located has the preeminent interest in protecting such customers."[16] We believe this approach avoids needlessly complicating the CFTC's regulatory oversight of certain foreign market participants and imposing duplicative regulatory requirements on already regulated foreign market participants. Providing the appropriate level of deference to foreign jurisdictions simplifies the CFTC's regulatory framework and provides the CFTC additional resources to oversee the activities of U.S. market participants. This approach is consistent with that of other major financial centers which permit foreign customers to rely on the customer protections afforded to them in their local jurisdictions.[17]

Further, the proposed amendments to CFTC Regulation 3.10(c) enhance the competitiveness of U.S. derivatives markets by allowing foreign customers and clearing members to access these markets without imposing unnecessary regulatory burdens. Increased participation by non-U.S. customers and clearing members will benefit U.S. market participants by enhancing the liquidity of U.S. derivatives markets, creating tighter bid-ask spreads and providing greater opportunities for U.S. market participants to efficiently hedge their own risks.

V. Miscellaneous Areas for Comment

Self-Regulatory Function – Proposed Changes and Suggestions

CME Group has reviewed certain aspects of its self-regulatory practices and has the following suggestions which we believe will enhance the operational effectiveness of our self-regulatory function:

a. Amend Regulation 38.154 to account for the provision of regulatory services by affiliated DCMs

The CME Group DCMs respectfully request that the Commission amend Regulation 38.154 to account for the provision of regulatory services by an affiliated designated contract market. Doing so will allow for the more efficient allocation of regulatory resources without sacrificing the effectiveness of the CME

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[14] *See, e.g.,* Remarks of CFTC Chairman J. Christopher Giancarlo before the Eurofi Financial Forum, "Future of CFTC-EU Regulatory Coordination in the Financial Sector" (September 14, 2017).

[15] *Id.*

[16] *Id.*

[17] Jurisdictions that offer this deference to local customer protections for foreign customers include, among others, major financial centers such as the United Kingdom, Germany, the Netherlands and Singapore.

Group DCMs in carrying out their regulatory responsibilities. CME Group's current structure provides for more effective regulation of their markets and participants compared to what is contemplated by subparts 38.154(b) and 38.154(c).

CME Group's regulatory and compliance efforts are centralized in a single, cohesive Market Regulation Department ("Market Regulation") that provides services on behalf of all the CME Group DCMs. We organized Market Regulation in this manner to maximize effectiveness and efficiency. Rather than having separate compliance and regulatory groups for each DCM, Market Regulation is divided into functional areas (*e.g.*, trade practice investigations, market surveillance, data quality assurance, regulatory systems and strategic initiatives, enforcement and employee learning initiatives) that focus on particular areas of responsibility across all of the CME Group DCMs to provide for the best visibility and consistency with respect to discharging our regulatory responsibilities.

Subpart 38.154(b) imposes the following obligations on a DCM that utilizes a third-party service provider for regulatory services:

- "retain sufficient compliance staff to supervise the quality and effectiveness of the services provided on its behalf;"

- "hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other matters of regulatory concern;"

- "conduct periodic review of the adequacy and effectiveness of services provided on its behalf;" and

- "carefully" document the periodic reviews and make them available to the Commission upon request.

Strict adherence to the requirements of subpart 38.154(b) would effectively require the CME Group DCMs to do away with their current structure and replace it with superfluous governance and administrative constraints that yield no meaningful regulatory benefit.

The CME Group DCMs have previously requested that the CFTC address these concerns in a No-action Request as well as a Regulation 13.2 Petition for Amendment of Regulation 38.154. Copies of these documents are attached as Appendix B.[18]

b. Revise Rule 1.52 to Eliminate Examinations Expert Requirement

The CFTC's 2013 amendments to Regulation 1.52 required self-regulatory organizations ("SRO") to modify their supervisory programs to conform to the auditing standards issued by the Public Company Accounting Oversight Board ("PCAOB"). To comply with those amendments, CME Group and NFA, in

[18] The Petition and accompanying documentation refer to the Kansas City Board of Trade ("KCBT"), which was acquired by CME Group in 2012. In 2013, the KCBT products were transferred to the CBOT and the KCBT DCM license was vacated.

consultation with Deloitte LLC ("Deloitte"), developed a set of FCM examination standards that conform to the auditing standards issued by the PCAOB.[19]

CME Group fully supports the objective of strengthening and enhancing our oversight programs for FCMs. CME Group expended significant resources revising the FCM supervisory program to address the new requirements of Regulation 1.52. While we believe that many of the changes have enhanced the examination program, CME Group does not believe that the requirement that an examinations expert be engaged every three years to evaluate the program provides any meaningful regulatory benefit and respectfully requests this requirement be eliminated.

Under the current framework, the CFTC's Division of Swap Dealer and Intermediary Oversight ("DSIO") staff provides effective oversight of the SRO FCM examination programs through the rule enforcement review process. Further, CME Group provides the FCM examination programs to DSIO staff for review annually as part of participating in the Joint Audit Committee. Having a third party's expertise was extremely beneficial in drafting the initial FCM examination standards and revising our supervisory program to address the standards. However, CME Group does not believe that an examinations expert is the most appropriate person to evaluate, comment and make recommendations on CME Group's application of the supervisory programs. Commission staff are the subject matter experts in CFTC regulatory requirements, and we believe that CFTC staff is best suited to evaluate the application of our supervisory program against the CFTC's own regulatory requirements. We believe that the CFTC already provides meaningful oversight over the FCM supervisory program and that requiring additional oversight by an examinations expert every three years imposes substantial unnecessary costs without a corresponding regulatory benefit.

c. Proposed Language Change to Regulation 1.52

CME Group requests that the CFTC change the reference in Regulations 1.52(c)(2)(ii) and 1.52(d)(2)(ii)(F) from "auditing standards issued by the PCAOB as such standards would be applicable to a non-financial statement audit" to the "FCM Examination Standards accepted by DSIO." This change will accurately reflect the current requirement to follow what has been accepted by DSIO and the work put into the program to align the FCM program and PCAOB standards.

d. Eliminate the Prohibition on Two Warning Letters

Market Regulation is prohibited from issuing more than one warning letter to a person or entity for the same rule violation within a rolling 12-month period. This regulation is overly prescriptive and eliminates the discretion SROs traditionally have had to determine whether it is appropriate to issue a

[19] CME Group completed the changes to the FCM supervisory program necessary to ensure that the program conformed to the FCM standards by the end of October 2015, and thereafter we engaged Deloitte to conduct the examinations expert's initial evaluation of the program. CME Group submitted Deloitte's examinations expert's report, which determined that the supervisory program addressed the FCM examination standards, on March 29, 2016. On April 20, 2016, the CFTC approved CME Group's supervisory program for immediate use.

20 South Wacker Drive Chicago, Illinois 60606 T 312-930-3488 Kathleen.Cronin@cmegroup.com

warning letter or pursue sanctions. Circumstances arise, particularly with respect to minor or unintentional violations, where a second warning letter is appropriate as opposed to investing the resources required to prosecute a case. The CFTC is able to review how this discretion is deployed during routine rule enforcement reviews and make recommendations as necessary.

e. Modify the Requirement that Investigations Must be Completed within One Year

SRO investigations are required to be completed within one year absent a documented justification for needing additional time. Due to the nature and complexity of cases and respondents, this requirement is no longer practicable and should be modified. Cases related to spoofing and disruptive trading have increased. These cases often involve review and analysis of millions of rows of data, review of complicated algorithm codes and communications such as IMs and emails of multiple traders. Further, we have seen an increase in cases involving foreign respondents; in many instances, these cases require time-consuming translation. It is an inefficient use of time and resources for investigators to prepare a memorandum seeking approval to exceed the one-year period— this time would be better spent on the investigation. We urge the CFTC to eliminate or, at a minimum, extend this time limitation. The CFTC has the ability to review the timeliness of SRO investigations during their rule enforcement review process.

f. Eliminate Requirement for CTI Codes

CFTC regulations require that an acceptable audit trail transaction database include the CTI code and that the Exchange conduct audits related to correct CTI codes. Since CTI codes are no longer used for trade reconstruction or monitoring of trade practice abuses, this is an archaic requirement that can be eliminated without an adverse impact.

Operational Issues

g. Revise Product “Terms and Conditions” to Include Initial Listing of Block Trades

Under Commission Regulation 40.2, a DCM may list a new product by self-certifying the product with the Commission by the open of business (8:15 a.m. ET) on the business day preceding the product’s listing. The intent behind this rule was to promote innovation on the part of the exchanges. One barrier to the implementation of this listing rule is the fact that the initial establishment of block levels is not considered a product “term and condition” by Commission staff and must therefore be self-certified not less than 10 business days prior to the registered entity’s implementation of the block minimum threshold. Consequently, a large majority of our new products are unable to enjoy the full benefits of the listing rules. To remedy this situation, we request that the Commission permit the initial establishment of a block trade level to be characterized as a product term and condition under the Part 40 rules. Any amendments to block trade levels should continue to be submitted under the ten-day timeframe contemplated by Regulation 40.6.

h. Adopt a Notice Requirement for Core Principle and Rule Non-Compliance

The CFTC should adopt a regulation or policy stating that the Commission will not bring an enforcement action against a registered entity for violation of a Commodity Exchange Act ("CEA") core principle or CFTC regulation without first providing the registered entity notice of non-compliance and thirty days to remedy the noted defect. The CEA's core principles are flexible standards that afford a registered entity discretion in determining how it will comply. A registered entity should not learn through an enforcement action that the Commission disagrees with the registered entity's interpretation of a core principle. Instead, the CFTC should adopt a regulation or policy stating that the Commission will use its prosecutorial discretion to provide notice of non-compliance and a thirty-day cure period before bringing an enforcement action against a registered entity for violation of a CEA core principle or CFTC regulation.

* * * *

We applaud the Commission's initiative to undertake this in-depth review of regulations imposed on exchanges, clearing houses and market participants to increase efficiency and reduce costs to the marketplace and make regulations make sense. We look forward to continuing this important dialogue with the Commission. We are happy to discuss any questions the Commission or its staff might have with respect to the comments contained in this letter. Please do not hesitate to contact me at 312-930-3488 or via email at kathleen.cronin@cmegroup.com.

Sincerely,

Kathleen Cronin
Senior Managing Director,
General Counsel and Corporate Secretary

cc: Chairman J. Christopher Giancarlo
Commissioner Rostin Behnam
Commissioner Brian D. Quintenz
Amir Zaidi, Director, Division of Market Oversight
John Lawton, Acting Director, Division of Clearing and Risk
Matthew Kulkin, Director, Division of Swap Dealer and Intermediary Oversight

CLEARING

Balancing CCP and Member Contributions with Exposures

As the industry considers the appropriate 'skin in the game' for CCPs, the risk incentives created by the CCP's contribution have largely been ignored

Key Takeaways on CCP Risk Management

1. **Central counterparties (CCPs) are market risk neutral as a normal course of business. CCPs do not engage in trading, lending, or any other market risk creating activities.**
2. **CCPs serve a crucial market function by reducing the likelihood of a clearing member failure having "too big to fail" consequences.**
3. **Monitoring participants to ensure they have sufficient skin in the game to support their activities is a fundamental aspect of a CCP's role.**
4. **CCPs with a "systemically important" designation maintain resources at least large enough to cover the default losses of their two largest clearing members.**
5. **A CCP's most important contribution to managing systemic risk is the management of concentration risk among their largest participants.**

CME Clearing is a strong supporter of sound risk management underpinned by the belief that market participants must be incentivized to manage the risks they create. This view, while not new, was bolstered by the financial crisis which saw lenders repackaging and offloading the risk of their loans via securitizations, separating risk creators from the responsibilities of bearing that risk. Securitization often resulted in a lack of incentives for lenders to conduct appropriate due diligence on their loans, as the lenders were not subject to losses if the loans were not repaid. For securitization lenders, as well as other risk creators, skin in the game must be used to ensure these market participants pay to support their positions. This concept applies in central clearing as well, where participants' skin in the game creates incentives for customers to diversify their exposures across clearing members and for clearing members to build balanced portfolios, which reduces systemic risk.

A CCP's core function is risk management – not trading, lending, or other types of risk creation. CCPs are fundamentally risk managers responsible for ensuring the overall safety and soundness of their markets. Discussions regarding the appropriate amount of capital a CCP should contribute to its clearing member default protections have not fully considered the role of a CCP and the way in which a CCP's skin in the game would be utilized. Ensuring that market participants and clearing firms have the proper skin in the game is one of the most critical roles of a CCP. It is important to clarify that a CCP's skin in the game does not protect clients of an insolvent clearing member from fellow customer risk or from the insolvency of the clearing member itself. A CCP's skin in the game is part of the mutualized resources available in the event the loss caused by the insolvent clearing member exceeds the available resources of that clearing member.

Recent industry suggestions for CCP contributions sized using arbitrary percentages or dollar amounts are not supported by any empirical evidence and fail to consider the role and risk profile of CCPs or the systemic risk reduction benefits they provide to the market. These proposals also ignore the incentives created by a CCP's capital contribution, which are critical to proper risk management and mitigation.

CME Clearing has long advocated for meaningful, funded, first-loss contributions to the CCP waterfall, in advance of the mutualized clearing member default fund, and has demonstrated this commitment with its own dedicated capital. CME Clearing maintains capital contributions to each waterfall that are generally equal to at least the average of the default fund requirements calculated for its clearing members. As of March 31, 2017, total CME waterfall contributions were approximately $300 million, all held in highly liquid assets on the balance sheet and explicitly set aside for the default management waterfall. This paper further explains the role of a CCP and the default management waterfall.

CCP Waterfall Purpose and Incentives

Industry discussions have recently focused on a misconception that central clearing results in a concentration of systemic risks. Risks are not concentrated by a CCP; rather risks may be concentrated within a clearing member through the exposures they bring to a CCP. A CCP's most important contribution to managing systemic risk is the management of concentration risk among their largest participants. CCPs structure the waterfall to ensure they can adequately manage the risks brought by clearing members and encourage prudent balancing of risk among clearing members. Key tools in managing concentration risk include ensuring clearing members pay for the exposures they bring and are incented to support policies that encourage diversification of risk across participants, and CCPs have the ability to attract and maintain a diverse set of clearing members to reduce concentration risk.

Nearly all CCPs follow a similar structure in building their waterfalls – layers of funding dedicated to protect against the losses caused by a clearing member default. These layers create a pre-defined and transparent system of protections; that system provides safety for all participants and also creates clear incentives for clearing members to manage risk. Each layer of the waterfall is transparent to market participants, giving clearing members the information they need to assess potential liabilities in the event of a clearing member default, information that is largely unavailable outside of a centrally cleared environment.

Waterfall Layers Encourage Prudent Risk Management

Clearing members are required to post collateral to support the risks of their portfolios and the portfolios of their customers, which make up many of the layers of risk protection. The first layer of risk protection is the mark-to-market calculation, which is performed at least daily and removes debt from the system by settling profits and losses rather than allowing outstanding obligations to accumulate in the system. In a central clearing model, this known as settlement variation. This serves as a preventative risk management tool to minimize any potential loss in the event a clearing member fails to pay its obligation to the CCP,

Illustrative example: CCP waterfall with large clearing member (CM)

Layer	Amount
Large defaulter Initial Margin	$2 billion
Large defaulter concentration margin	$100 million
Large defaulter default fund	$80 million
CCP Capital Contribution	$100 million
Remaining default fund (less defaulter)	$3.5 billion
CM Assessments*	$10 billion

** Represents a single default, could be higher if more than one firm defaults*

resulting in a default. The second layer is comprised of initial margin (IM), which is an ex-ante risk tool that covers the potential future exposures and closeout costs of clearing member positions in the event of a clearing member default. CME Clearing calculates IM to cover at least 99% of potential expected losses and collects IM from every participant at least daily. IM collected by CME Clearing also includes additional concentration charges to ensure clearing members with concentrated exposures are properly supporting the risk brought by their positions. Industry studies have shown that in the recent financial crisis, one of the largest seen in history, the IM collected from large defaulting clearing members was sufficient to resolve the losses associated with the default.[1]

The next layer in the waterfall is the defaulter's contribution to the mutualized default fund. The default fund is designed to cover tail risk, potential losses under extreme but plausible scenarios as measured by stress tests. Stress test

1 *How central counter-parties strengthen the safety and integrity of financial markets*

scenarios include extreme historical scenarios, such as the global financial crisis, the 1987 crash, LTCM, etc., as well as hypothetical scenarios that break assumptions of correlations and risk offsets used to calculate IM. Stress tests are used to identify potential losses in excess of IM, known as shortfall. CME Clearing, like all systemically important US derivatives clearing organizations (DCOs), sizes its default funds to cover at a minimum the losses caused by the simultaneous default of the two clearing members with the largest shortfalls ("cover 2"). Individual clearing member default fund requirements are sized based on their risk exposures; requirements increase and decrease as clearing member risks increase and decrease, respectively.

If the defaulters' funded resources have been exhausted and losses persist – which would mean the default is more significant than relevant historical stress events, including the record financial crisis of 2008 and 2009 – best practice for CCPs is to use an appropriate and transparent amount of their own funds to satisfy the continued losses, their waterfall contribution. By adding a meaningful amount of first-loss capital, prior to the non-defaulting clearing members, CCPs demonstrate their commitment to risk management and efficient default management, which will additionally help limit the accumulation of losses and reduce the risk of a default impacting their capital. Most CCPs are completely transparent about this contribution and its usage, allowing participants to fully evaluate their risks, and choose their partners accordingly.

In the event of truly extreme default losses, which exceed the defaulted clearing member's IM and default fund contribution, as well as the CCP's contribution to the waterfall, the next layer is the mutualized default fund contributions of solvent clearing members. Mutualizing the remaining losses of a defaulted clearing member is a fundamental benefit of central clearing as it reduces the impact of a counterparty default to any single individual counterparty and mitigates systemic risk. Further, in a central clearing model, the capital available to manage the default of a counterparty is pre-funded and dedicated solely for this purpose, including clearing member contributions and the CCP's contribution to the waterfall. IM and default fund contributions are held by the CCP, who has a first priority unencumbered lien on the funds to ensure immediate access to collateral in a default scenario. This is unlike the capital maintained by a bank that is not dedicated to individual counterparties and has numerous creditor claims that are not transparent to the market.

Beyond the mutualized default fund, CCPs are able to call on unfunded contributions, sometimes called "assessments", which serve as a rules based recovery tool to provide funding to the clearinghouse in the event of a catastrophic default. Assessments act primarily as a tool to ensure the CCP is able to keep its markets open in the event of excessively large default losses, allowing the CCP to recover from and appropriately respond to a stress situation. CME Clearing strongly prefers recovery to resolution and has designed its assessments program to incentivize clearing members to meet their obligations and help avoid resolution. CME Clearing ensures clearing members are able to meet their assessment powers from a financial standpoint on an ongoing basis. On average, CME's bank-affiliated clearing member assessments represent less than 1% of the parent's Tier 1 capital. Further, CME Clearing ensures clearing members are incented to meet their assessment powers through its rules, which provide for clearing members who do not meet assessment calls to be declared in default, resulting in the unwinding and liquidation of their portfolio at the CCP. Assessment calculations, described in CCPs' rulebooks and other public documents, are based on the risk profile of the portfolio and are reported to the clearing members regularly to ensure members are fully aware of their responsibilities and can manage their risk exposures accordingly.

In addition to the waterfall structure and the incentives, described above, CME believes that these protections are further strengthened by the concentration margin required of clearing participants with large concentrated portfolios. By charging additional requirements to support these positions, CCPs can encourage clearing members to reduce concentrated positions in their portfolios, reducing the total risks brought to the CCP while ensuring that existing concentration risks are properly supported by the risk takers. Encouraging more balanced, less concentrated portfolios will result in less costly default management processes in the event of a clearing member default, as these portfolios will be easier to liquidate or auction. With this funding, deposited in

the form of IM and immediately available to cure the losses of their potential default, and the benefits of an efficient default management process due to more balanced portfolios, CCPs can provide even greater protection to clearing participants through active concentration risk management. Additionally, concentration margin requirements also help defend the CCP against potential losses by applying collateral requirements to clearing members that bring significant risks to the clearinghouse.

CCP Risk Management and Benefits to Market Security

CME Clearing recognizes that the effectiveness of its risk management protections, including the waterfall, relies on the efficiency of the supporting risk management tools. CME Clearing utilizes a number of tools to monitor and limit the total risks facing its clearing members and customers. These tools include, but are not limited to: credit risk evaluations, transparent daily settlement processes, real-time risk monitoring and credit controls, liquidity risk management, and daily stress testing. These tools have been tested in recent stressed markets and have demonstrated their effectiveness against the worst financial crises in memory, with no major CCP, including CME, having to access their own capital or the mutualized capital of their clearing members to cure default losses.

The safeguards package and waterfall structure described in the previous section allows a CCP to limit the systemic impact of a failing clearing member. The safeguards package is part of a broader risk management framework employed by CCPs to mitigate systemic risk and reduce the likelihood of a clearing member default. All CCPs are designed primarily to provide risk management services for their participants and the markets they serve, reducing systemic risk and improving crisis management through their risk management practices and the waterfall structure.

CCP Risk Management Standards

Unlike clearing members and market participants, CCPs do not bring market risk to the clearing system. However, CCPs do face unique risks themselves, including ensuring that the skin in the game of clearing members and participants are designed adequately to protect non-defaulting clearing members and customers from losses. Risk management standards for CCPs have been defined by local and international regulators, generally following the recommendations of the CPSS-IOSCO[2] Principles for Financial Market Infrastructures (PFMIs) to address the risks faced by CCPs specifically. Some CCPs, including CME,[3] have published public disclosures to these Principles, describing their risk management practices and compliance with international standards and best practices. This provides the market full transparency into each CCP's risk management philosophy and practices.

CCP Skin in the Game and Improved Crisis Management

As correctly noted by industry participants, a CCP's book will be temporarily unmatched if one of its clearing members defaults. In the event of default, the goal of the CCP's default management process is to restore the matched book as quickly as possible. Therefore, it is imperative that the IM and default fund of the defaulted clearing member are sized appropriately to cure the default losses. Historically, the IM of the insolvent clearing member has been sufficient to cure the losses without needing to use even the default fund of that clearing member. Additionally, CME has not needed to access its own capital layer, or the mutualized layer of non-defaulted clearing members, to satisfy the losses of a clearing member default.

Other than the extremely rare event of a clearing member default, CCPs support a matched book and do not have market exposure. CCPs themselves create no additional market risk that would necessitate the skin in the game support required of risk creators; therefore it is unreasonable to conclude that CCPs should contribute excessive amounts of capital to the default waterfall, as has been suggested by some in the industry.

2 CPSS has been renamed CPMI

3 http://cmegroup.com/pfmidisclosure and http://www.cmegroup.com/clearing/cpmi-iosco-reporting.html

Balancing CCP Contributions to Reduce Risk

Recognizing the benefits of first-loss CCP waterfall contributions, it is important to consider the appropriate balance of the CCP contribution to ensure proper motivations and risk management among market participants. Some industry suggestions for arbitrary, excessively large CCP contributions fail to consider the negative incentive effects resulting from such large contributions, which would result in CCPs subsidizing their participants' risks.

Default fund contributions and IM motivate clearing members to manage their risk, by creating incentives to maintain balanced portfolios, and the risks of their clients. These contributions motivate clearing members to actively participate in the default management process to ensure their default fund contributions are not utilized in a fellow clearing member default. At a minimum, a significant increase to the size of CME's contribution would undermine default management by incentivizing clearing members to bid less aggressively to receive the benefit of the CCP's capital while simultaneously reducing the risk to a non-defaulting clearing member's capital during a default.

If a CCP contributes an extremely large amount to the waterfall, clearing members can take on more risks without being exposed to the same level of losses, creating moral hazard by separating risk creation from skin in the game. For example, if CME were to increase its capital contribution to the waterfall to cover the shortfall for the largest potential defaulting clearing member, clearing members could potentially increase their risk exposures by over 40% for the same level of default fund contributions they make today, with CME subsidizing the additional risk with its own funding and reducing the clearing members' skin in the game relative to their risk. Ensuring clearing members maintain default fund contributions reflective of their risk profile further incents mutual alignment of interests between the CCP and its clearing members.

Clearing is the core function of a CCP, therefore CCPs have strong motivation to ensure clearing member contributions and their own capital contributions will be sufficient to avoid the mutualization of losses in a default situation. Unlike banks, risk management is the core market offering and franchise value of CCPs and utilization of non-defaulter resources in the waterfall would be seen as a failure of the CCP at its main offering – risk management.

Conclusion

Skin in the game is at the core of a centrally cleared market and the most critical component of a CCP's ability to manage the default of a clearing member. The discussion of skin in the game should focus largely on the amount of skin in the game that each clearing member must contribute to the waterfall, including IM, concentration margin, default fund, and assessments. A clearing member's skin in the game should scale with the exposures they bring to the CCP. CCPs are market risk neutral and their role is to ensure that all market participants have the proper amount of skin in the game to create incentives for managing their exposures. These incentives clearly benefit markets through reduced systemic risk and prudent management of crisis events, as shown by the performance of CCPs during past stress events, including the 2008 financial crisis. CME Clearing believes that skin in the game requirements must be developed on principles that incentivize market participants to manage the risks they create.

CME GROUP HEADQUARTERS

20 South Wacker Drive
Chicago, Illinois 60606
cmegroup.com

CME GROUP GLOBAL OFFICES

Chicago
+1 312 930 1000

Singapore
+65 6593 5555

Houston
+1 713 658 2347

Tokyo
+81 3 3242 6228

New York
+1 212 299 2000

Calgary
+1 403 444 6876

São Paulo
+55 11 2787 6451

Washington D.C.
+1 202 638 3838

London
+44 20 3379 3700

Hong Kong
+852 2582 2200

Seoul
+82 2 6336 6722

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PM2195/0817

February 1, 2013

VIA E-MAIL AND FEDERAL EXPRESS

Secretariat of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Regulation 13.2 Petition for Amendment of Regulation 38.154

Dear Secretariat:

CME Group Inc. ("CME Group"), on behalf of its five affiliated designated contract markets ("DCMs"), respectfully petitions the Commodity Futures Trading Commission ("CFTC" or "Commission") pursuant to CFTC Regulation 13.2 ("Petition for issuance, amendment, or repeal of a rule") to amend CFTC Regulation 38.154 ("Regulatory services provided by a third party"). As discussed in our October 17, 2012 letter addressed to Mr. Richard Shilts seeking no-action relief, Regulation 38.154 does not address the type of regulatory structure adopted by CME Group whereby a single, centralized regulatory department and Market Regulation Oversight Committee oversee multiple affiliated DCMs. Amending Regulation 38.154, as proposed below, would provide for more efficient allocation of regulatory resources and more effective administration of regulatory responsibilities. Conversely, strict adherence to Regulation 38.154 as currently written will result in an inefficient allocation of regulatory resources and unnecessary structural complexity, while yielding no corresponding regulatory benefit.

1. Background

On October 17, 2012, the four DCMs then owned and controlled by CME Group, Chicago Mercantile Exchange Inc. ("CME"), Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX") and Commodity Exchange, Inc. ("COMEX") submitted a petition ("Petition") to the CFTC for no-action relief from the provisions of CFTC Regulation 38.154 in connection with the regulatory services provided by CME and NYMEX to CME, CBOT, NYMEX and COMEX. On November 30, 2012, CME Group acquired Board of Trade of Kansas City, Missouri, Inc. ("KCBT") (collectively, with CME, CBOT, NYMEX and COMEX, the "CME Group DCMs"), a DCM registered with the Commission under CFTC Regulation 38.3 ("Procedures for designation"). KCBT is wholly-owned by CME Group and affiliated with the other CME Group DCMs by virtue of common ownership under the CME Group umbrella. CME Group's Market Regulation Oversight Committee ("MROC") is now responsible for overseeing KCBT's regulatory and compliance activities, and its Charter (attached as Exhibit A) has been amended to include KCBT.

CME Group's regulatory and compliance efforts are centralized in a single, cohesive Market Regulation Department ("Market Regulation") that provides services on behalf of all the CME Group DCMs.[1] As noted in our October 17 letter (attached as Exhibit B), we purposely organized Market

[1] KCBT's regulatory and compliance functions are currently handled by KCBT staff on location in Kansas City. Plans are underway to fully integrate KCBT's regulatory services into CME Group's Market Regulation

20 South Wacker Drive Chicago, Illinois 60606 T 312 930 1000 F 312 466 4410 cmegroup.com

Regulation in this manner to maximize effectiveness and efficiency. Rather than having separate compliance and regulatory groups for each DCM, Market Regulation is organized into functional areas (*e.g.*, trade practice investigations, market surveillance, data quality assurance, regulatory systems and strategic initiatives, enforcement and employee learning initiatives) that focus on particular areas of responsibility across all of the CME Group DCMs' markets to provide for the best visibility and consistency with respect to discharging our regulatory responsibilities. This structure also enables us to continue to comply with incorporation and employment commitments following the mergers.

2. Proposed Amendments to Regulation 38.154

The CME Group DCMs propose making three amendments to Regulation 38.154. For the Commission's convenience, a complete "redline" version of the proposed amendments is attached as Exhibit C.

- Amendment 1: Title Change

  The title of Regulation 38.154 should be changed from "Regulatory services provided by a third party" to "Regulatory services provided by a third party or an affiliated designated contract market."

- Amendment 2: Reorganization of current subparts (a), (b) and (c)

  A new subpart (a) should be added immediately after the title for Regulation 38.154. It should state "Regulatory services provided by a third party." To accommodate this addition, current subparts (a), (b) and (c) should be re-designated as (1), (2) and (3) and follow new subpart (a).

- Amendment 3: Add a new subpart (b) to set forth language for affiliated DCMs

  A new subpart (b) should be added to accommodate regulatory structures of affiliated DCMs. The CME Group DCMs propose the following language:

  > (b) *Regulatory services provided by an affiliated designated contract market*. A designated contract market may choose to utilize an affiliated designated contract market for the provision of services to assist in complying with the core principles, as approved by the Commission. An affiliated designated contract market is any designated contract market directly or indirectly controlling, controlled by or under common control with a designated contract market, control being the ownership of more than 50% of the capital stock or other equity interests or possession, directly or indirectly, the power to direct or cause the direction of management or policies (whether through ownership of securities or partnership or other ownership interests, by contract or otherwise) of such designated contract market. The affiliated designated contract markets must enter into a written agreement that sets forth the terms and conditions for any

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Department. KCBT will then become a party to the inter-affiliate regulatory services agreement that CBOT and COMEX entered into with CME and NYMEX.

> regulatory, trade cancellation or price adjustment services that will be provided. A designated contract market will at all times remain responsible for the performance of any regulatory, trade cancellation or price adjustment services received from an affiliated designated contract market, and for compliance with the designated contract market's obligations under the Act and Commission regulations.

3. Rationale for Proposed Amendments

As set forth in our October 17 letter (which we adopt by reference herein), it is clear from the current language of Regulation 38.154 and earlier guidance on the provision of regulatory services that Regulation 38.154 does not address the regulatory structure employed by CME Group. Rigid application of Regulation 38.154 would result in an inefficient use of regulatory resources. As noted above, the CME Group DCMs' regulatory structure is based on a single department (Market Regulation) that oversees all of the CME Group DCMs' markets. That department is organized across functional areas and reports into a Chief Regulatory Officer and Deputy Chief Regulatory Officer. We have found over time that this structure provides the most effective means of satisfying the regulatory responsibilities of each DCM.

Subpart 38.154(b) imposes the following obligations on a DCM that utilizes a third-party service provider for regulatory services:

- "retain sufficient compliance staff to supervise the quality and effectiveness of the services provided on its behalf;"
- "hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other matters of regulatory concern;"
- "conduct periodic review of the adequacy and effectiveness of services provided on its behalf;" and
- "carefully" document the periodic reviews and make them available to the Commission upon request.

Strictly adhering to these requirements would effectively require the CME Group DCMs to do away with their current structure and replace it with superfluous governance and administrative constraints that yield no meaningful regulatory benefit. Our current structure, which we think is the most optimum for complying with our regulatory responsibilities, would need to be replaced with one of two lesser options.

One option would be to decentralize Market Regulation by dividing it into separate and autonomous regulatory departments for each of the DCMs. Each would be responsible for carrying out all the regulatory responsibilities for that DCM's markets. This would be less effective and efficient for several reasons. To begin with, breaking up Market Regulation into separate regulatory staffs would obligate each DCM to employ its own staff, which is not currently the case. Changing current practice would require that we set up employment, human resource and benefits support for employees of COMEX and CBOT, which would require additional cost for CME Group while providing no added regulatory benefit.

A much more important consideration than this, however, is that decentralizing Market Regulation would result in significantly less effective regulatory oversight of our markets and participants. Take, for example, the case of our wash trade review team. Currently, we have a dedicated team that reviews potential wash trade violations within or across the CME Group DCMs' markets.

Decentralizing Market Regulation in order to demonstrate compliance with subpart 38.154(b) would mean that instead of having one wash trade team analyzing potential violations across all markets, we would instead have multiple teams – one for each DCM – reviewing wash trades only within a respective DCM. This would jeopardize the cohesive application of the wash trade review program across DCMs, and lose the current benefit gained from having a single team with visibility into activity in all markets. While it is possible that the teams could communicate with one another, that would certainly be a less efficient alternative, and it could not replace the effectiveness of utilizing people with broader visibility across markets. This would not be a desirable result, and its perils are even more evident when considered in the context that the wash trade program is but one of Market Regulation's regulatory programs that are staffed across DCMs to maximize utility. The perils are more pronounced when multiplied by the number of other regulatory programs that would be affected, such as cross trades, money passes, open interest reporting, block reviews and trading ahead, to name only a few.

CME Group's second option would be to outsource the regulatory obligations of one or more DCMs to other CME Group DCMs, which is what we are currently doing pursuant to the regulatory services agreement mentioned above. CME Group has utilized this arrangement for several years now following the various mergers, and it has worked extremely well. CME Group believes, however, that the heightened supervision requirements imposed by subpart 38.154(b) set forth unnecessary hurdles that, when applied to CME Group's structure, would have no corresponding regulatory benefit. To begin with, subpart 38.154(b) mandates that each DCM retain "sufficient compliance staff" in order to supervise the regulatory activities being provided by the other CME Group DCMs (*i.e.*, the regulatory service provider). In order to meet this requirement, we would still need to staff and employ compliance professionals in each DCM, which is different than our current construct whereby CME and NYMEX employ all staff in Market Regulation.[2] This would add the same employment, human resource and benefit restraints that we discussed in option 1 were we to revert to self-autonomous regulatory departments for each of the CME Group DCMs.

Moreover, this would result in highly inefficient and less effective administration of our regulatory responsibilities. For illustrative purposes, let us revisit the wash trade team example used above. If we were to maintain a single wash trade review team that is outsourced to other CME Group DCMs, strict application of subpart 38.154(b) would require that team to meet regularly with the regulatory staffs of each of the DCMs upon whose behalf it is performing the regulatory responsibility of analyzing potential wash trades. In other words, if CME employed the regulatory staff charged with reviewing trades for potential wash trade violations, and it provided those services to CBOT, NYMEX and COMEX, then that wash trade review team would have to set up separate, regular meetings with the supervision staffs of each of the other DCMs to review its work. Further, CBOT, NYMEX and COMEX would each have to separately conduct periodic reviews of the "adequacy and effectiveness" of the CME wash team's services, and then document that review. This is highly inefficient and not the best use of available regulatory resources. A more effective use of those resources would be to ensure that our regulatory efforts are harmonized, applied consistently, and are able to be discharged free of the unnecessary reviews and meetings that the DCMs are contemplated by subpart 38.154(b).

The untenable outcomes that arise out of the strict application of the requirements of subpart 38.154(b) also extend to the requirements of subpart 38.154(c). Under that subpart, each DCM must "retain exclusive authority in decisions involving the cancellation of trades." Currently, staff of CME and NYMEX already have this responsibility, both for themselves and other CME Group DCMs. Strictly adhering to the language of subpart 38.154(c), however, would preclude the CME Group DCMs from continuing this practice. Instead, subpart 38.154(c) would have us hire and employ staff at each DCM so

[2] Again, this does not apply to KCBT at the moment.

they would be responsible for making such determinations. This is unnecessary and provides no added regulatory benefit, however, because current CME and NYMEX staff (in the Global Command Center ("GCC")) are very experienced in trade cancellation procedures, considerations and decision-making. And they are intimately familiar with all markets owned and operated by CME Group DCMs. GCC should be able to retain full authority to cancel trades or make price adjustments for CME, CBOT, NYMEX and COMEX without having to contact (in the middle of the night, for example) a specifically designated person to obtain approval. This structure is much more efficient and effective than what is contemplated in subpart 38.154(c) because it allows for more decisive and comprehensive action across markets, and for those actions to be more quickly communicated to market participants. Obtaining approval from a designated person at another DCM only adds unnecessary delay, expense and administration.

The amendments proposed in Section 2 above provide a straightforward solution that will eliminate the loss of effectiveness and efficiency in regulatory oversight that would result from a strict application of Regulation 38.154. It will enable the CME Group DCMs to continue operating under their current operating structure, which we have found to be the most efficient and effective way to demonstrate compliance with core principle requirements. Further, it will obviate the need to add superfluous administrative governance and human resource, employment and benefits requirements that provide no regulatory benefit to the marketplace.

4. Conclusion

The CME Group DCMs respectfully request that the Commission amend Regulation 38.154 to account for the provision of regulatory services by an affiliated designated contract market. Doing so will allow for the more efficient allocation of regulatory resources without sacrificing the effectiveness of the CME Group DCMs in carrying out their regulatory responsibilities. CME Group's current structure provides for more effective regulation of their markets and participants compared to what is contemplated by subparts 38.154(b) and 38.154(c).

If you have any questions regarding this submission or if you require any additional information, please contact me at (312) 930-3488 or kathleen.cronin@cmegroup.com, or Joe Adamczyk at (312) 648-3854 or joseph.adamczyk@cmegroup.com

Sincerely,

Kathleen M. Cronin
Senior Managing Director, General Counsel
and Corporate Secretary

cc: Richard Shilts
Rachel Berdansky
Bryan Durkin
Julie Holzrichter
Tom LaSala
Dean Payton
Joe Adamczyk

CME GROUP INC.
CHICAGO MERCANTILE EXCHANGE INC.
BOARD OF TRADE OF THE CITY OF CHICAGO, INC.
NEW YORK MERCANTILE EXCHANGE, INC.
COMMODITY EXCHANGE, INC.
THE BOARD OF TRADE OF KANSAS CITY, MISSOURI, INC.
KANSAS CITY BOARD OF TRADE CLEARING CORPORATION
MARKET REGULATION OVERSIGHT COMMITTEE

CHARTER

I. Purpose

The Market Regulation Oversight Committee (the "Committee") is a Committee of the Board of Directors (the "Board") of CME Group Inc. ("CME Group"), Chicago Mercantile Exchange Inc. ("CME"), Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX"), Commodity Exchange, Inc. ("COMEX"), The Board of Trade of Kansas City, Missouri, Inc.("KCBT"), and Kansas City Board of Trade Clearing Corporation ("KCBT Clearing"), (collectively, referred to as, the "Company"). The primary purpose of the Committee is to provide independent oversight of the policies and programs of the Company's regulatory functions relating its operations of designated contract markets, designated clearing organizations and a swap data repository and their senior management and compliance officers, as applicable, collectively referred to as the "Regulatory Compliance Functions" with the goal that the policies and programs enable each of those individuals and departments to administer effectively and independently the regulatory responsibilities of the Company.

II. Membership & Organization

- The members of the Committee and its Chairperson shall be appointed in accordance with the provisions of the Company's Corporate Governance Principles. In accordance with the Principles, the Governance Committee, after consultation with the Executive Chairman & President, shall make a recommendation to the Board with respect to the assignment of directors to the Committee, including the designation of Chair, to the full Board for approval. After reviewing the Executive Chairman & President's recommendations, the Board shall be responsible for appointing the members of the Committee.

- The Committee shall be comprised of three (3) or more directors who qualify as public directors as that term is defined in Appendix B to Part 38 (Designated Contract Markets) of the Commission's regulations under the Commodity Exchange Act.

- The Chairperson shall schedule all meetings of the Committee and provide the Committee with a written agenda as appropriate. A quorum of the Committee shall consist of a majority of the appointed members of the Committee. The Committee may ask members of management or others to attend the meeting and provide information.

EXHIBIT A

III. Committee Meetings, Tasks and Authority

General

- The Committee shall meet at least quarterly and keep minutes of its proceedings.

Responsibilities

- The Committee shall review the scope of and make recommendations with respect to the responsibilities, budget and staffing of the Company's Regulatory Compliance Functions and the resources available to the them with the goal that each department, business unit or function is able to fulfill its regulatory responsibilities. Additionally, the Committee shall oversee the performance of the Regulatory Compliance Functions with the goal that each department, business unit or function is able to implement its regulatory responsibilities independent of any improper interference or conflict of interest that may arise.

- The Committee will review the annual performance evaluations and compensation determinations and any termination decisions made by senior management with respect to the Managing Director and Chief Regulatory Officer, the Managing Director, Audit Department, the Clearing House Compliance Officer and the Swap Data Repository Chief Compliance Officer, with the goal that the determinations or decisions are not designed to influence improperly the independent exercise of their regulatory responsibilities.

- The Committee shall review the compliance of CME, CBOT, NYMEX, COMEX, KCBT and KCBT Clearing with their regulatory responsibilities as prescribed by statute and the rules and regulations promulgated thereunder.

- The Committee shall review such other matters and perform such additional activities, within the scope of its responsibilities, as the Board deems necessary or appropriate.

- The Committee shall review changes (or proposed changes, as appropriate) to the rules of CME, CBOT, NYMEX, COMEX, KCBT and KCBT Clearing to the extent that such rules are likely to impact significantly regulatory functions.

- The Committee shall review conflict of interest matters brought to its attention by the senior management and compliance officers responsible for the Company's Regulatory Compliance Functions.

Reporting Activities

- The Committee Chairperson, or his or her designee, shall make regular reports to the Board of the Committee's activities.
- The Committee shall prepare and adopt an annual report to the Board summarizing the activities, conclusions and recommendations of the Committee during the previous year and the Committee's working agenda for the coming year and such other matters as considered appropriate.
- The Committee shall confer with Company management and other employees to the extent it may deem necessary or appropriate to fulfill its duties.
- The Committee shall reassess the adequacy of this Charter no less frequently than annually and submit any recommended changes to the full Board for approval.

Approved effective January 30, 2013

October 17, 2012

VIA E-MAIL AND FEDERAL EXPRESS

Mr. Richard Shilts
Acting Director, Division of Market Oversight
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: No-Action Request in Connection with Rule 38.154

Dear Mr. Shilts:

On behalf of the four affiliated Designated Contract Markets ("DCMs") of CME Group Inc., Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX") and the Commodity Exchange Inc. ("COMEX"), I am requesting no-action relief from the provisions of Commodity Futures Trading Commission ("CFTC" or "Commission") Rule 38.154 ("Regulatory Services Provided by a Third Party") in connection with the regulatory services provided by CME and NYMEX to CME, CBOT, NYMEX and COMEX.

I. Introduction

As part of the regulations implementing the DCM Core Principles, which have a compliance date of October 17, 2012, CFTC Rule 38.154 requires, in part, that a DCM using a regulatory service provider maintain compliance staff to supervise the regulatory service provider through regular meetings and periodic reviews. Given the affiliated (rather than arms-length) relationship between CME, CBOT, NYMEX and COMEX, and the manner in which regulatory services are structured and performed, the requested no-action relief is appropriate because rigid application of CFTC Rule 38.154 in this context would impose artificial structures and unnecessary costs, and would result in the inefficient allocation of regulatory resources in the absence of any legitimate regulatory benefit.

EXHIBIT B

a. Relevant Facts

CME, CBOT, NYMEX and COMEX are each DCMs under the holding company CME Group Inc. Although each DCM is separately registered with the CFTC, the DCMs are affiliated by common ownership under the CME Group umbrella. CME and CBOT are wholly owned by CME Group, Inc.; NYMEX is wholly owned by CME Group NYMEX Holdings, Inc., which is wholly owned by CME Group, Inc.; and COMEX is wholly owned by NYMEX.

The four DCMs are party to a regulatory services agreement (attached hereto) whereby CME and NYMEX jointly provide all regulatory services that are required for each of the four DCMs to satisfy their regulatory obligations under the Commodity Exchange Act and Commission regulations.

The regulatory services for all four DCMs are performed by the Market Regulation Department, which is comprised of staff who are employees of either CME or NYMEX, depending upon location. However, Market Regulation operates as a single department, and staff responsibilities are broadly functionally oriented. The Market Regulation global leadership team, which includes the Chief Regulatory Officer, Deputy Chief Regulatory Officer, and five functional area Executive Directors, are each responsible for their respective responsibilities across all four DCMs, and the various functions they oversee are functionally oriented rather than DCM oriented. The Commission has recognized this structure, and conducts joint rule enforcement reviews of CME/CBOT and NYMEX/COMEX, rather than of each DCM separately.

b. CFTC Rule 38.154

CFTC Rule 38.154 addresses a DCM's use of a CFTC-registered entity for the provision of services to assist the DCM in complying with the core principles; such entity is referred to as a "regulatory service provider". A DCM that elects to utilize a regulatory service provider is required to retain sufficient compliance staff of its own to supervise the quality and effectiveness of the services on its behalf, to hold regular meetings with the regulatory service provider and conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf.

Although the definition of "regulatory service provider" in CFTC Rule 38.154 is silent on the treatment of a regulatory service provider that is itself an affiliate of the DCM, the heading of the rule and headings in the rule text, as well as certain language in the CFTC's preamble adopting the rule, indicate that CFTC Rule 38.154 applies only to *third-party* regulatory service providers. The heading of Rule 38.154 states that it applies to "regulatory services provided by ***third***

EXHIBIT B

party" (emphasis added). Moreover, the headings in the text of the rule include: (a) "Use of a ***third-party*** provider permitted"; and (b) "Duty to supervise ***third-party***" (emphasis added).

In the preamble to the final rule, the Commission stated that "[i]n the past, the Commission has described acceptable 'contracting' and 'delegating' arrangements for the performance of core principle functions by ***third parties***. The Commission proposed 38.154 to clarify its previous guidance on such arrangements." 77 Fed. Reg. at 36612, 36627 (June 19, 2012) (emphasis added).

The "previous guidance" to which the CFTC refers is found in a 2001 Federal Register final rule release entitled "A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations." In that guidance, the CFTC specifically refers to conditions on a DCM's use of "***outside contractors*** to perform duties in connection with self-regulatory functions." *See* 66 Fed. Reg. 42256, 42266 (Aug. 10, 2001) (emphasis added).

Moreover, in the preamble to the final rule, the Commission further states that "[t]he Commission also notes that DCMs must remain responsible for carrying out any function delegated to a ***third party***, and that DCMs must ensure that the services received will enable the DCM to remain in compliance with the CEA's requirements. The Commission believes that proposed 38.154 effectively establishes a system for administering regulatory services provided to DCMs by ***third party*** regulatory services providers." 77 Fed. Reg. at 36612, 36627 (June 19, 2012) (emphasis added).

It appears clear from the foregoing that the rule was not designed to address the type of scenario presented by CME Group's structure, and as explained in the subsequent section, rigidly applying CFTC Rule 38.154 to the four affiliated CME Group DCMs whose regulatory services are provided by a single Market Regulation Department would yield illogical results.

c. Basis for No-Action Relief

The application of CFTC Rule 38.154 to affiliated relationships such as those between the four CME Group DCMs is incongruous with the objectives of the rule. The affiliated DCMs currently share a single compliance staff that provides all of the regulatory services for the four DCMs and the rule requires each DCM's compliance staff to monitor the regulatory service provider's performance through regular meetings and periodic reviews. In this circumstance, however, the compliance staff of the four affiliated DCMs is the Market Regulation Department, and the Market Regulation Department is itself the regulatory services provider.

The rigid application of Rule 38.154 would require that each of the affiliated DCMs create additional, unique compliance staffs to meet with and

monitor both CME and NYMEX, which jointly provide regulatory services to all four DCMs – CME to CBOT, NYMEX and COMEX, and NYMEX to CME, CBOT and COMEX. This would make little practical sense, result in the inefficient allocation of regulatory resources and undermine a structure that has been in place and operated effectively for a number of years following the mergers of CME, CBOT and NYMEX, as well as the NYMEX/COMEX relationship that preceded the CME/NYMEX merger. It would create clearly unnecessary costs and yield no corresponding regulatory benefit.

Moreover, it should be noted that CME Group has a single Board-level Market Regulation Oversight Committee, comprised of five public directors, which provides independent oversight of Market Regulation's programs to ensure the independent and effective administration of its responsibilities with respect to all four DCMs.

II. Conclusion and Request for No-action Relief

CME Group, its Market Regulation Oversight Committee and the Market Regulation Department are all committed to preserving market integrity and to the effective administration of our regulatory responsibilities as designated contract markets. Mandating that the affiliated CME Group exchanges implement new regulatory structures that were clearly intended to ensure proper oversight for DCMs contracting with independent third-parties to provide regulatory services would be to mandate form over substance and would unnecessarily create unwarranted inefficiencies in the administration of our regulatory responsibilities.

CME, CBOT, NYMEX and COMEX therefore respectfully request that Division staff provide the requested no action relief and agree not to recommend any enforcement action against the four CME Group DCMs for failure to comply with the requirements of CFTC Rule 38.154.

Please do not hesitate to contact me at 212-299-2897 or via email at Thomas.LaSala@cmegroup.com or Christopher Bowen, Managing Director, Chief Regulatory Counsel, at 212-299-2200 or via email at Christopher.Bowen@cmegroup.com.

Very truly yours,

Thomas LaSala
Managing Director,
Chief Regulatory Officer

EXHIBIT B

Exhibit C – Redline of Proposed Amendments to CFTC Regulation 38.154

§ 38.154 Regulatory services provided by a third party or an affiliated designated contract market.

(a) *Regulatory services provided by a third party.*

(1) *Use of third-party provider permitted.* A designated contract market may choose to utilize a registered futures association or another registered entity, as such terms are defined under the Act, (collectively, ''regulatory service provider''), for the provision of services to assist in complying with the core principles, as approved by the Commission. Any designated contract market that chooses to utilize a regulatory service provider must ensure that its regulatory service provider has the capacity and resources necessary to provide timely and effective regulatory services, including adequate staff and automated surveillance systems. A designated contract market will at all times remain responsible for the performance of any regulatory services received, for compliance with the designated contract market's obligations under the Act and Commission regulations, and for the regulatory service provider's performance on its behalf.

(~~b~~2) *Duty to supervise third party.* A designated contract market that elects to utilize a regulatory service provider must retain sufficient compliance staff to supervise the quality and effectiveness of the services provided on its behalf. Compliance staff of the designated contract market must hold regular meetings with the regulatory service provider to discuss ongoing investigations, trading patterns, market participants, and any other matters of regulatory concern. A designated contract market also must conduct periodic reviews of the adequacy and effectiveness of services provided on its behalf. Such reviews must be documented carefully and made available to the Commission upon request.

(~~c~~3) *Regulatory decisions required from the designated contract market.* A designated contract market that elects to utilize a regulatory service provider must retain exclusive authority in decisions involving the cancellation of trades, the issuance of disciplinary charges against members or market participants, and the denials of access to the trading platform for disciplinary reasons. A designated contract market may also retain exclusive authority in other areas of its choosing. A designated contract market must document any instances where its actions differ from those recommended by its regulatory service provider, including the reasons for the course of action recommended by the regulatory service provider and the reasons why the designated contract market chose a different course of action.

(b) *Regulatory services provided by an affiliated designated contract market.* A designated contract market may choose to utilize an affiliated designated contract market for the provision of services to assist in complying with the core principles, as approved by the Commission. An affiliated designated contract market is any designated contract market directly or indirectly controlling, controlled by or under common control with a designated contract market, control being the ownership of more than 50% of the capital stock or other equity interests or possession, directly or indirectly, the power to direct or cause the direction of management or policies (whether through ownership of securities or partnership or other ownership interests, by contract or otherwise) of such designated contract market. The affiliated designated contract markets must enter into a written agreement that sets forth the terms and conditions for any regulatory, trade cancellation or price adjustment services that will be provided. A designated contract market will at all times remain responsible for the performance of any regulatory, trade cancellation or price adjustment services received from an affiliated designated contract market, and for compliance with the designated contract market's obligations under the Act and Commission regulations.