CME Group

March 18, 2024

VIA ON-LINE SUBMISSION

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

Re: Protection of Clearing Member Funds Held by Derivatives Clearing Organizations (RIN 3038-AF39); 89 FR 236 (Jan. 3, 2024) (Notice of proposed rulemaking)

Dear Mr. Kirkpatrick:

CME Group Inc. ("CME Group")[1] appreciates the opportunity to provide comments to the Commodity Futures Trading Commission (the "CFTC" or "Commission") on its proposed amendments to the Commission's Part 39 Regulations regarding protection of clearing member funds held by derivatives clearing organizations ("DCOs") (the "Proposal").

Chicago Mercantile Exchange Inc. ("CME") is a wholly owned subsidiary of CME Group. CME is registered with the CFTC as a derivatives clearing organization ("DCO") ("CME Clearing"). CME Clearing offers clearing and settlement services for listed futures and options on futures contracts, including those listed on CME Group's CFTC-registered designated contract markets ("DCMs"), and cleared swaps derivatives transactions, including interest rate swaps ("IRS") products. These DCMs are CME, 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"). On July 18, 2012, the Financial Stability Oversight Council designated CME as a systemically important financial market utility ("SIFMU") under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act"). As a SIFMU, CME is also a systemically important DCO ("SIDCO").

I. General Comments

CME Group firmly supports the goal of ensuring that a DCO adequately protects clearing member funds. This is not simply a rhetorical position for us. In fact, CME Clearing currently operates with policies and procedures to protect clearing member funds in a manner that is very similar to how it protects customer funds, as called for in the Proposal. Our policies and procedures are designed to support the stability of the broader financial system and the safety of funds entrusted to CME Clearing, both member funds ("proprietary funds" under the Proposal) and public customer funds of clearing members that are futures commission merchants ("FCMs").

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[1] As a leading and diverse derivatives marketplace, CME Group enables clients to trade in futures, cash and over-the-counter markets, optimize portfolios, and analyze data – empowering market participants worldwide to efficiently manage risk and capture opportunities. CME Group's exchanges offer the widest range of global benchmark products across all major asset classes based on interest rates, equity indexes, foreign exchange, energy, agricultural products, and metals. CME Group offers futures trading through the CME Globex platform, fixed income trading via BrokerTec, and foreign exchange trading on the EBS platform.

Given our commitment to the protection of clearing member funds, we do not oppose adoption of the Proposal, subject to our additional comments below. However, before the Commission moves forward with the Proposal, the marketplace would benefit from clarity on its rationale. To the extent the Commission's rationale is primarily, or even secondarily, focused on facilitating the introduction of a direct-to-retail leveraged model, we caution the Commission against pursuing that path without careful consideration of the legal, regulatory, and financial risks inherent to that model.

Our primary cause for concern stems from the wide-ranging public discussion addressing the Proposal at the open meeting. Viewed in the best light, this discussion, as well as the related statements by Commissioners, both supporting and dissenting, gave a confused and mixed message as to the impetus for the Proposal. Viewed in the worst light, the discussion and statements intimated that the Commission believes the Proposal is a necessary step to address a direct-to-retail leveraged model. If the driving rationale here is in fact to facilitate that model, there are significant statutory and regulatory issues that would need to be addressed. And even if the statutory questions could be adequately answered, it would in our view be incumbent on the Commission to construct an entirely new, comprehensive set of regulations to govern any prospective direct-to-retail leveraged model.

The Commission is well aware that many across the industry, including CME Group, voiced serious questions and concerns about permitting any direct-to-retail leveraged model in the context of the FTX application debate.[2] We assume that the Commission recognizes the significance of such a sea change to established market structure and protections, which is exactly why it conducted a public roundtable to solicit industry views, feedback and concerns, in addition to an extensive public comment period to gather written feedback. The events of November 2022 both mooted FTX's application and demonstrated the dangers of overhauling a well-established and time-tested regulatory framework without careful consideration.

We appreciate that the Commission has approved non-intermediated, *fully collateralized* DCOs. Further, some DCOs, such as CME Clearing, do have non-FCM clearing members who meet their standard clearing membership requirements today. Of course, there are critical distinctions between fully collateralized models and direct clearing at CME Clearing by institutions subject to the full panoply of CME Clearing membership rules. For example, CME Clearing's direct clearing members are subject to a whole host of clearing membership requirements, including with respect to financial resources (e.g., minimum capital requirements), reporting, and risk management practices consistent with those clearing members who operate as registered FCMs.

To avoid marketplace confusion, further clarity regarding the Commission's policy goals for the Proposal is critical. If the Commission's intention with the Proposal is to address considerations related to a direct-to-retail leveraged model, then a thorough analysis of whether such a model is appropriate or even permitted under current laws must be the first step. And if the Commission determines to proceed from there, a comprehensive set of rules to govern the new model would be required. If, on the other hand, the Commission's intention is merely to shore up protections in existing DCO models, then it should clearly signal that intention and more clearly explain what practices and procedures need enhancement.

II. Specific Comments

We are concerned that the Proposal does not appropriately recognize the differing roles of DCOs and FCMs in centrally cleared derivatives markets. In contrast to FCMs, a DCO does not carry any directional exposure. The aggregate positions cleared by a DCO are inherently flat. These unique characteristics warrant a special approach to CFTC regulation of a DCO. Given the inherent differences between these two types of registrants, the Commission should not attempt to transplant wholesale concepts that make sense for an FCM to the business of a DCO. Instead, we urge the Commission to engage directly with U.S. DCOs to ensure any final rule appropriately recognizes their unique risk management model.

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[2] CME Group, Letter to the CFTC on the Request for Comment on FTX Request for Amended DCO Registration Order (May 2022), *available at* **https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=33621**.

Along these lines, we offer the following more specific suggestions and requests for clarification as areas for future engagement:

- Written Acknowledgement Letters from Depositories – Proposed CFTC Regulation 39.15(f)(2):

  Accounts at Depositories other than the Federal Reserve Bank

  While CME Group supports the proposal to require a DCO to obtain a written acknowledgement letter from any depository holding proprietary funds, consistent with the current customer funds template letter in CFTC Regulation 1.20, some modifications are warranted considering the risk management practices employed by a DCO.

  As part of its preparation for addressing a liquidity event, CME Clearing holds dedicated proprietary funds securities accounts ("Liquidity Accounts") at its custodian banks for the limited purpose of pledging non-cash collateral to its syndicated liquidity facility. This practice allows for a lien to attach to collateral in favor of the collateral agent on behalf of the relevant syndicate. The Proposal's template written acknowledgement letter between DCO and a bank, if applied to a Liquidity Account, only allows for recovery of funds by that bank where the account resides. However, collateral pledged to CME Clearing's liquidity facility is used to secure funds received from multiple lending banks in the syndicate. Therefore, the template written acknowledgment letter for proprietary funds should contemplate a multi-lender scenario.

  To address the above considerations, as well as other discrete practices DCOs may employ to manage their risks, Commission staff before adopting final rules should collaborate with U.S. DCOs to develop a template acknowledgement letter for proprietary funds which accounts for all DCO risk management practices.

  Federal Reserve Bank Accounts

  As the Commission is no doubt aware, CME Clearing provides legal analysis to its bank and bank-affiliated clearing members that sets forth how funds held by CME are "bankruptcy remote" for the purpose of cleared transactions and as required by U.S. banking regulators in connection with the implementation of the international framework recommended by the Basel Committee on Banking Supervision for risk-based and leverage capital requirements for banking organizations. CME Group appreciates the constructive working and regulatory relationship it maintains with the Federal Reserve Bank ("FRB") as a SIFMU. We understand and appreciate why the FRB is not required to provide the same form acknowledgment letter as commercial banks as discussed in the Proposal. However, it would strengthen CME Clearing's bankruptcy remoteness analysis if the FRB were subject to the acknowledgment requirement for money center central banks under proposed CFTC Regulation 39.15(f)(2)(vi)(A), which would require such banks to acknowledge that they were "informed that the proprietary funds deposited therein are those of clearing members who trade commodities, options, swaps, and other products . . . ".

- Commingling of Proprietary Funds – Proposed CFTC Regulation 39.15(f)(3):

  CME Group supports that the Proposal permits a DCO to commingle proprietary funds belonging to multiple clearing members in a single account at a depository. However, the Commission should consider certain amendments to proposed CFTC Regulation 39.15(f)(3)(ii) to account for certain limited circumstances where proprietary funds may be commingled with a DCO's own funds for day-to-day operations for a short period of time. For example, in the normal course, certain depository accounts may be credited with interest income or coupon payments, a portion of which may belong to the DCO, with the remainder belonging to clearing members. Therefore, the Commission should amend proposed CFTC Regulation 39.15(f)(3) to permit DCO funds arising from normal course of operations events to be commingled and recognized as reconciling items under proposed CFTC Regulation 39.15(g)'s daily reconciliation requirements.

- Limitation on Use of Proprietary Funds – Proposed CFTC Regulation 39.15(f)(4):

  CME Group appreciates the recognition under proposed CFTC Regulation 39.15(f)(4) that in limited circumstances a DCO may use the proprietary funds of its clearing members consistent with its rules. However, CME Group is concerned that proposed CFTC Regulation 39.15(f)(4)(i) as drafted may be misinterpreted to limit a DCO's use of these funds consistent with its rules, which would be contrary to the Commission's statement that it "does not intend for this requirement to interfere with or alter DCOs' risk management programs." Therefore, CME Group recommends that the Commission clarify that it is permissible for a DCO to use proprietary funds in accordance with a DCO's rules and in a manner consistent with the policy goals of the Proposal.

- Daily Reconciliation – Proposed CFTC Regulation 39.15(g):

  The Proposal would require a DCO to calculate the amount of funds owed to its clearing members per account class and reconcile this with the funds held across all depositories, per account class. The objective of the Proposal is to ensure that the funds posted to a DCO by its clearing members are kept separate from CME's own funds and tracked accordingly. For a number of reasons, including the distinction between initial margin and settlement variation at the DCO level, simply applying the FCM approach to reconciliation is not feasible for DCOs. To ensure the Proposal is fit for purpose, we urge Commission staff to work with DCOs on this highly technical requirement as a next step to ensure that any final rule appropriately recognizes the differing roles and risk management practices of FCMs and DCOs.

- Permitted Investments – CFTC Regulation 39.15(c):

  CME Group supports that the Proposal conforms the permitted investments of a clearing member's proprietary funds with those under CFTC Regulation 1.25 for customer funds. CME Group also supports that the Proposal specifies that a DCO is responsible for any investment losses, regardless of their account class, consistent with our past public statements on this topic. However, as discussed above, CME Clearing provides to its bank-owned clearing members and customers that are bank or bank affiliates a bankruptcy remoteness legal memorandum, an important part of which relies on CME Clearing being able to demonstrate that it does not commingle its own funds with the initial margin deposits of customers or clearing members.

  Therefore, while CME Clearing acknowledges its responsibility for such investment losses as set forth in proposed CFTC Regulation 39.15(c), CME Clearing asks for clarification that any short-term deficiency in a clearing member account caused by losses on investments of clearing member margin will not result in CME Clearing being deemed to be in violation of any reconciliation requirement or trigger a notice requirement if CME Clearing covers any investment losses from one of its own accounts that does not contain clearing member margin funds.

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III. Conclusion

As explained above, we think it is important for the Commission to provide further clarity regarding its rationale for introducing the Proposal. Further, given the highly technical and prescriptive nature of the Proposal, CME Group believes that CFTC staff would benefit from more engagement with U.S. DCOs to ensure any final rule appropriately recognizes that the risk management model of DCOs is unique and thus necessitates an approach that is different from the rules applicable to FCMs.

CME Group thanks the Commission for the opportunity to comment on this matter. We would be happy to discuss any of these issues with the Commission or Commission staff. If you have any comments or questions, please contact me at (312) 930-2324 or via email at **Jonathan.Marcus@cmegroup.com**.

Sincerely,

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