CME Group

May 1, 2013

The Honorable Debbie Stabenow
Chairwoman
Committee on Agriculture, Nutrition and Forestry
United States Senate
328A Russell Senate Office Building
Washington, D.C. 20510

The Honorable Thad Cochran
Ranking Member
Committee on Agriculture, Nutrition and Forestry
United States Senate
328A Russell Senate Office Building
Washington, D.C. 20510

Dear Chairwoman Stabenow and Ranking Member Cochran:

Thank you for the opportunity to share CME Group's[1] recommendations relating to the reauthorization of the Commodity Futures Trading Commission ("CFTC"). We agree that this reauthorization comes during an important and challenging time for the industry as businesses that are dependent on the financial services sector for pricing information, hedging and other forms of risk mitigation are being hit by major costs in trying to adapt to new regulatory systems promulgated by U.S. and foreign regulators. We applaud your leadership in ensuring that the CFTC focuses its efforts on enhancing the safety and soundness of derivatives trading and clearing markets, making certain that the massive set of new regulations are both internally consistent and consistent with the Dodd-Frank Act ("DFA"), evaluating the costs and benefits of this new regulatory regime, and preserving the U.S. competitive stance in the global financial marketplace.

Our recommendations to the Committee focus on the following primary areas of concern: Implementation of the DFA, which unfortunately has led to confusion and unwarranted expense for

[1] CME Group Inc. is the holding company for four exchanges, 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") (collectively, the "CME Group Exchanges"). The CME Group Exchanges offer a wide range of benchmark products across all major asset classes, including derivatives based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. The CME Group Exchanges serve the hedging, risk management, and trading needs of our global customer base by facilitating transactions through the CME Group Globex electronic trading platform, our open outcry trading facilities in New York and Chicago, and through privately negotiated transactions subject to exchange rules.

market participants; evolution of the derivatives markets post DFA and misplaced concerns regarding "futurization"; appropriate funding of the agency; and efforts to strengthen customer protection and confidence in the derivatives markets post MF Global and Peregrine.

DFA Rulemaking and Implementation

The CFTC sought public comment over two years ago regarding the logical sequencing of DFA rules. Despite substantial public comment, the agency has implemented rules in an illogical and at times haphazard manner, leading to unnecessary cost and confusion for market participants. For example, the CFTC adopted many substantive rules before deciding what a swap is, who is a U.S. Person, and even who must register as a swap dealer. Compounding the unnatural flow of rulemakings, much of the rule set adopted by the CFTC was not – and still is not – clear. Through these two factors, the CFTC rules have chilled activity in certain markets and stymied businesses that rely on derivative markets to manage risk.

Throughout this process, the Commission has also developed a habit of waiting until the last minute to provide no-action or delayed compliance relief for market participants. The relief is welcome, but the timing is very disruptive to our customers that are making every effort to comply with the CFTC's new rules. Further, this approach has eroded the highly successful principles-based regulatory system at the heart of the Commodity Exchange Act ("CEA") in favor of a highly prescriptive regulatory model that was neither authorized nor envisioned by Congress when enacting DFA. We urge the Committee to ensure that the Commission implements DFA with greater clarity and guidance for market participants, including specifically with respect to the pending compliance, recordkeeping, and reporting requirements.

Evolution of the Derivatives Markets Post-DFA and "Futurization"

One of the fundamental purposes of the DFA was to respond to the financial crisis of 2008 by bringing regulatory oversight to the previously unregulated and opaque swaps market. The DFA accomplished this through two primary changes to the swaps market: (1) centralized clearing, to reduce systemic risk; and (2) reporting and trading on regulated platforms, to provide transparency. These policies mirror, in many ways, the regulatory structure under which the U.S. futures markets have operated for many decades.

Recently, some have claimed that marketplace choice between the trading of swaps versus futures is being driven by regulatory arbitrage, specifically with respect to margin rules that apply to swaps and futures. These claims about "futurization" fail to recognize that while many of the new swap regulations are similar to the regulations that are currently imposed on futures markets, swap regulations also reflect key differences between swaps and futures: (1) the different risk characteristics of futures and swaps and (2) the different manner in which futures and swaps have traded to date, which directly affects the risk characteristics of each.

Futures are standardized, cleared, and offered for trading in open and competitive centralized markets. Swaps have historically been more customized and predominantly traded bilaterally on OTC dealer markets. While under DFA certain swaps are required to be cleared and traded on a new type of regulated platform, the swap execution facility ("SEF"), SEFs are not required to offer open and competitive centralized markets. Also, unlike futures, there is an end-user exemption for swaps, which allows this important customer base to continue such trades OTC and uncleared.

Margin requirements permit the clearing house that is clearing a contract to mitigate the risk attendant to that specific contract. CFTC rules set a floor for the amount of initial margin that clearinghouses must collect. At CME Group, margin is determined by risk management policies and procedures designed to account for the actual risk profile of the product, not its label as a swap or a future. In fact, many of our futures products require initial margin in excess of the CFTC's regulatory floor.

It is consistent with the risk mitigation objectives of DFA to ensure that margin requirements be tailored to address the risk characteristics of different contracts. Market participants will continue to use both customizable swaps and standardized futures products. Innovation, competition and customer choice among well-regulated markets is not only a positive development for customers and the public as a whole, but is entirely consistent with the goals of DFA.

Agency Funding

With the passage of the DFA, the CFTC's jurisdiction greatly expanded to cover most of the previously unregulated OTC swap market. We support adequate funding for the CFTC, particularly in light of the agency's new jurisdictional reach. However, the manner by which the CFTC is funded does not need to change in order to ensure that it has the resources it needs to carry out its mission, including completing the rulemakings necessary to fully implement DFA. Further, the CFTC must be accountable for ensuring appropriated resources are not misallocated by, among other things, promulgating rules that are either unnecessary or not supported by an adequate cost benefit analysis.

The Administration's FY-2014 Budget proposes to increase the Commodity Futures Trading Commission's budget by $109 million to $315 million and to fund the entire amount with a "user fee" levied on futures and derivatives trades. Such a "user fee" will impose a $315 million per year transaction tax on market makers resulting in reduced liquidity, increased volatility, and less efficient use of U.S. futures markets. Less liquid and more volatile futures markets will result in increased costs for market participants. It will make it more difficult and expensive for farmers, ranchers, and other end users to hedge commodity price risk in the market. This will force farmers and other market participants to pass along these higher costs to consumers in the form of higher food prices. A $315 million tax on U.S. derivatives markets will also fail to actually collect the funds anticipated when market participants choose lower cost alternative jurisdictions and markets. For all of these reasons, Congress should reject a transaction tax to fund the CFTC.

Strengthening Customer Protection

Industry Safeguards

Customer protection is the cornerstone of the futures industry. In the wake of the unprecedented failures of MF Global and Peregrine Financial, CME Group, together with the National Futures Association ("NFA") and other U.S. futures exchanges have implemented new rules and procedures to strengthen the protection of customer property (and its investment) at the FCM through strict and regular reporting and on-line access to customers' balances at banks and other depositories. Timely access to this additional information is enabling us to better direct our regulatory resources at risk-based reviews of customer balances at clearing members and FCMs and their activity with respect to those balances. Our efforts to enhance our monitoring continue today through the use of an account balance aggregation tool supplied by a third-party service provider.

Moreover, the CFTC has recently proposed additional rules on customer protection that include provisions codifying these initiatives, which we strongly support. However, this rulemaking also seeks to fundamentally change the way in which the futures marketplace operates. The industry is conducting an impact analysis of these rules, as they could have a very significant impact on certain sectors in the marketplace, particularly smaller FCMs that serve the agricultural sector. We have urged the CFTC to allow the industry to complete this impact analysis before proceeding further with the rulemaking process.

Bankruptcy Code Improvements

In addition to the above-mentioned measures, we believe that Congress could further enhance customer protections through amendments to the Bankruptcy Code that would mitigate problems encountered in the MF Global bankruptcy. Potential amendments range from fundamental changes that would facilitate individual segregation of customer property to narrower revisions that would enhance a clearinghouse's ability to promptly transfer positions of non-defaulting customers, thereby reducing the risk that another customer's default or mishandling of customer funds by the FCM impairs customers' risk management activities. While amending the Bankruptcy Code is a significant undertaking, CME Group believes that modification to the bankruptcy regime in light of recent experience would benefit customers and the market as a whole.

Insurance for Futures

In the wake of MF Global and Peregrine Financial, some have advocated establishing an insurance scheme to protect futures customers. As we have testified before, such a fund would certainly boost confidence. However, any such proposal must be analyzed in light of the costs and potentially limited efficacy of such an approach due the extraordinarily large amount of funds held in U.S. segregation.

The futures industry, led by the Futures Industry Association ("FIA")[2], is researching various futures insurance mechanisms in order to provide a quantitative, data-based analysis that will enable policymakers and market participants to determine whether an insurance scheme would be viable.

Thank you again for the opportunity to share our recommendations relating to the CFTC's reauthorization as well as our views on a few of the significant issues facing our industry during this critical time of market evolution. As Congress considers reauthorization of the CFTC, we urge the Committee to continue its strong oversight of the CFTC's implementation of DFA and regulation of futures and derivatives markets. We look forward to working with the Committee during this process.

Sincerely,

Terrence A. Duffy

[2] CME Group, the Institute for Financial Markets ("IFM") and the National Futures Association ("NFA") are also sponsoring the study.