cme
Chicago Mercantile Exchange

Craig S. Donohue
Chief Executive Officer

20 South Wacker Drive
Chicago, IL 60606-7499
www.cme.com

312/930.8275 *tel*
312/930.3209 *fax*

March 14, 2007

VIA ELECTRONIC DELIVERY

Ms. Jennifer Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, N.W.
Washington DC 20551

Re: Docket No. OP-1257; Consultation Paper on Intraday Liquidity Management and Payment System Risk Policy

Dear Ms. Johnson:

The Chicago Mercantile Exchange Inc. ("CME") welcomes the opportunity to comment upon the Board of Governors of the Federal Reserve System's (the "Board") consultation paper on intra-trading day liquidity management and payment system risk ("PSR") policy (the "Consultation Paper").

CME is the largest and most diverse financial exchange in the United States. As an international marketplace, CME brings together buyers and sellers on its CME Globex electronic trading platform and trading floors. CME offers futures and options on futures primarily in four product areas: interest rates, stock indexes, foreign exchange and commodities. CME is also the largest derivatives clearing organization in the world. In 2006, the CME Clearing House cleared more than 1.3 billion contracts, which represents 90% of all futures and options contracts traded on U.S. designated contract markets. While maintaining an average of $47 billion of performance bond collateral, we move approximately $1.6 billion up to $8.4 billion in daily settlement variation payments among market participants, depending upon market activity. We believe that CME's substantial experience and leadership in clearing and risk management will benefit the Board with respect to the Consultation Paper.

According to the Consultation Paper, the Board seeks information from interested parties on their experience in managing intra-trading day liquidity, credit, and operational risks associated with Fedwire fund transfers and associated transactions. Notably, the Consultation Paper examines the significant increase in larger late-in-the-day payments and finds that the "combined effect of depository institutions' intra-trading day liquidity management strategies, coupled with other factors, has been to shift the sending of larger Fedwire payments to later in the day. From an operational risk perspective, delaying the sending of large payments until late in the day increases the potential magnitude of liquidity dislocation and risk in the financial industry if late-in-the-day operational disruptions should occur." 71 Fed. Reg. 35680. At the same time, the Board recognizes the "gridlock" that late-in-the-day payments cause, in which institutions wait for each other to send payments in order to obtain intraday funding and limit their daylight overdrafts. 71 Fed. Reg. 35682. Such a gridlock, the Board notes, may raise systemic risk concerns.

CME shares the Board's concerns. Since the Board implemented changes to its intra-trading day liquidity policies, particularly with respect to imposing a charge for daylight overdrafts, CME has observed an increasing tendency for banks to withhold large-value payments until the end of the Fedwire day. Such payment strategies, while reducing the banks' level of daylight credit, could place a significant strain on the financial system, particularly in the event of a liquidity crisis. We thus join the Board in recognizing that a potential issue could arise.

To address the issue, CME believes that the Board should strive to create incentives to deter late-in-the-day payments. Creating the appropriate economic incentives is likely to encourage the timely movement of payments without imposing unnecessary and potentially burdensome regulation. In this respect, we believe that CME's financial safeguard system offers helpful insights into the resolution of late-in-the-day settlement payments.

As you know, CME's financial safeguard system is designed for the protection of the clearing members and their customers. The structure of the financial safeguard system averts liquidity settlement risk through the use of approved settlement banks to transfer funds held by the settlement bank for the account of the CME clearing member. This settlement bank financial safeguard structure operates pursuant to established contractual arrangements and permits the CME Clearing House to easily access funds.

Moreover, CME's financial safeguard system settlement procedures provide for the routine transfer of funds in both the morning and afternoon, with specific authority to implement non-routine settlement procedures when market conditions warrant. The afternoon settlement procedure is designed to result in an intra-trading day transfer of funds that covers approximately fifty to sixty percent of that trading day's market exposure. Additionally, the clearing fund financial resources of approximately $4.5 billion, bolstered by a temporary liquidity facility of $800 million—which is expandable to $1 billion—are available to meet liquidity requirements.

The risk management and financial surveillance techniques employed by CME Clearing House are designed to:

- Anticipate potential market exposures;
- Ensure that sufficient resources are available to cover future obligations;
- Result in the prompt detection of financial and operational weaknesses;
- Allow swift and appropriate action to be taken to rectify any financial problems and protect the clearing system; and
- Prevent the accumulation of losses.[1]

CME's financial safeguard system has withstood periods of tremendous volatility in the financial markets. However, in an effort to improve further the safety and soundness of the financial system, CME encourages the Board to consider the following changes to its intra-day liquidity policy:

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[1] These techniques are consistent with risk management recommendations by the CPSS/IOSCO Task Force on Securities Settlement Systems and the Group of Thirty.

1. The Board should consider implementing a risk-based fee model where participants that increase the systemic risk in the "payment system" are charged higher overdraft fees, while those who reduce systemic risk via timely payments are eligible for reduced rates or credits. Thus, those banks that continue to bunch their large value payments late in the day would be subject to a higher fee structure.

2. The Board should consider a two-tiered pricing policy for daylight overdrafts, with one rate for uncollateralized overdrafts and another, lower rate, for collateralized drafts. Increasing the use of collateral to cover daylight overdrafts could, as the Board notes, lower the overall cost of daylight overdrafts, reduce credit risk to the Federal Reserve Banks, and provide the Board with a more flexible means to address the impact of future stresses in the financial system on the availability of intraday balances through the daylight overdraft process.

3. The Board should consider adopting throughput requirements, as CME does, where a certain percentage of a member's payments (on average) are required to be paid at a regular time (e.g., 10:00 a.m. EST), another percentage by noon, and so on. Much like CME's procedure of multiple settlement cycles, and specifically CME's afternoon settlement cycle, these mandates would automatically reduce the operational and credit risks inherent in the system, at prescribed times. A variation of the foregoing requirement might involve adopting throughput requirements in conjunction with brief periodic synchronization periods during which banks may be willing to send large value payments if they had some realistic expectation that they would also receive large value payments. At the same time, the Board should consider reducing the maximum payment size allowed by the Fedwire. With a lower maximum, smaller and more frequent payments are likely to occur. While the total amount of total transactions processed will increase, these frequent payments will "prime the pump," promote timely payments, and prevent payment gridlock.

Ultimately, we believe that market-based refinements to the Board's intraday liquidity policy, as discussed above, will further bolster the strength of the U.S. financial system. If you have questions concerning this letter, please contact Kim Taylor, President of CME Clearing House, at (312) 930-3156.

Respectfully submitted,

Craig S. Donohue