



May 3, 2012

Robert deV. Frierson, Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, DC 20551
regs.comments@federalreserve.gov

Re: Regulation HH: Financial Market Utilities
78 Fed. Reg. 14024 (March 4, 2013), Docket No. R-1455 and RIN No. 7100-AD 94

Dear Mr. deV. Frierson:

CME Group Inc. ("CME Group"), on behalf of the Chicago Mercantile Exchange Inc. ("CME Inc.") clearing house division ("CME Clearing" or "CME") appreciates the opportunity to comment on the notice of proposed rulemaking ("NPR") implementing Sections 806(a) and 806(c) of the Dodd Frank Act ("DFA") issued by the Board of Governors of the Federal Reserve System ("Board"). CME Group commends the Board and Board staff for the timely release of this NPR. Section 806(a) of DFA authorizes a Federal Reserve Bank to establish and maintain an account for, and provide certain financial services to, financial market utilities ("FMUs") designated systemically important by the Financial Stability Oversight Council ("FSOC"). Section 806(c) of DFA permits Reserve Banks to pay interest on balances maintained in such accounts. The implementation of both of these sections is to be effected by amending Part 234 of Title 12 of the Code of Federal Regulations or Regulation HH.¹

CME Group is the parent of CME Inc. CME Clearing is one of the largest central counterparty ("CCP") clearing services for regulated derivatives contracts, and is registered with the Commodity Futures Trading Commission ("CFTC") as a derivatives clearing organization ("DCO") and a registered clearing agency with the Securities and Exchange Commission. CME offers clearing and settlement services for exchange-traded derivatives contracts and for over-the-counter ("OTC") derivatives transactions, including interest rate swaps, credit default swaps, agricultural swaps, and other OTC contracts. On July 18, 2012, FSOC designated CME Inc. as a systemically important FMU (each such entity, a "designated FMU").

¹ Establishment and maintenance of accounts with Federal Reserve Banks is to be authorized under section 13 of the Federal Reserve Act and the services provided to designated FMUs would be those listed in section 11A(b) of the Federal Reserve Act.

I. Overview

CME Group acknowledges the overall goals of section 806 of DFA and its various subparts. Enabling designated FMUs to have direct access to Federal Reserve Bank account services has the potential to advance a number of objectives of macro-prudential policy reforms targeting the mitigation of possible systemic risks by promoting safe and sound clearing and settlement systems. This access, along with the payment of interest on the balances that designated FMUs maintain in their Federal Reserve Bank accounts, should improve the efficiency and effectiveness of CCP services and activities with positive impacts on the costs and range of services offered to CCP members and end-users.

CME Clearing has a long-standing and time-tested business model of utilizing commercial banks for payment, settlement, securities safekeeping and other transaction services and expects to continue using key elements of this established model in the future. This model proved sufficient during the 2008 – 2010 financial crisis. As a result, CME Clearing foresees its future use of the Federal Reserve Bank accounts and services covered in the NPR as a complement to, rather than a replacement of, its existing operating business model. Access to Federal Reserve Bank accounts and services will provide additional avenues for designated FMUs to meet the expanding scope for US Dollar (“USD”) denominated account services for centrally cleared products mandated by both U.S. and global regulatory reform efforts.²

In this context, CME Group supports the overall direction of the NPR in implementing Sections 806(a) and 806(c) of DFA. A particularly important and insightful element of the NPR is the Board’s recognition in the preamble that the different organizational structures, operations and business models of designated FMUs will require flexibility in tailoring Board orders and certain parts of account and service agreements for the services accessed by individual designated FMUs. As the Board recognizes, DCOs have an operating model and risk profile than is different from depository institutions that accept deposits and extend loans.

The unique regulatory requirements imposed by an FMU’s Supervisory Agency and how these requirements may impact the manner in which a designated FMU accesses Reserve Bank services will also need to be an important consideration in tailoring Board orders and certain parts of account and service agreements. In particular, some CCPs may require multiple accounts with Federal Reserve Banks in order to comply with various customer segregation requirements of its Supervisory Agency. This necessity may diverge from the existing Board policies and Reserve Bank operating circular requirements and standards imposed on depository institutions.

² CME would like to highlight for the Board that CME processes significant settlement and interbank payments in currencies other than USD.

Although CME Group recognizes the potential positive industry impacts associated with the proposed rule, CME Group requests that certain elements of the NPR's regulatory language or its preamble be revised or clarified to improve the rule's overall effectiveness and applicability for designated FMUs. In particular, the Board should consider the following changes and enhancements to the final rule or the preamble to the final rule.

1. The Board should further define and clarify §234.6(b)(1) of the NPR that requires a designated FMU accessing Federal Reserve Bank services to be, "...in the Federal Reserve Bank's judgment...in generally sound financial condition." In particular, the requirement for determining that a designated FMU is in "generally sound financial condition" should be based solely on the FMU's compliance with the financial and risk management requirements of its Supervisory Agency. At a minimum, the Board should more explicitly identify the types of standards and risk management requirements that will be used by Reserve Banks to judge that a designated FMU is in "generally sound financial condition" under §234.6(b)(1) of the NPR. Such clarification should identify how these standards and expectations would differ from the requirements under §234.6(b)(2) and §234.6(b)(3) that mandate full compliance with the requirements imposed by a designated FMU's Supervisory Agency and the Federal Reserve, respectively.
2. In implementing §234.6(b)(2) of the NPR, the Federal Reserve should call for and rely solely upon the formal attestation from the designated FMU's Supervisory Agency that the FMU is in compliance with that agency's requirements "...regarding financial resources, liquidity, participant default management and other aspects of risk management." Such formal attestations should be used instead of the proposed "...Federal Reserve Bank's judgment." At a minimum, the final rule should clarify and identify the rationale and possible areas where a Federal Reserve Bank's judgment might supersede the judgment and formal attestation of an FMU's Supervisory Agency.
3. The final rule should clarify and identify the standards, considerations, and requirements that designated FMUs must use to "...demonstrate an ongoing ability, including during periods of market stress or a participant default, to meet all of its obligations under its agreement for a Federal Reserve Bank account and services" as required by §234.6(b)(4) of the NPR.

II. Discussion of Issues and Topics Requiring Clarification

A. Need for Tailoring Existing Reserve Bank Account Requirements

Section 234.6(b)(3) of the NPR requires that FMUs be in compliance with “...Federal Reserve Bank operating circulars, and other applicable Federal Reserve requirements regarding the establishment and maintenance of a Reserve Bank account and the receipt of financial services from a Reserve Bank.” As the Board recognizes, in some cases Board orders for granting certain types of FMUs access to Federal Reserve Bank services may need to be tailored in a manner different than existing provisions applied to depository institutions.

For example, Federal Reserve Bank Operating Circular 1 (“OC1”) stipulates that a financial institution may maintain only one Master Account with its Administrative Reserve Bank.³ However, due to customer segregation rules of Supervisory Agencies, some designated FMUs, including CME Inc., will need ongoing multiple Federal Reserve Accounts in manners different from depository institutions. FMUs utilizing book entry and securities transferring services and collateral management services may also need multiple accounts for the same reason.

In particular, current CFTC regulations adopted under the Commodity Exchange Act (“CEA”) require DCOs to strictly segregate cleared swaps customer funds and futures customer funds from house/proprietary funds.⁴ As a result of these regulatory requirements, CME Inc. is expected to require the following accounts with its Administrative Reserve Bank:

1. Proprietary / House Account – to service house/proprietary performance bond assets (i.e., trading margin), in accordance with CFTC Regulation 1.3(y);
2. Futures Customer Segregated Account – for futures customer segregated performance bond assets as required by section 4d(a) of CEA;
3. Cleared Swaps Customer Segregated Account – for cleared swaps customer segregated performance bond assets, as required by section 4d(f) of CEA; and

³ Federal Reserve Banks Operating Circular 1, Account Relationships, Effective February 1, 2013, p.3.

⁴ Section 4d(a)(2) of the CEA requires each FCM to segregate from its own assets all money, securities and other property deposited by futures customers to margin, secure, or guarantee futures contracts and options on futures contracts traded on designated contract markets. Section 4d(a)(2) also requires an FCM to treat and deal with futures customer funds as belonging to the futures customer, and prohibits an FCM from using the funds deposited by a futures customer to margin or extend credit to any person other than the futures customer that deposited the funds. Section 724(a) of DFA added Section 4d(f) to the CEA, which requires each FCM to segregate from its own assets all money, securities and other property deposited by Cleared Swaps Customers to margin transactions in Cleared Swaps. While these regulations are directly applicable to FCMs, section 4d(b) of the CEA extends account segregation requirements to clearing agencies. In addition, Section 39.15(b) of the CFTC’s DCO General Provisions and Core Principles states, “a derivatives clearing organization must comply with the applicable segregation requirements of section 4d of the Act and Commission regulations thereunder, or any other applicable Commission regulation or order requiring that customer funds and assets be segregated, set aside, or held in a separate account.”

4. Default/Reserve Account – for financial safeguard deposits, membership deposits and operating cost reserves and other similar assets⁵.

To effectively implement customer accounts, Administrative Reserve Banks may need to sign customized segregation acknowledgement letters with the designated FMU as required by CFTC regulations.⁶ Additionally, the account documentation will need to acknowledge no inter-account right of setoff.

B. Clarification of the term “generally sound financial condition

Section 234.6(b)(1) of the NPR requires a designated FMU to be deemed in “...generally sound financial condition” in the judgment of its Administrative Reserve Bank’s in order to “...establish and maintain an account with a Federal Reserve Bank or receive financial services from a Reserve Bank...” CME Group agrees with the Board on the need for designated FMUs to be in generally sound financial condition. It also recognizes the importance of strict financial safeguards in mitigating risks to Reserve Banks providing services through their accounts and in minimizing the potential systemic risk associated with possible financial difficulties experienced by a major FMU. Accordingly, it has worked cooperatively with its Supervisory Agency and self regulatory organizations (“SROs”) on establishing appropriate controls and standards through ongoing dialogue and participation in the comment process of public rulemakings.

However, the preamble of the proposed rule includes only high level, summary and qualitative statements of the expectations surrounding the criteria that constitutes “generally sound financial condition.” These include the need for an FMU to “...maintain adequate capital to support its ongoing operations and absorb reasonable business losses and have sufficient operating revenue and working capital to cover its actual and projected operating expenses, giving due regard to the economic conditions and circumstances in the market in which the designated FMU operates.” Moreover, the preamble calls for such resources to be “separate and in addition to resources held to cover participant defaults that may arise through a designated FMU’s payment, clearing, or settlement activities.”

It is uncertain as to the need for such general judgmental assessments in light of the requirements specified in sections §234.6(b)(2) and §234.6(b)(3) of the NPR. Section 234.6(b)(2) mandates full compliance with requirements imposed by a designated FMU’s “...Supervisory Agency regarding financial resources, liquidity, participant default management and other aspects of risk management.” Section 234.6(b)(3) requires compliance with Board

⁵ CFTC Regulation 39.11(a)(2) requires each DCO to maintain financial resources sufficient to cover at least one year’s operating costs calculated on a rolling basis.

⁶ CFTC Regulation 1.20(b) requires a clearing organization to retain a written acknowledgment from a depository that it was informed that the customer funds deposited therein are those of customers and are held in accordance with the Act and the CFTC Regulations

orders and policies, Federal Reserve Bank operating circulars, and other applicable Federal Reserve requirements regarding the maintenance of an account at a Federal Reserve Bank and the receipt of Federal Reserve Bank services.

The requirements of an FMU's Supervisory Agency already include capital standards, operating requirements, and various risk management practices. For example, the CFTC issued a DCO General Provisions and Core Principles final rule in November 2011 which mandates that a DCO "maintain sufficient financial resources to meet its financial obligations to its clearing members notwithstanding a default by the clearing member creating the largest financial exposure for the DCO in extreme but plausible market conditions, and...maintain sufficient financial resources to cover its operating costs for at least one year, calculated on a rolling basis."⁷ Moreover, the Federal Reserve has its own complement of policies, standards and requirements for ensuring the financial integrity of the entities utilizing its accounts and services.

In addition, existing policies, regulations and requirements of both primary Supervisory Agencies and the Federal Reserve regarding access to its accounts and services are subject to ongoing change and updating. Such changes can arise from the introduction of new and the revision of existing U.S. laws and regulations, as well as international standards. For example, it is expected that the international Principles for Financial Market Infrastructures jointly issued by the Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions ("CPSS-IOSCO") in April 2012 will be incorporated in CFTC, SEC and Federal Reserve regulations and requirements in the near future. Finally FMUs have their own internal risk management operating policies and procedures above and beyond regulatory requirements.⁸

FMUs are thus already subject to operating their businesses under multiple regulatory and internal risk management requirements that promote the general safety and soundness of the organization. Separate additional language codifying the broad requirement of "generally sound financial condition" subject to Federal Reserve Bank judgment introduces unnecessary additional regulatory uncertainty and has the potential to reduce operational efficiencies at

⁷ CFTC Regulation 39.11(a); 76 Federal Register 69344.

⁸ For example, CME Group dedicates considerable time and resources to limiting the potential impact associated with potential market disruptions. Upon applying to become a clearing member at a CME exchange, applicants must submit to a meticulous screening, including a detailed review of financial health, operational performance, risk management infrastructure, and disciplinary history. For all current members, CME Group performs real-time monitoring at both the clearing firm and account level 24 hours a day, 6 days a week to observe position and exposure levels. Through the use of performance bonds (good faith deposits by customers to guarantee performance on open positions), CME Group seeks to cover 99% of possible market volatility. Cash mark-to-market is performed daily to prevent the accumulation of losses. Each business day, CME Group performs two full settlement cycles for futures and one full cycle for OTC positions in order to eliminate accumulated debt and stabilize markets cleared at our exchanges. CME Group considers its rigorous, time-tested risk management system as offering extensive protection from potential market disruption, and this approach is subject to regular regulatory review that appropriate safeguards are in place.

designated FMUs.⁹ Given the above, this duplicative requirement could be eliminated or revised in the final rulemaking such that the determination of “...generally sound financial condition” be based solely on the information provided by the FMU’s Supervisory Agency as currently set forth in proposed 234.6(b).

If this requirement is to be retained in the final rule, the Federal Reserve should offer more tangible expectations and requirements that, in a Reserve Bank’s judgment, would define the term “generally sound financial condition.” In order to comply with the high-level supervisory expectations articulated in the NPR, designated FMUs will need more clarity on the specific criteria to be used in these judgmental assessments. Therefore, the Board should, at a minimum, more formally clarify such expectations in the preamble of the final rule. Such clarification should identify how these standards and expectations would differ with the requirements under §234.6(b)(2) of the NPR. This clarification should also identify how the standards and expectations used to determine the “generally sound financial condition” of a designated FMU would differ with the requirements under §234.6(b)(3) of the NPR.

C. Federal Reserve Judgment of Compliance with Supervisory Agency Rules and Regulations

As mentioned above, §234.6(b)(2) of the NPR requires that a designated FMU must, in the judgment of the Administrative Reserve Bank, be deemed to be in compliance with requirements imposed by the FMU’s “...Supervisory Agency regarding financial resources, liquidity, participant default management and other aspects of risk management.” While such judgments are to be “...based on information provided by the Supervisory Agency”, CME Group questions the need for additional judgment to be imposed by the Federal Reserve on a designated FMU’s compliance with Supervisory Agency rules and regulations above and beyond the opinion of the Supervisory Agency itself. Instead, it would appear sufficient that the Supervisory Agency be required to make an annual attestation to the Federal Reserve Bank of such compliance. Section 805(a)(2) of DFA provides the Federal Reserve the process for remediating any prudential requirements of Supervisory Agencies that it determines are “...insufficient to prevent or mitigate significant liquidity, credit, operational or other risks to the financial markets or to the financial stability of the United States.” Moreover, the Federal Reserve’s responsibilities and powers regarding examinations and enforcement actions in coordination with a Supervisory Agency under Section 807 of DFA, would appear sufficient for ensuring compliance with Supervisory Agency requirements. As a result, CME Group recommends that the final rule require an explicit designation from the Supervisory Agency as evidence of compliance with its rules and requirements instead of imposing the judgment of the Federal Reserve Bank in this determination. Alternatively, should the final rule maintain the Federal Reserve Bank’s judgment of compliance with Supervisory Agency requirements, such

⁹ It is recognized that existing regulatory requirements and expectations as specified by primary regulators and the Federal Reserve’s Payment System Risk Policy are subject to change and updating, which already introduces a measure of regulatory uncertainty and regulatory risk.

final rule should provide clarification on when the Supervisory Agency's attestation is insufficient consistent with Title VIII of Dodd-Frank.

D. Clarification of requirements for demonstrating the ability to meet obligations

Section 234.6(b)(4) of the NPR includes language stating that designated FMUs must demonstrate an ongoing ability to meet its obligations to the Reserve Bank under periods of "...market stress or a participant default." It would be useful for the Federal Reserve to further clarify the criteria and expectations that will be used in assessing the adequacy of this demonstration and how such assessments will be conducted. Similar to the concerns raised above on "generally sound financial condition," the inclusion of this requirement in the final rule without further clarification presents the possibility of a new set of standards being established in parallel to the existing regulatory framework thus substantially increasing regulatory uncertainty and burden for designated FMUs.

III. Conclusion

CME Group would like to thank the Board for the opportunity to provide these comments. The NPR implementing Sections 806(a) and 806(c) of the Dodd Frank Act is a significant step in advancing a number of objectives of macro-prudential policy reforms targeting the safety and soundness of clearing and settlement systems. We would be happy to further discuss and clarify any of the above issues with Board staff. If you have comments or questions regarding this submission, please feel free to contact Kim Taylor, President, CME Clearing by telephone at (312) 930-3156 or by e-mail at kim.taylor@cmegroup.com.

Sincerely,



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