CME Group

**Sunil Cutinho**
President
CME Clearing

**By Electronic Mail**

August 5, 2016

Mr. Robert deV. Frierson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW
Washington DC 20551

**Re: Restrictions on Qualified Financial Contracts of Systemically Important US Banking Organizations, Docket No. R–1538 and RIN No. 7100 AE–52**[1]

Dear Mr. Frierson:

CME Group Inc. ("CME Group") appreciates the opportunity to comment on the Notice of Proposed Rulemaking ("NPR") the Board of Governors of the Federal Reserve System ("Board") has proposed that would place restrictions on the terms of non-cleared qualified financial contracts ("QFCs")[2] entered into by US banking organizations and the US operations of foreign banking organizations that the Board has identified as global systemically important banking organizations ("GSIBs") and such GSIBs subsidiaries (collectively, "covered entities").

CME Group is the parent of four U.S.-based designated contract markets ("DCMs"): Chicago Mercantile Exchange Inc. ("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" 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. CME Group's 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 facilities in New York and Chicago, as well as through privately negotiated transactions. CME Group also operates a swap execution facility as well as a derivatives clearing organization ("CME Clearing") which provides clearing and settlement services for exchange-traded and over-the-counter

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1 81 Fed.Reg. 29169 (May 11, 2016) (the "Proposed Rules")

2 A QFC is defined in section 210(c)(8)(D)(i) of Title II of the Dodd-Frank Act: "The term "qualified financial contract" means any securities contract, commodity contract, forward contract, repurchase agreement, swap agreement, and any similar agreement that the Corporation determines by regulation, resolution, or order to be a qualified financial contract for purposes of this paragraph."

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derivatives transactions. CME Clearing is also a designated financial market utility ("DFMU") under Section 804 of the Dodd-Frank Act and is also a "systemically important derivatives clearing organization" ("SIDCO") subject to oversight by the Commodity Futures Trading Commission ("CFTC").

In order to facilitate orderly resolution of a covered entity, the Proposed Rules set forth certain restrictions for GSIB entities entering into QFCs by requiring the covered parties to ensure that any QFC to which it is a party provides that (a) default rights are limited to those that would exist under Title II off the Dodd-Frank Act and the Federal Deposit Insurance Act and (2) does not allow the counterparty to exercise its default rights against the covered entity based on the resolution proceeding of an affiliated entity. However, the Board has proposed that such requirements would not apply to QFCs that are cleared through a central counterparty ("CCP")[3].

CME Group fully supports the Board's decision to exclude cleared QFCs from the restrictions set out in the proposed rules. CME Clearing functions as a CCP and its activities are generally governed by the Commodity Exchange Act ("CEA") and the regulations of the CFTC promulgated thereunder. CME Clearing's operations are also governed by the U.S. Bankruptcy Code.

Cleared QFCs are currently subject to a comprehensive and tested regulatory regime. As a CCP and SIDCO, CME Clearing is already subject to Section 5b of the CEA ("Core Principles") and Part 39 of the CFTC's rules. Pursuant to these Core Principles, CME Clearing must comply with a number of provisions designed to ensure the CCP has sufficient capital, robust risk management, and liquidity. CME's clearing members acting on behalf of customers are also registered as futures commission merchants ("FCM") under the rules of the CFTC and subject to significant oversight. In addition, all clearing members are subject to CME's Rules.

With respect to a potential default by a clearing member, and CME Clearing's ability to resolve such a default in accordance with CME Rules, including closing out or liquidating open positions, liquidating collateral and/or liquidating or transferring customer positions and collateral, currently there is a high degree of legal certainty that CME Clearing will be able to act under and enforce CME Rules without being subject to stays, or such Rules being voided, or CME Clearing's actions being reversed. This is necessary to maintain a stable and orderly market in the event of a default by a clearing member, whose positions face CME Clearing directly. Any restrictions on CME Clearing's ability to close out a defaulting clearing member's portfolio, including potential liquidation of cleared contracts,, may negatively affect CME Clearing's ability to maintain market integrity and provide for the orderly

[3] The Board defines CCP as: "*Central counterparty (CCP)* means a counterparty (for example, a clearing house) that facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts." 12 CFR § 217.2.

liquidation of such clearing member. CME Clearing acts as the buyer to every seller and seller to every buyer for the contracts cleared on its markets, ensuring that at all times the cumulative positions on its market are risk-neutral. In the event of a clearing member default, this introduces a temporary period where CME Clearing must act to manage that defaulting clearing member's portfolio to reestablish the matched book of the market. This is often done within a few hours of the notification of the clearing member default, and thus the need for a high degree of legal certainty around CME Clearing's ability to enforce its rules quickly, and to manage the default, is a key component to the CME Clearing market, and CCP markets more generally.

Cleared derivatives in the U.S. performed admirably during recent periods of financial stress, including but not limited to the 2008 financial crisis, due to the significant systemic risk benefits that CCP risk management brings to the financial system. CCPs serve as a firewall against the spread of systemic risk, and in addition to their advanced risk management tools such as pre-trade credit controls, at least daily mark-to-market elimination of debt, initial margin requirements and default fund requirements, amongst others, part of the reason for this stability is the CCPs rights to close out the positions of defaulting clearing members without the application of an automatic stay. One of the primary goals espoused in the NPR is to "reduc[e] the damage that such a company's failure would do if it were to occur." CCPs accomplish similar goals and protect their clearing members and market participants, some of which may be GSIBs or GSIB subsidiaries, by applying robust risk management standards and efficiently managing the default of their clearing members in the unlikely event that they fail to meet their obligations. In part, this efficient default management is predicated on the ability to immediately close out the positions of a defaulting clearing member to mitigate the negative impact of their failure on the cleared markets and market participants. Eliminating the power to immediately close out QFCs would undermine the ability of CCPs to serve as a firewall, and undermine the systemic stability benefits they offer while negatively impacting both the non-defaulting clearing members, including GSIB subsidiaries and the broader markets by creating continued uncertainty and preventing the CCP's return to a matched book. Thus, if the restrictions were applicable to cleared QFCs, instead of facilitating orderly resolution of one GSIB, it may put strain on the other GSIBs and non-GSIBs who are participating in the cleared market.

Finally, we note that the U.S. Bankruptcy Code provides specific exceptions to an automatic stay that permit the exercise of certain contractual rights, such as offset, netting out, payment, or transfer obligations by, among others, a DCO reflecting the belief that CCPs must have the authority to close out QFCs to protect the markets which they clear. In fact, the U.S. Bankruptcy Code emphasizes that these specific exceptions to the automatic stay "shall not be stayed by any order of a court or administrative agency in any proceeding" under the U.S. Bankruptcy Code.[4] Furthermore, U.S. courts have recognized that such exceptions to a stay in

[4] See 11 U.S.C. § 362(o).

a bankruptcy proceeding are consistent with legislative intent to avoid systemic harm to clearing regimes and market integrity.

For the above reasons, CME Group believes that cleared QFCs are subject to rigorous regulatory oversight and a measured approach to default and thus concurs with the Board's decision to exempt cleared QFC's from the further restrictions set forth in the Proposed Rules.

We appreciate the opportunity to provide these comments. We would be happy to further discuss and provide any additional information with respect to the matters described herein with Board staff.

If you have questions regarding this letter, please feel free to contact me at (312) 634-1592 or sunil.cutinho@cmegroup.com.

Sincerely,

/s/ Sunil Cutinho
President, CME Clearing