CME Group
A CME/Chicago Board of Trade/NYMEX Company

Via E-Mail (BaselCommittee@bis.org)

16 April, 2010

The Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Re: Consultative Document: *Strengthening the resilience of the banking sector*

Dear Committee Members:

CME Group Inc. ("CME Group"), on behalf of Chicago Mercantile Exchange Inc.'s clearing house division and CME Clearing Europe Ltd. (collectively, the "CME Group CCPs"), would like to express our appreciation to the Basel Committee on Banking Supervision ("Committee") for the opportunity to comment upon its Consultative Document issued on December 17, 2009 on *Strengthening the resilience of the banking sector* ("Consultative Document"). In our view, it is particularly important that the CME Group CCPs and other central counterparties ("CCPs") provide meaningful input to the Committee at a time when crucial decisions on the future of financial regulation are being made. The fact that the Committee on Payment and Settlement Systems ("CPSS") and the International Organization of Securities Commissions ("IOSCO") are reviewing their 2004 *Recommendations for Central Counterparties* for potential enhancements makes this input even more urgent.

The CME Group CCPs recognize the importance of active and thoughtful participation in the debate over the role of CCPs in over-the-counter ("OTC") derivatives markets, and have frequently commented to the regulatory community, both in the U.S. and abroad, on proposals and initiatives related to the role, functions, operation and supervision of CCPs. In this regard, we note our comment letters to the European Commission ("EC"),[1] the U.S. federal banking supervisory agencies,[2] and the Commodity Futures Trading Commission ("CFTC"). We have also provided testimony at hearings in a number of

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[1] *E.g.*, CME Group letter commenting on the EC's Staff Working Paper with respect to possible initiatives to enhance the resilience of OTC derivatives markets, and the "Questions to Stakeholders" contained therein (Aug. 31, 2009).

[2] *E.g.*, Chicago Mercantile Exchange Inc. letter to the Board of Governors of the Federal Reserve System; the Federal Deposit Insurance Corp.; the Office of the Comptroller of the Currency; and the Office of Thrift Supervision; in re: Notice of Proposed Rulemaking; Risk-Based Capital Standards: Advanced Capital Adequacy Framework, 71 Fed. Reg. 55830 (Mar. 6, 2007).

fora, including the hearings of the U.S. Senate Committee on Agriculture.[3]

Our comments herein are limited to Paragraphs 165 through 167 of the Consultative Document relating to CCPs. We are generally supportive of the statements and recommendations contained in these paragraphs, as they are reflective of the Committee's desire to arrive at standards that will assure greater transparency, safety and efficiency in global financial markets - goals to which we remain steadfastly committed.

I. Introduction to CME Group and the CME Group CCPs

CME Group operates four exchanges: Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc., New York Mercantile Exchange, Inc. and Commodity Exchange, Inc. (collectively, the "CME Group Exchanges"). Each of these exchanges is registered with the CFTC as a designated contract market ("DCM").[4] The CME Group Exchanges offer a wide range of benchmark products available across all major asset classes, including futures and options on futures 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 Globex electronic trading platform, open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions.

CME Group also operates the clearing house division of CME, which is one of the largest CCPs in the world, and which provides clearing and settlement services for exchange-traded contracts on CME Group Exchanges, as well as for "cleared-only" OTC derivatives contracts through CME ClearPort. In its capacity as a clearing house, CME is registered with the CFTC as a derivatives clearing organization ("DCO"). In 2009, CME processed and cleared approximately 2.6 billion contracts on behalf of the CME Group Exchanges, with an estimated notional value of 813 trillion dollars (US).

In the U.K., CME is a Recognised Overseas Clearing House, the recognition having been granted by the Financial Services Authority ("FSA"). CME Clearing Europe, Ltd. ("CMECE") has applied to the FSA to operate as a Recognised Clearing House.

II. Comments on Consultative Document

The CME Group CCPs share the Committee's view that the interconnectedness of systemically important institutions was a major contributing factor to the recent global financial crisis. From our perspective, some of the largest financial institutions had become so interconnected with other counterparties that the failure, or even prospective failure, of some of these large counterparties began to threaten the global economy. This, in turn, has focused attention on the significant credit and systemic risk

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[3] *E.g.*, Testimony of Terrence A. Duffy, Executive Chairman of CME Group (Dec. 2, 2009).

[4] CME is also notice-registered with the Securities and Exchange Commission as a special purpose national securities exchange for the purpose of trading securities futures products.

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management benefits that can be achieved by using qualifying CCPs ("QCCPs"),[5] which interpose themselves between buyers and sellers of OTC transactions in order to assume the rights and obligations of both parties and, thus, assure successful completion of OTC transactions even in the event of counterparty default. Indeed, as discussed below, the essential services that financially strong, highly experienced and well-managed CCPs perform can help stabilize the financial sector by (i) better allowing individual institutions to manage their credit risk, and (ii) assisting regulators with managing and containing systemic risk.

The Consultative Document and the Committee's recent *International framework for liquidity risk measurement, standards and monitoring - consultative document,* issued in December 2009, are a comprehensive set of proposals to address and strengthen banks' liquidity and capital standards. We realize that these proposals must be considered in their entirety in order to determine whether, in the aggregate, they could be successful in promoting a more resilient banking sector. We will comment on those paragraphs of the Consultative Document (165, 166 and 167) that most clearly relate to one of the CME Group CCPs' core functions: acting as CCPs for derivatives products.

A. Paragraph 165

Paragraph 165 of the Consultative Document provides:

> Currently, banks' exposures to CCPs generally attract a zero EAD [Exposure At Default]. The changes being proposed by the Committee will reinforce the existing incentive for banks to use CCPs for OTC derivatives as these revisions would increase the assessed capital requirements against such exposures if completed on a bilateral basis (rather than through a CCP).

We note that Basel II is not yet fully implemented in the U.S. Accordingly, U.S. banks cannot currently apply a zero EAD to their bilaterally negotiated derivatives transactions that are cleared by a CCP. However, we believe that Basel II should be fully implemented in the U.S. and that the zero EAD is appropriate for transactions cleared by a QCCP, irrespective of the regulators' desire to hold CCPs to more rigorous standards in the future. Not only does the use of QCCPs in clearing OTC derivatives

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[5] Basel II rules define a "qualifying central counterparty" as:

> . . . a counterparty (for example, a clearinghouse) that:
>
> > (1) Facilitates trades between counterparties in one or more financial markets by either guaranteeing trades or novating contracts;
> > (2) Requires all participants in its arrangements to be fully collateralized on a daily basis; and
> > (3) The bank demonstrates to the satisfaction of [agency] that it is in sound financial condition and is subject to effective oversight by a national supervisory authority.

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transactions allow banking institutions to better assess and manage counterparty risk arising out of individually negotiated OTC derivatives transactions, but the 0% risk weighting also serves as an incentive for derivatives traders and market makers to use the CCPs across market segments and asset classes for clearable transactions.

In this regard, it is important to address an issue that is not specifically raised in the Consultative Document, but which will be an important element of implementing the recommendations contained therein: that is, determining which OTC derivatives transactions are, and can be, cleared by a CCP. Many current regulatory reform proposals would mandate CCP clearing of "standardized" OTC derivatives transactions, with, in some cases, exemptions from this requirement based on the counterparties to the transaction or their reasons for entering into the transaction. We do not believe that all standardized OTC derivatives transactions can or should be cleared by a CCP. Rather, it is critical to distinguish between transactions that are merely standardized,[6] and transactions that are both standardized and clearable.

The CME Group CCPs are proponents of the view that each CCP must, at its discretion and risk judgment, decide which derivatives contracts it will accept for clearing. Only CCPs that interpose themselves contractually in the chain of derivatives transactions can determine whether particular contracts present the risk and default-management profile necessary to be acceptable to central clearing without imposing undue costs on market participants or undue risk on the clearing house and its members. Ultimately, it is up to each CCP to set risk tolerances and determine whether particular transactions fall within that tolerance. It is established best practice for CCPs to have a risk committee comprised of a range of risk specialists, including clearing member firms and independent market participants, and for the terms of reference of such committees to make clear that their focus lies in examining the risk certainty of arrangements and policies designed by risk specialists employed by the CCP. When appropriately resourced, CCP risk committees are uniquely positioned to assess whether it is possible to risk manage, within acceptable boundaries of certainty, previously uncleared OTC derivatives.

We believe that standardization alone is not necessarily enough to permit central clearing of a particular contract, or to conclude that the market for that product will benefit from central clearing. Even if a particular contract is standardized, in order to successfully clear that contract, a CCP must be able to properly manage the associated risks, including being able to: (a) accurately determine initial and variation margin requirements which participants must post or pay, respectively, with respect to the transactions; (b) establish limits, if appropriate, on the holdings of such transactions; and (c) perform stress tests on the positions and exposures arising from such transactions. Standardization, by itself, does not ensure that a CCP can perform each of these critical functions.

[6] The definition of "standardized" OTC contracts should reflect that such contracts share the essential elements of traditional exchange-traded contracts (*i.e.*, buyers and sellers know the contract's terms and legal consequences based on communication of a very small set of information). In other words, if the parties can describe and execute the contract by means of a short description (*e.g.*, September Eurodollars), a direction or delivery date, and a price or price convention, it should be considered to be a "standardized" contract.

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Assuming that a derivatives contract is standardized, we believe the following factors, among others, should be taken into consideration to determine whether the contract is also clearable:

1. *Adequate pricing information.* The accuracy of pricing information available to the CCP is critical in order for the CCP to perform its risk-management function and to settle transactions in the product with minimal disputes from participants. Accuracy depends on: (a) whether the pricing information represents completed transactions or at least tradable bids and offers; (b) whether prices are reasonably tight across multiple sources; and (c) whether prices behave in predictable ways over time. A sufficient amount of detailed historical pricing information is required for effective clearing to begin so that the CCP can effectively model risks on the standardized products to within appropriate risk-management tolerances.

2. *Publicly available reporting on market size and transaction activity on a frequent periodic basis.* This factor is an important gauge of the ability of the market in question to absorb the liquidation of cleared positions, if necessary. Growing, or at least stable, market liquidity will also enhance the CCP's overall risk management and confidence in the accuracy of pricing information received.

3. *Sufficient market transparency.* In order to minimize opportunities for price manipulation, it is important to have sufficient transparency in the market for the derivatives product and, where applicable, the market for the underlying subject matter or reference entity.

While the CME Group CCPs do not believe that standardized OTC derivatives contracts can or should be cleared unless they also satisfy the types of criteria described above, we do support efforts to reduce systemic risk in the marketplace by providing incentives for centralized clearing. Appropriately established capital charges can be an effective regulatory tool to achieve this goal. In establishing the capital requirements for non-cleared transactions, we urge the Committee to consider differentiating between those transactions that are not eligible for clearing because they fail to meet the standards set forth above, and those transactions that satisfy those standards but nevertheless are not submitted to a CCP for clearing.

The CME Group CCPs are supportive of capital requirements that are proportionate to the risk they assume. We agree that bilateral transactions, due to their higher risk, should be subject to higher capital requirements than those cleared by a CCP. We also believe it would be reasonable to establish further regulatory capital incentives to have CCP-eligible contracts cleared by a CCP. These additional incentives could include a higher capital requirement for CCP-eligible but not CCP-cleared contracts if the risk exposure warrants such treatment.

B. <u>Paragraph 166</u>

Paragraph 166 of the Consultative Document states:

> CCPs will play an important role in the efforts to reduce systemic risks. Supervisors need to ensure that CCPs have strong risk management procedures in place, as well

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> as be aware of the potential systemic risk that could arise due to concentrating transactions in a CCP that does not have strong risk management processes. Therefore, the Committee is of the view that collateral and mark-to-market exposures to CCPs could only have a zero exposure if they comply with the enhanced standards for CCPs which are to be later issued by the Committee on Payment and Settlement Systems (CPSS) and the International Organization of Securities Commissions (IOSCO). Counterparty credit exposures to CCPs that do not meet these high standards would be treated as bilaterally cleared exposures subject to a non-zero risk weight under the regulatory capital framework. Other exposures to CCPs, such as default or guarantee fund exposures, would require a capital charge that is higher than the current effective capital requirement of zero. The Committee will consider establishing simple risk weights for the exposures arising from guarantee fund contributions. Equity investments in CCPs will continue to receive equity treatment under Basel II.

The CME Group CCPs are generally supportive of the concepts expressed in Paragraph 166. We are aware that CPSS and IOSCO established a working group in July 2009 to review their 2004 *Recommendations for Central Counterparties* and to consider further enhancements to the standards established for a QCCP under Basel II. We anticipate that IOSCO and the CPSS will announce enhanced standards for CCPs upon the completion of their work later this year, and we expect such enhancements to be appropriate to current and anticipated future industry conditions. We applaud the CPSS/IOSCO working group's efforts given the importance of strong and well-managed CCPs to the mitigation of systemic and credit risks. And we encourage the working group to continue to seek industry practitioners' input as they study these critical issues.

In the U.S., CCPs that clear exchange-traded futures and options are required to register with the CFTC as DCOs and must meet the high standards and principles established and enforced by the CFTC. Pursuant to the Commodity Exchange Act, 7 U.S.C. § 1, *et seq.* ("CEA"), CME must comply with 14 core principles articulated and enforced by the CFTC for DCOs.[7] CFTC staff conducts regular audits or risk reviews of CME to ensure compliance with these core principles. Among other things, the DCO core principles mandate that CME:

- Have adequate financial, operational and managerial resources.
- Manage its risks through the use of appropriate risk management tools and procedure.
- Complete settlements in a timely manner.
- Have standards, rules, procedures or programs designed to:
    - Protect and ensure the safety of clearing member collateral and funds;
    - Ensure the daily processing, clearing and settlement of transactions in the event of an emergency;

[7] Because CME is also a DCM, it must further comply with the 18 core principles set forth in the CEA with respect to DCMs.

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- Allow for efficient, fair and safe management in the event of a clearing member's insolvency or default; and
- Ensure its systems function properly and have adequate capacity and security.

As part of its system of regulatory oversight, the CFTC routinely reviews the controls and tools utilized by CME, including: (a) appropriate membership standards and continuing oversight of clearing members; (b) collection of position reports from large traders; (c) daily marking to market of all open positions; (d) collection of an appropriate amount of performance bond (or margin); (e) periodic stress testing of open positions; (f) the ability to liquidate and/or transfer market participants' open positions quickly; and (g) the availability of other financial resources to CME to cover a member default.

In addition, a number of CCPs, including CME, have undertaken to "self-assess" against existing CPSS/IOSCO standards as part of the supervisory review process. In the wake of the financial crisis, the importance of a CCP's observance of such standards consistently and across the geographic jurisdictions in which it conducts its clearing activities should be re-emphasized. We note that CME's self-assessment, which we have provided to the CFTC and the Securities and Exchange Commission ("SEC"), evidences our observance of all standards,[8] as well as our commitment to maintaining full observance by continuing to monitor our operations.

We are informed that, at least in some situations, U.K. regulators have granted 0% risk weight to guarantee fund deposits. We highly support this action and recommend the extension of the 0% risk weight for default and guarantee fund exposures to any CCP that meets the standards established by CPSS/IOSCO for QCCPs. As with CCP-cleared OTC derivatives transactions, the safety of default and guaranty fund deposits posted with a CCP depends upon the CCP's strength, including its financial resources and risk management program. CME's financial safeguards provide the highest level of security to default and guarantee fund deposits, and other CCPs also operate with integrity and strong risk models. Although we recognize that certain differences exist between the nature of transactions cleared by a CCP and deposits posted with it, we believe that default and guaranty funds deposited with QCCPs that meet any enhanced standards established by CPSS/IOSCO should also be entitled to a 0% risk weight.

C. Paragraph 167

Paragraph 167 of the Consultative Document provides:

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[8] CME's self-assessment was performed with respect to its compliance with the standards set forth in the Recommendations for CCPs issued November 2004 by CPSS/IOSCP (the "CCP Recommendations"). In its Executive Summary, CME noted that the principal conclusions of its self-assessment were "full observance with the CCP Recommendations". CME's most recent self-assessment is dated November 17, 2009.

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The current CPSS/IOSCO recommendations for CCPs are being updated and the Basel Committee will contribute to this effort with the goal of establishing a single set of high standards for CCPs that also can be used for regulatory capital purposes. Among others, the Committee is of the view that the following risk management elements should be addressed in the enhanced standards for CCPs:

- Establish a high specific level of initial margin and on-going collateral posting requirements;
- Require a rigorous schedule for calculating margin requirements, monitoring exposures and conducting back-testing exercises, and a rigorous process for managing such risks;
- Require that procedures be in place to identify, monitor and limit the amount of specific wrong way risk, investment risk, settlement risk and default/guarantee fund risk to which a participant can be exposed;
- Require that a CCP has the financial resources necessary to withstand the default of significant participants under exceptional risk circumstances;
- Require that stress testing includes an analysis of the potential losses, the size of default fund needed, and the mechanics of accessing such a default fund under exceptional risk circumstances; and
- Clarify the responsibility for the supervision of CCPs.

The CME Group CCPs believe that the six factors set forth in Paragraph 167 are important elements of a robust CCP risk-management program. We generally agree that these elements should be contained in the enhanced risk-management standards developed by CPSS/IOSCO. However, we encourage the committee to advocate a standard or principle based approach instead of imposing explicit margin levels or guarantee fund amounts. We address each of these elements in further detail below.

1. *Establish a high specific level of initial margin and on-going collateral posting requirements.*

In considering this risk management factor, we believe it is important to distinguish between a "high" as opposed to an "appropriate" level of initial margin. This distinction is critical, particularly because market participants may be dissuaded from utilizing a CCP's clearing services if initial margin requirements are set at a level that is unnecessarily high. Such a result would go against the very purpose of trying to encourage OTC counterparties to utilize CCP clearing services in order to promote greater stability in the financial system.

Establishing an *appropriate* level of initial margin and ongoing collateral requirements requires daily recalibration for all cleared products. CME has provided clearing and settlement services for a growing number of derivatives contracts over the course of the past century. To preserve the safety of its clearing house, CME relies on a tested approach to risk management which includes daily marking-to-market of positions and the requirement that clearing members settle obligations created by any losses in their proprietary and customer accounts. To accomplish this, CME imposes margin requirements on

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its clearing member firms which, in turn, impose margin requirements on their customers. The margining approach used by CME is, in general, a risk-based portfolio approach that evaluates position losses that could occur under extreme movements in the markets. CME's margin methodologies for both exchange-traded and "cleared only" derivatives recalibrate initial margin and mark-to-market variation margin on a daily basis. CME conducts routine stress tests on its margin methodologies for all products.

For many of the contracts that CME clears, CME's risk team determines initial margin requirements utilizing our proprietary Standard Portfolio Analysis of Risk ("SPAN") system. SPAN – a global industry standard made available by license agreement – is a VaR-based, portfolio margin methodology that calculates performance bond or margin requirements by analyzing the "what ifs" of potential worst-case scenarios that a portfolio of instruments may incur over a chosen time horizon. Using SPAN, CME establishes the *appropriate* level of initial margin to cover the risk of a clearing member's proprietary and customer positions, and we believe this is the standard (rather than "a high specific level of initial margin") that CPSS/IOSCO should adopt.

2. *Require a rigorous schedule for calculating margin requirements, monitoring exposures and conducting back-testing exercises, and a rigorous process for managing such risks.*

The CME Group CCPs agree that this should be an element of a CCP risk-management program and should be included in the enhanced standards developed by CPSS/IOSCO. We further believe that our margin methodology enables us to meet this standard. The SPAN system, which has been in use for over 20 years, is based on a transparent and widely understood modeling procedure, and has been subjected to rigorous external review. Our margin methodology is also highly monitored for regular parameter adjustments and subject to daily back testing to determine whether the loss estimates are supported by observed outcomes.

For certain cleared-only OTC products, the CME Group CCPs use or will use VaR-based margin methodologies that share the same intellectual heritage as SPAN that are customized for the risks of those particular products. [9] The margining models we have developed for the clearing certain OTC derivatives have been, or will be, subjected to validation by external reviewers. Each of our margin methodologies will be subject to regular back testing and monitoring to determine whether the loss estimates are supported by observed outcomes.

3. *Require that procedures be in place to identify, monitor and limit the amount of specific wrong way risk, investment risk, settlement risk and default/guarantee fund risk to which a participant can be exposed.*

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[9] For certain cleared-only OTC derivatives, CME does not use the SPAN margin system. For cleared-only credit default swaps, for example, CME uses a multi-factor margin methodology sometimes referred to as "PC-Credit." Both SPAN and PC-Credit are risk-based portfolio margin approaches and have been vetted by regulators and market participants.

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Paragraph 127 of the Consultative Document describes specific wrong-way risk as something that:

> ...typically arises from poorly constructed transactions. For example, consider a counterparty that provides its own shares as collateral. A long put option position on that counterparty's shares would put the bank at risk. A sharp drop in counterparty share price would increase the exposure to that counterparty at the same time the ability of the counterparty to meet its obligation decreases.

We note that banks' measurement, management and mitigation of wrong-way risk have become of even greater importance to U.S. banking regulators in the wake of the financial crisis. While we believe that bank counterparties to an OTC transaction have primary responsibility for wrong-way risk, we are of the view that CCPs also have a major, and increasing, responsibility for identifying and monitoring the amount of specific wrong-way risk to which a bank counterparty can be exposed with respect to its CCP-cleared transactions. We do not believe, however, hard limits should be imposed on specific risk exposures. We generally prefer handling excessive risk concentration with enhanced protection measures including higher margin and capital requirements and more frequent financial surveillance.

Existing CME procedures are designed to limit the amount of specific wrong-way risk to which CME can be exposed. CME does not accept a clearing member's own stock as collateral. With respect to cleared-only credit default swaps ("CDS"), CME risk management standards prohibit clearing CDS which are short sales of a customer's own CDS. CME also monitors other clearing firm's CDS positions for indicators of the risk of the position that it clears. CMECE will follow these same policies.

4. *Require that a CCP has the financial resources necessary to withstand the default of significant participants under exceptional risk circumstances.*

A CCP's financial resources should consist of a variety of elements, including clearing members' collateral, CCP capital, guaranty funds, assessment rights and access to a liquidity facility. CME's financial safeguards package includes each clearing member's collateral on deposit to support its positions, the collateral of the clearing member's customers to support their positions, CME's capital, clearing members' guaranty-fund deposits, and CME's assessment powers. As of December 31, 2009, excluding collateral supporting open positions, which exceeds 80 billion dollars (US), CME's financial safeguards package is approximately 9 billion dollars (US), comprised chiefly of the following elements:

- CME Capital contribution of 100 million dollars (US)
- Guaranty fund deposits of approximately 2.4 billion dollars (US)
- Assessment powers of approximately 6.5 billion dollars (US)

In addition, CME Clearing has access to a temporary liquidity facility in the amount of 1 billion dollars (US).[10] As part of a large corporation, CME Clearing also has access to extensive corporate liquidity

[10] This facility can be expanded to US 1.5 billion dollars (US) pursuant to an accordion feature in the relevant agreement.

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sources, which provides further assurance of survivability of the CCP during extreme market stress. For all contracts that it accepts for clearing – whether exchange-traded contracts or cleared-only OTC derivatives – CME is substituted as the counterparty, eliminating credit risk to a market participant's original counterparty by guaranteeing performance of each trade. CMECE is in the process of obtaining the necessary approvals from the FSA to operate as a CCP in the U.K. CMECE will have a robust risk-management program that we expect will share many of the same or similar features as CME's clearing house. Although CMECE will not immediately have the same level of financial resources as CME, its financial safeguard package will be appropriate to the size and composition of the risk exposures it carries. As currently proposed, CMECE's risk management framework will include the following elements, among others:

- A guaranty fund sourced from clearing members;
- Powers of assessment on clearing members up to 275% of their initial contributions to the guaranty fund;
- Like CME, CMECE will design its risk management systems to anticipate and minimize counterparty risk (*i.e.*, in the form of potential clearing member failure and default) by alerting CMECE to risks represented by clearing members and their positions and allow CMECE to, among other things, take action to close out and/or transfer positions in contracts while a troubled member is still solvent. CMECE's systems and processes are designed always to maintain financial resources adequate to manage potential clearing member default in circumstances of extreme market volatility.

A well-run CCP, with robust risk management and adequate financial resources, should never default on an obligation to its clearing members. In its 110-plus years of existence, CME has never defaulted on an obligation to its clearing members, nor have its clearing members defaulted on their obligations to CME. This is reflective of the financial strength, safeguards, quality and proactive nature of risk management of CME, as well as the CFTC regulatory regime that applies to CME and its clearing members.

Most recently, in September 2008, this regime admirably withstood the financial demise of former CME clearing member, Lehman Brothers Inc. ("LBI"). Working in conjunction with the CFTC, CME helped protect the positions and collateral of LBI's customers and transfer them to other clearing firms. CME also worked to transfer and liquidate (where possible) LBI's sizeable "house" or proprietary portfolio, while safeguarding the continuity of our cleared markets and avoiding losses to futures customers or CME's financial safeguards package.

5. *Require that stress testing includes an analysis of the potential losses, the size of default fund needed, and the mechanics of accessing such a default fund under exceptional risk circumstances.*

We strongly agree that a rigorous stress-testing program must include an analysis of the potential losses, the size of default fund needed, and the mechanics of accessing the default fund under exceptional risk circumstances. At the heart of the CME Group CCPs' margin methodologies is the calculation of how individual contracts will gain or lose money under an array of scenarios. CME risk

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managers test the impact of new scenarios on instrument and portfolio values on a daily basis, and conduct stress testing of clearing members' portfolios and individual accounts of large customers. Numerous stress scenarios have been modeled to reflect a diverse set of possible market events. Stress results are evaluated against performance bonds on deposit and clearing member adjusted net capital. Results of the stress tests may lead CME to ask clearing members for additional information about their liquidity resources and their house and customer accounts, such as whether any offsetting positions exist in other (non-CME cleared) markets. In some cases, stress test results may cause CME to increase a clearing member's performance bond requirements or request that the clearing member reduce or transfer positions.

6. *Clarify the responsibility for the supervision of CCP.*

The CME Group CCPs agree that the responsibility for the supervision of CCPs should be clarified, and we strongly favor a single regulator for each CCP. A CCP should be regulated by its home state regulator, and where a CCP operates across jurisdictions, its home state regulator should have primary jurisdiction and should coordinate with the host regulators. The determination of the single regulator in any particular jurisdiction should be left to that jurisdiction, in light of its regulatory framework and other relevant factors. However, we generally believe that the single regulator in any one country should be the market regulator for derivative products.

The market regulators generally have historical knowledge and experience in supervising and regulating CCPs consistent with their supervisory and regulatory authority over the entire derivatives market, including products and participants. Accordingly, market regulators are generally better equipped to supervise and examine CCPs. We are concerned about the current proposal by the EC that CCPs should be licensed by the European Securities and Markets Authority but supervised by the relevant member state authority. We agree with the FSA's view that it is unclear what additional benefits can be achieved by supervision at a pan-European level, as is being considered by the EC. We do not believe that the EC's proposal takes into account the fact that, in the event of a default by a CCP, support would have to be provided by the central bank and funded by the taxpayers of the member state in which the CCP is located. We believe the current EC proposal would create unnecessary regulatory conflict, duplication of roles and responsibilities, and additional regulatory burdens for CCPs.

Again, we appreciate this opportunity to provide the Committee with our comments. We would be happy to discuss any of these issues with the Committee. If you have any comments or questions, please feel free to contact Kim Taylor, President, CME Clearing, at (312) 930-3156 or Kim.Taylor@cmegroup.com; or Andrew Lamb, Chief Executive Officer, CME Clearing Europe, Ltd., at (44) 207-796-7170 or Andrew.Lamb@cmegroup.com.

Very truly yours,

Kim Taylor, President
CME Clearing House Division

Andrew Lamb

Andrew Lamb, Chief Executive Officer
CME Clearing Europe, Ltd.

20 South Wacker Drive Chicago, Illinois 60606 T 312 930 1000 F 312 466 4410 cmegroup.com