CME Group

Kathleen M. Cronin
Managing Director
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November 24, 2010

Elizabeth M. Murphy
Secretary of the Commission
Securities and Exchange Commission
100 F St., NE.
Washington, DC 20549-1090

RE: Ownership Limitations and Governance Requirements for Security-Based Swap Clearing Agencies, Security-Based Swap Execution Facilities, and National Securities Exchanges With Respect to Security-Based Swaps Under Regulation MC (RIN 3235-AK74) (Federal Register Volume 75, No. 206, Page 65,882, October 26, 2010)

Dear Ms. Murphy:

CME Group Inc. ("CME Group"), on behalf of its four designated contract markets ("Exchanges" or "DCMs"), appreciates the opportunity to comment on the Security Exchange Commission's (the "SEC" or "Commission") Notice of Proposed Rulemaking ("*Release*") that was published in the Federal Register on October 26, 2010. In addition to its comments included in this letter, CME submits its comment letter addressing the comparable proposal released by the Commodities Futures Trading Commission ("CFTC") addressing "Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding Mitigation of Conflicts of Interest" (RIN 3038-AD01), which is attached as an exhibit to this letter.

In the *Release*, the Commission sets forth Proposed Rules pursuant to Section 765 of the Dodd-Frank Act ("Dodd-Frank"). Section 765 authorizes the Commission to adopt rules to mitigate conflicts of interest that arise "in connection with a security-based swap dealer or major security-based swap participant's conduct of business with a clearing agency, national securities exchange, or security-based swap execution facility that clears, posts, or makes available for trading security-based swaps and in which such security-based swap dealer or major security-based swap participant has a material debt or equity investment." Such rules may include numerical limits on the degree of control of voting rights that a Specified Entity may possess with respect to a clearing agency, national securities exchange, or security-based SEF. Before the Commission imposes any rules under this provision, however, it must first conduct a "review" and make a determination that "such rules are necessary or appropriate" to mitigate such conflicts of interest.

In the *Release*, the Commission acknowledges its statutory obligation to conduct such a review and make a determination that that such rules are "necessary or appropriate" to "improve the governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with" a security-based swap dealer ("SB swap dealer") or major security-based swap participant's ("SB MSP") conduct of business with a clearing agency, national securities exchange ("SBS exchange facility") or security-based swap execution facility ("SB SEF").[1] To

[1] Additionally, Section 765 limits the Commission's authority to impose rules to address conflicts of interest that arise from a particular set of facts –SB swap dealer's or major SB swap participant's conduct of business with a clearing agency, SBS exchange facility or SB SEF that clears or posts security-based swaps or makes security-based swaps available for trading and in which such SB

this end, we believe that the Commission has correctly identified concerns that could render the Proposed Rules unnecessary or inappropriate. Specifically, the Commission has correctly observed that the security-based swap clearing and trading market is in its infancy, and that any rules promulgated by the Commission will affect the development of that market, possibly curbing the proper development of the market if such regulations are too onerous. Additionally, the Commission correctly acknowledges that the instant rulemaking is one of the first it has considered under Dodd-Frank, and that the development of the market and any conflicts of interest that arise will be affected by many rulemakings that have yet to occur.

In essence, the Commission acknowledges that it cannot know whether the conflicts of interest it discusses in the *Release* will actually materialize or whether such conflicts will need to be addressed by Commission rulemaking because the post-Dodd-Frank derivatives market has yet to develop. Indeed, as the Commission notes, the development of this market effectively is in a holding pattern while awaiting several rulemakings from the Commission and the CFTC that will define the scope of and the rules for the operation of that market. Significantly, neither the Commission nor the CFTC has even proposed rules defining key market participants, including SB swap dealer and SB MSP, or set the parameters for what will qualify as a security-based swap execution facility. Additionally, the provisions of Dodd-Frank relating to central clearing of SB swaps are not yet effective. Once effective, market participants will be subject to substantially more regulation, which will affect potential conflicts of interest. Given the vast uncertainty that exists, CME agrees with the Commission's concerns and believes that it is neither necessary nor appropriate for the Commission to promulgate the Proposed Rules at this juncture.[2]

Additionally, some of the Commission's concerns and corresponding Proposed Rules are already addressed by other sources of law and therefore, such rules are not, and will not in the future be, necessary or appropriate. Specifically, the Proposed Rules dictating corporate board composition and committee requirements are neither necessary nor appropriate because of obligations imposed on boards of directors under applicable state law. Under Delaware law, directors of corporations are fiduciaries who owe duties of due care, good faith and loyalty to the corporation and its stockholders. Skeen v. Jo-Ann Stores, Inc., 750 A.2d 1170, 1172 (Del. 2000) (citing Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998)). Most relevant here, the directors' duty of loyalty "mandates that the best interest of the corporation and its shareholders takes

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swap dealer or major SB swap participant has a material debt or equity investment creates a conflict of interest. The Commission has recognized certain limitations on its rulemaking authority, notably applying its Proposed Rules only to entities that trade or clear security-based swaps. However, CME believes that the Commission has not recognized the full scope of the limitations Congress placed on its authority under Section 765 of Dodd-Frank. Specifically, the Commission's proposed ownership limitations apply not only to specified entities but to any participant in a clearing agency as defined by 15 U.S.C. 78c(a), including, but not limited to, specified entities, and to any SB SEF participant or SBS exchange facility member. Although the Commission's Proposed Rules are more tempered than those proposed by the CFTC, as discussed in the attached comment letter, CME believes that the Proposed Rules still constitute an unlawful exercise of the Commission's authority.

[2] Any possible conflicts of interest that arise in the interim will not go completely unchecked. Such conflicts of interest are already addressed by the Core Principles, see, e.g., Core Principle 11 for SB SEFs, other aspects of Dodd-Frank, such as the installment of Chief Compliance Officers, and fiduciary duties established by state law. See infra.

precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the shareholders generally." Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1994) (citing Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984)). This duty of loyalty addresses the Commission's overriding concern that directors of a clearing agency, SBS exchange facility, or SB SEF will act in their own personal interests rather than those of the exchange or clearinghouse as a whole. Moreover, the Commission's concern that an entity's board of directors, in fulfilling their duties, may face a conflict between serving the economic interests of their shareholders and fulfilling their regulatory duties is unwarranted. A director's duty to ensure that a regulated entity abides by its regulatory duties overlaps with its duty or loyalty generally due to the detrimental effect that a failure to abide by regulatory obligations would have on the business of a regulated entity.

Further, matters of corporate governance are traditionally the province of the states. CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 8991 (1987) ("[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations"); Edgar v. MITE Corp., 457 U.S. 624, 645 (1982) ("only the law of the state of incorporation governs and determines issues relating to a corporation's internal affairs"). It is well-settled law that regulators may not enact rules or regulations that reach into an area of State sovereignty unless the plain language of the federal law compels the intrusion. See, e.g., ABA v. FTC, 430 F.3d 457, 471-72 (D.C. Cir. 2005); Air Line Pilots Ass'n, Int'l v. UAL Corp., 874 F.2d 439, 447 (7th Cir. 1989). Section 765 does not evidence Congressional intent to alter the balance between State and Federal Government with respect to corporate governance. Therefore, CME does not believe it is appropriate for the Commission to intrude into this area of traditional state sovereignty in promulgating the Proposed Rules.

Although the Commission has included in the *Release* a more thoughtful and complete discussion than the CFTC did in its release as to the appropriateness of the Proposed Rules, CME does not believe this discussion satisfies the Commission's obligations under Section 765(b). Significantly, for the reasons discussed above, CME believes that neither the Commission nor the CFTC can satisfy its statutory obligations in this regard at the very least, until such times as the rules that will serve as the building blocks for the post-Dodd-Frank derivatives market are in place, particularly the definitions rulemaking referenced above. Accordingly, CME disagrees with the Commission's decision to propose rules at this time.[3] CME strongly encourages the Commission to withdraw the Proposed Rules, and to enact the rules that are essential for the development of the relevant marketplace and allow some time for such development before taking up rulemaking again on this topic.

Sincerely,

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Managing Director
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[3] CME disagrees with the substance of the Proposed Rules for the reasons stated herein.

CME Group

Kathleen M. Cronin
Managing Director
General Counsel and Corporate Secretary

November 17, 2010

VIA ELECTRONIC MAIL

David Stawick
Secretary of the Commission
Commodity Futures Trading Commission
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Re: Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest (RIN 3038-AD01) (Federal Register Vol. 75, No 200, Page 63,732, October 18, 2010)

Dear Mr. Stawick:

CME Group Inc. ("CME Group"), on behalf of its four designated contract markets ("Exchanges" or "DCMs"), appreciates the opportunity to comment on the Commodity Futures Trading Commission's (the "CFTC" or "Commission") Notice of Proposed Rulemaking ("*Release*") that was published in the Federal Register on October 18, 2010. In the *Release*, the Commission seeks comment on proposed rules that would impose new requirements on derivatives clearing organizations ("DCOs"), designated contract markets ("DCMs") and swap execution facilities ("SEFs"), with respect to mitigating conflicts of interest.

CME Group is the world's largest and most diverse derivatives marketplace. We operate four separate Exchanges: the Chicago Mercantile Exchange, Inc. ("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"). The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products.

We also operate CME Clearing, one of the largest central counterparty clearing services in the world, which provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter derivatives transactions through CME ClearPort®.

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, our open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions. CME Group is a corporation registered in the State of Delaware and is thus subject to Delaware state law.

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I. Background

As the Commission notes in the *Release*, Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank") established a comprehensive new regulatory framework for swaps and certain security-based swaps. The stated purpose of the legislation is to, *inter alia*, reduce systemic risk, increase transparency, and promote market integrity within the financial system by, among other things: (i) providing for the registration and comprehensive regulation of swap dealers and major swap participants; (ii) imposing mandatory clearing and trade execution requirements on clearable swap contracts; and (iii) creating robust recordkeeping and real-time reporting regimes.[1] In the *Release*, the Commission states that, with respect to (ii) above, Dodd-Frank "requires the Commission to promulgate rules to mitigate conflicts of interest in the operation of certain DCOs, DCMs, and SEFs." 75 Fed. Reg. at 63,732. The Commission then proceeds to discuss Section 726, the provision in Dodd-Frank that purportedly gives the Commission authority to promulgate the rules it is proposing. Specifically, the Commission states:

> First, Section 726(a) of the Dodd-Frank Act specifically empowers the Commission to adopt 'numerical limits on control' or 'voting rights' that enumerated entities[2] may hold with respect to such DCOs, DCMs, and SEFs. Second, Section 726(B) of the Dodd-Frank Act directs the Commission to determine the manner in which its rules may be deemed necessary or appropriate to improve the governance of certain DCOs, DCMs, or SEFs or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with the interaction between swap dealers and major swap participants, on the one hand, and such DCOs, DCMs and SEFs. Finally, Section 726(c) of the Dodd-Frank Act directs the Commission to consider the manner in which its rules address conflicts of interest in the abovementioned interaction arising from equity ownership, voting structure, or other governance arrangements of the relevant DCOs, DCMs, and SEFs.

75 Fed. Reg. at 63,732-33 (emphasis added.)

Based on the foregoing characterization of Section 726 of Dodd-Frank, the Commission sets forth in the *Release* proposed rules to address <u>potential</u> conflicts of interest, which it describes generally as follows:

1. Conflicts of interest that a DCO may confront when determining (i) whether a swap contract is capable of being cleared, (ii) the minimum criteria that an entity must meet

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[1] The Commission asserts in the *Release* that a fourth way that Congress sought to accomplish the said purposes of the legislation was by "enhancing the rulemaking and enforcement authorities of the Commission with respect to, among others, all registered entities and intermediaries subject to the oversight of the Commission." Requirements for DCOs, DCMs, and SEFs Regarding the Mitigation of Conflicts of Interest, 75 Fed. Reg. 63,732, 63,732 (proposed Oct. 18, 2010) (to be codified at 17 C.F.R. pts. 1, 37, 38, 39, and 40). While we agree that, in certain limited respects, Dodd-Frank grants the Commission more authority than it previously possessed with respect to the regulation of certain swap market participants, as discussed herein, we believe that the Commission overstates its authority in this regard in the *Release*.

[2] Enumerated entities include: a bank holding company (as defined in section 2 of the Bank Holding Company Act of 1956) with total consolidated assets of $50,000,000,000 or more, a nonbank financial company (as defined in section 102) supervised by the Board, an affiliate of such a bank holding company or nonbank financial company, a swap dealer, major swap participant, or associated person of a swap dealer or major swap participant. Section 726(a).

in order to become a swap clearing member, and (iii) whether a particular entity satisfies such criteria; and

2. Conflicts of interest that a DCM or SEF may confront in balancing advancement of commercial interests and fulfillment of self-regulatory responsibilities.

75 Fed. Reg. at 63,733 (footnote omitted). To address these alleged potential conflicts of interest, the Commission proposes a number of prescriptive rules to be imposed on DCOs, DCMs and SEFs dictating ownership and voting limits and internal matters of corporate governance (collectively, the "Proposed Rules"). Specifically, the Commission proposes, among other things, rules that would:

- Impose structural governance requirements and limits on the ownership of voting equity and the exercise of voting power. They impose specific composition requirements on DCO, DCM and SEF boards of directors and require each DCO, DCM, or SEF to have a nominating committee and one or more disciplinary panels. Each DCO must have a risk management committee and each DCM or SEF must have a regulatory oversight committee and a membership or participation committee, subject to specific composition requirements.

- Limit DCM or SEF members (and related persons) from beneficially owning more than twenty (20) percent of any class of voting equity in the registered entity or from directly or indirectly voting an interest exceeding twenty (20) percent of the voting power in any class of equity interest in the registered entity.

- Require a DCO to choose one of two alternative limits on the ownership of voting equity or the exercise of voting power --

    - Under the first alternative, no individual member may beneficially own more than twenty (20) percent of any class of voting equity in the DCO or directly or indirectly vote an interest exceeding twenty (20) percent of the voting power of any class of equity interest in the DCO. In addition, the enumerated entities, whether or not they are DCO members, may not collectively own on a beneficial basis more than forty (40) percent of the voting power of any class of equity interest in the DCO.

    - Under the second alternative, no DCO member or enumerated entity, regardless of whether it is a DCO member, may own more than five (5) percent of any class of voting equity in the DCO or directly or indirectly vote an interest exceeding five (5) percent of the voting power of any class of equity interest in the DCO.

As discussed in more detail below, the Commission misreads the plain language of Section 726. In so doing, the Commission exceeds its statutory authority as delineated in these provisions and seeks to implement a set of rules that go far beyond the bounds of what Congress intended; Congress intended to vest the Commission with authority to address the narrow issue of conflicts of interest that might arise from an enumerated entity's business dealings with a DCO, DCM or SEF in relation to the DCO's, DCM's or SEF's swap-related business. Additionally, the Commission failed to comply with the statutory mandate that it perform a review and make a determination that any rules adopted pursuant to Section 726 are "necessary or appropriate" to mitigate conflicts of interest arising from a swap dealer's or major swap participant's business dealing with any DCO, DCM or SEF in which it has a "material debt or equity interest." Finally, the Proposed Rules intrude upon matters, such as corporate governance, which are traditionally the province of the States. Without a clear mandate from Congress, which is absent here, such intrusion is improper.

II. Comments

A. The Proposed Rules Exceed the Commission's Authority Under Section 726

Section 726 of Dodd-Frank authorizes – but does not require – the Commission to adopt rules to mitigate conflicts of interest that arise "in connection with a swap dealer or major swap participant's conduct of business with a [DCO, DCM or SEF]" that clears or lists swaps for trading and "in which such swap dealer or major swap participant has a material debt or equity investment." Such rules may include numerical limits on the degree of control of voting rights that an enumerated entity may possess with respect to a DCO, DCM or SEF. Before the Commission imposes any rules under this provision, however, it must first conduct a "review" and make a determination that "such rules are necessary or appropriate" to mitigate such conflicts of interest. Specifically, Section 726 (b), in relevant part, provides:

> The Commission shall adopt rules if it determines, after the review described in subsection (a), that such rules are necessary or appropriate to improve the governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with a swap dealer or major swap participant's conduct of business with a [DCO, DCM or SEF] that clears or posts swaps or makes swaps available for trading and in which such swap dealer or major swap participant has a material debt or equity investment.

(emphasis added.) It is well-settled law that an agency's "rulemaking power is limited to adopting regulations to carry into effect the will of Congress as expressed in the statute." Bd. of Governors of Fed. Reserve Sys. v. Dimension Fin. Corp., 474 U.S. 361, 374 (1986) (emphasis added); see also Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842-43 (1984) (If the intent of Congress is clearly expressed in the statute, "that is the end of the matter; for the court, as well as the agency," and such intent must be given effect). Moreover, agencies are "bound, not only by the ultimate purposes Congress has selected, but by the means it has deemed appropriate, and prescribed, for the pursuit of those purposes." See, e.g., Colo. River Indian Tribes v. Nat'l Indian Gaming Comm'n, 466 F.3d 134, 139 (D.C. Cir. 2006) (internal quotations and citation omitted) (finding no statutory basis empowering the Gaming Commission to regulate class III gaming operations, explaining that "[a]n agency's general rulemaking authority does not mean that the specific rule the agency promulgates is a valid exercise of that authority"); Bd. of Governors, 474 U.S. at 374 (invaliding rules providing that nonbank offering the functional equivalent of traditional banking services would be regulated as banks on the ground that the Federal Reserve Board lacked authority under the applicable statute to enact such rules). Indeed, the Commission has no power to correct flaws that it perceives in Dodd-Frank specifically, or the CEA more generally. Id. at 374.

By its unambiguous terms, this statutory provision limits the Commission's authority to impose rules to address conflicts of interest that arise from a particular set of facts – where a swap dealer or major swap participant's conduct of business with a [DCO, DCM or SEF] that clears or posts swaps or makes swaps available for trading and in which such swap dealer or major swap participant has a material debt or equity investment creates an actual conflict of interest. The Commission, however, proposes to impose rules that affect all DCOs, DCMs and SEFs, including those (i) in which no swap dealer has a material debt or equity investment and (ii) that do not clear or trade swaps. The Proposed Rules, therefore, constitute an unlawful exercise of the Commission's authority.

B. The Commission Has Failed to Conduct the Necessary Review and Make the Requisite Determination as Required by Statute

In addition to the foregoing, the statute requires the Commission first to conduct a review and make certain determinations before promulgating such rules. Specifically, the plain language of Section 726 provides that the Commission "shall adopt rules if it determines" after review, that such rules are "necessary or appropriate" to "improve the governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with a swap dealer or major swap participant's conduct of business with, a [DCO, DCM or SEF] that clears or posts swaps or makes swaps available for trading and in which such swap dealer or major swap participant has a material debt or equity investment" (emphasis added). Rules promulgated without compliance with this statutory requirement exceed the Commission's authority under Dodd-Frank.

Here, the Commission has not conducted the required review. By proposing rules in the absence of such review, the Commission did something that Congress expressly declined to do itself – impose numerical limitations on the ownership interests that swap dealers and major swap participants could have in certain DCOs, DCMs and SEFs without understanding whether such restrictive rules would actually operate to mitigate conflicts of interest or the market-impact that such rules would have. Specifically, the amendment that was proposed by Representative Lynch (D-MA),[3] which would have imposed numerical limitations on the ownership of (among others) DCOs, DCMs and SEFs, was rejected by Congress in favor of a provision that more closely resembled the language in the final Senate bill, which requires a review and a "necessary or appropriate" determination before imposing rules. Thus, the statutory terms and the omission of the Lynch Amendment from Dodd-Frank make clear that Congress expected a meaningful administrative review and reasoned treatment of the derivatives market in transition. The Commission's reference to conversations with other agencies and unsupported statements from industry commentators in the *Release* does not constitute the type of substantive review contemplated by Congress; **nor does it otherwise justify the imposition of potentially harmful limitations on the markets.**

Even if the referenced conversations in the *Release* somehow constituted a "review" (which they do not), the Proposed Rules still exceed the Commission's statutory authority. Indeed, the Commission has not made the requisite findings in support of the Proposed Rules, and in particular, makes no finding that the Proposed Rules are "necessary or appropriate" to "improve the governance of, or to mitigate systemic risk, promote competition, or mitigate conflicts of interest in connection with a swap dealer or major swap participant's conduct of business with a [DCO, DCM or SEF] that clears or posts swaps or makes swaps available for trading and in which such swap dealer or major swap participant has a material debt or equity investment."[4] The requirement that the Commission make a determination that

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3 http://www.house.gov/apps/list/speech/financialsvcs_dem/lynch_035.pdf

4 The Commission offers no evidence of wrongdoing by enumerated entities or any other market participants. In fact, the Commission does not even identify or define actual conflicts of interest. Instead, the *Release* contains inconclusive language throughout with respect to "potential" conflicts of interest, see 76 Fed. Reg. at

the rules are "necessary or appropriate" is designed to ensure that the Commission enacts rules that are no more intrusive than necessary to fulfill the stated Congressional intent, which cannot be said of the Proposed Rules. In other words, any rules promulgated under this provision must be narrowly tailored to address instances in which a conflict of interest exists as a result of a swap dealer's or major swap participant's business with the DCO, DCM or SEF in which it has a material debt or equity interest. A broad set of rules of general applicability, such as the Proposed Rules, clearly falls short of this statutory mandate.

To be sure, it is inappropriate to impose rules that require, *inter alia*, a certain composition of corporate boards and their related committees as such rules in no way relate to the conflict of interest Congress sought to address through Section 726. Indeed, the Commission provides absolutely no basis whatsoever for asserting that a director who meets the Commission's unique definition of independence is more likely to consider and accord proper weight to regulatory considerations, nor does the Commission explain how such a director mitigates conflicts of interest "in connection with a swap dealer or major swap participant's conduct of business with, a [DCO, DCM or SEF] that clears or posts swaps or makes swaps available for trading and in which such swap dealer or major swap participant has a material debt or equity investment." In fact, the Commission effectively concedes that the Proposed Rules respecting structural governance requirements exceed the limitations Congress placed on its rulemaking authority in Section 726:

> [B]y introducing a perspective independent of competitive, commercial, or industry considerations to the deliberations of governing bodies . . . . Such independent perspective would more likely encompass regulatory considerations, and to accord such considerations proper weight. Such independent perspective also would more likely contemplate the manner in which a decision might affect all constituencies, as opposed to concentrating on the manner in which a decision affects the interests of one constituency.

We believe that, in order to effect the intent of Congress, the Commission should heed the unambiguous language of Section 726 and conduct a review designed to identify: (i) actual conflicts of interest that arise from a swap dealer's or major swap participant's business dealings with a DCM, DCO or SEF in which it has a material debt or equity interest; and (ii) rules that would mitigate such conflicts of interest. The Commission should then consider whether such rules are "necessary or appropriate" to mitigate such conflicts, and should propose rules that are no more expansive than necessary to address Congressional concerns singled out in this statutory provision.

C. <u>CME Group Policies Adequately Address Conflicts of Interest Faced By Our Board Members in the Decision-Making Process</u>

The CME Group Exchanges and CME Clearing must, as required by the Commodity Exchange Act, operate in strict conformance with the relevant core principles and all conditions of their designation. Each director and officer of the holding company and the exchanges must place that goal at the forefront of his duties as the right of the exchanges and clearing house to continue in operation, as well as CME Group's reputation for integrity and honestly, depends on conforming to those responsibilities.

63,735-36 n. 30-33 and accompanying text, and unsubstantiated allegations as to problems in other markets, <u>see</u> 75 Fed. Reg. at 63,736 n. 34 and accompanying text.

To ensure that the CME Group Exchanges' boards[5] effectively avoid or minimize conflicts of interests and quickly resolve any that arise, CME Group has adopted a code of ethics, a conflict of interest policy and a related party approval policy. In accordance with these policies, members of each board are required to: act in the best interests of the organization; disclose any potential for the director to receive any private benefit in connection with a matter being presented to the board; never use their positions for their personal benefit; and preserve the confidentiality of information provided to them.

Additionally, certain transactions, commonly referred to by the U.S. Securities and Exchange Commission ("SEC") as "related party transactions," in which a director or executive officer would have a material benefit, must be approved by the audit committee of CME Group. The audit committee is composed of members who meet the independence criteria of the applicable listing standards set forth by the NASDAQ. Additionally, more than 85% of the members of the audit committee are "public directors" as defined in the Commission's currently applicable "acceptable practices" for Core Principle 15. 17 C.F.R. 38, App. B, Core Principle 15(b)(ii) (hereinafter "Acceptable Practices"). The combination of these policies works to appropriately mitigate conflicts of interest and provides a process whereby potential and actual conflicts of interests are addressed.[6] While mitigating such conflicts, these policies still allow CME Group to place the most knowledgeable and qualified individuals on its board and thus ensure the proper functioning of its market.

Moreover, the experience and diversity of our directors has been, and continues to be, critical to our success. To this end, our corporate governance principles require that the board be composed of at least a majority of independent directors as defined in the Marketplace Rules of the NASDAQ Stock Market and the SEC requirements. Similarly, members of our audit, compensation, governance and nominating committees must be independent.[7] For a director to be considered independent, the board must affirmatively determine that the director has no direct or indirect material relationship with the company. The board has adopted categorical independence standards to assist the board in making its determinations regarding independence. These standards conform to and exceed the independence criteria specified in the listing standards of the NASDAQ.

Furthermore, CME Group also has appropriate disciplinary and risk assessment committees. As to disciplinary committees, CME Group imposes independence requirements with regard to our probable cause and business conduct committees. Our Exchange rules require panels of our probable cause and business conduct committees to be composed of a panel chairman, three members or representatives of member firms and three individuals who are nonmembers. Additionally, each exchange's probable cause and business conduct committees include at least one panel chairman that meets the definition of a public director as set forth in the Acceptable Practices. Our clearing house risk committee also

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5 The CME Group Exchanges share the same board of directors as that of CME Group, Inc. That board of directors will hereinafter be referred to only as "CME Group."

6 As an example, members of the board must recuse themselves from both the deliberations and voting with respect to any "significant action" as defined in each of the Exchange's Rule 234 if the board member knowingly has a direct and substantial financial interest in the result of the vote based upon either Exchange or non- Exchange positions that could reasonably be expected to be affected by the action or is otherwise conflicted based on existing Exchange policy.

7 Currently, all members of our nominating committee are independent.

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currently includes two individuals who are Public Directors."[8] This arrangement mitigates any potential conflicts of interest while ensuring that the clearing members, whose funds are actually at stake in any risk-related decisions, are adequately represented.

Finally, the CME Exchanges have a market regulation oversight committee ("MROC") comprised solely of Public Directors.[9] This committee is charged with providing independent oversight of the policies and programs of the Audit Department and the Market Regulation Department with the goal that the policies and programs enable each of the departments to administer effectively the self-regulatory responsibilities of the Exchanges.

As illustrated above, the CME Exchanges have various policies and procedures in place that mitigate conflicts of interest in decision-making and prevent any group of market participants from wielding excessive influence over CME's decision-making process. CME Group believes that, at present, these policies and procedures are in the best interest of our shareholders and other stakeholders because they ensure the integrity of our markets and clearinghouse. This integrity is the cornerstone of our reputation and global success.

D. The Commission's Proposed Rules Impermissibly Reach Into An Area of State Sovereignty

Under Delaware law, directors of corporations are fiduciaries who owe duties of due care, good faith and loyalty to the corporation and its stockholders. Skeen v. Jo-Ann Stores, Inc., 750 A.2d 1170, 1172 (Del. 2000) (citing Malone v. Brincat, 722 A.2d 5, 10 (Del. 1998)). The directors' duty of loyalty – well-established under Delaware law – is most relevant here. "[T]he duty of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the shareholders generally." Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1994) (citing Pogostin v. Rice, 480 A.2d 619, 624 (Del. 1984)). Put differently, "[c]orporate officers and directors are not permitted to use their position of trust and confidence to further their private interests." Guth v. Loft, 5 A.2d 503, 510 (Del. 1939). This duty of loyalty, which is already imposed upon the directors of CME Group by virtue of its status as a Delaware corporation, addresses the Commission's overriding concern that directors of a DCO, DCM or SEF will act in their own personal interests rather than those of the exchange or clearinghouse as a whole. That is, regardless of how the board is composed and which shareholders elected the directors, the board is obligated by its fiduciary duties to operate in the best interest of the exchange or clearinghouse as a whole – not in the interests of a single constituency, such as an enumerated entity. Therefore, the Commission's concerns are already addressed, and both its proposed limitations on ownership and its proposed limitations on corporate board composition are unnecessary.

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8 The only other disciplinary committee, the floor conduct committee, is composed solely of exchange members. This committee is responsible for adjudicating violations related to decorum, price quotation practices and pit etiquette standards on the trading floors via summary proceedings. Given the limited scope of the matters addressed by the panels, we do not believe the inclusion of a panelist meeting the definition of a public director would result in more effective adjudication of these matters.

9 This committee qualifies as a "Regulatory Oversight Committee" under the Acceptable Practices.

The Commission's attempt to dictate the governance arrangements of corporations is also improper because it represents an unwarranted and unauthorized intrusion into an area of traditional state sovereignty. As the Commission is aware, matters of corporate governance are traditionally the province of the states – specifically the state of incorporation, and in CME Group's case, the state of Delaware. Indeed, "[n]o principle of corporation law and practice is more firmly established than a State's authority to regulate domestic corporations." CTS Corp. v. Dynamics Corp. of Am., 481 U.S. 69, 8991 (1987) (noting that "it thus is an accepted part of the business landscape in this country for States to create corporations, to prescribe their powers, and to define the rights that are acquired by purchasing their shares"). Pursuant to the internal affairs doctrine, "only the law of the state of incorporation governs and determines issues relating to a corporation's internal affairs." See Vantagepoint Venture Partners 1996 v. Examen, Inc., 871 A.2d 1108, 1112-13 (Del. 2005) (citing Edgar v. MITE Corp., 457 U.S. 624, 645 (1982)). This doctrine applies to matters pertaining to the relationships among or between the corporation and its officers, directors and shareholders. Id. at 1113. Federal law does not give rise to and govern the fiduciary duties of corporate directors and officers – those matters are governed by state law. Pfeiffer v. Toll, 989 A.2d 683, 704 (Del. Ch. 2010).

It is well-settled law that regulators may not enact rules or regulations that reach into an area of State sovereignty unless the plain language of the federal law compels the intrusion. See, e.g., ABA v. FTC, 430 F.3d 457, 471-72 (D.C. Cir. 2005) (invalidating regulations enacted by the Federal Trade Commission purporting to regulate the conduct of attorneys); Air Line Pilots Ass'n, Int'l v. UAL Corp., 874 F.2d 439, 447 (7th Cir. 1989) (noting that regulation of corporations is a matter of primary state responsibility and thus subject to a presumption against federal preemption). Moreover, an agency may not infer that federal law compels intrusion into areas of State sovereignty; rather, "if Congress intends to alter the usual constitutional balance between State and the Federal Government, it must make its intention to do so unmistakably clear in the language of the statute." ABA, 430 F.3d at 471-72 (emphasis added) (internal quotations and citation omitted). As such, if Congress intended to authorize the Commission to regulate internal corporate governance arrangements under Sections 725(d) and 726, it was required to have stated so unequivocally.

Neither Section 726, nor the Core Principles for DCOs, DCMs, and SEFs, nor any other provision in Dodd-Frank evidence Congressional intent to alter the balance between State and Federal Government with respect to corporate governance. As such, it is not appropriate for the Commission to intrude into this area of traditional state sovereignty in promulgating the Proposed Rules.

E. The Proposed Rules Will Stifle the Competition Among Registered Entities In the U.S. and With Their Counterparts Abroad

CME Group agrees with Commissioner Sommers that not only are the Proposed Rules not necessary or appropriate to mitigate the identified conflicts of interest, such rules would "do more harm than good." Dodd-Frank creates, in essence, a new market for trading and clearing swaps, which can lead to the emergence of new DCOs, DCMs and SEFs, as well as new opportunities for current DCMs and DCOs. The Commission acknowledges in the *Release* that enumerated entities are the most likely source of funding for new DCMs, SEFs and DCOs to trade and clear swaps. As such, by limiting the funding that enumerated entities can provide to new DCMs, SEFs and DCOs, the Commission limits entries into the new marketplace. Consequently, the power in the marketplace will likely become concentrated in the hands of a few established or lucky entities that can procure their necessary funding from sources other than enumerated entities, and the Commission stifles the competition it purports to protect. This situation by necessity limits the trading and clearing options of participants in the marketplace, possibly leading to less favorable options for those participants.

Likewise, the proposed voting and ownership rights requirements create uncertainty in the marketplace with regard to existing DCMs and DCOs. That is, because enumerated entities are a major source of funding for DCMs and DCOs, pursuant to the proposed regulations, many DCMs and DCOs must ensure that those enumerated entities divest large portions of their interests, and, as a corollary, the DCMs and DCOs must replace that funding in order to remain in operation. As such, investors will be left unsure as to whether the DCM or DCO on which they are trading or clearing contracts will be able, under the regulations, to remain in existence, creating uncertainty in the marketplace and possibly driving investors to a small number of "likely to survive" DCMs and DCOs.

The Commission should withdraw the Proposed Rules and perform the review required by Section 726. If, after performing that review, the Commission makes a determination that rules are necessary or appropriate to mitigate conflicts of interest that arise from a swap dealer's or swap entity's business dealings with a DCO, DCM or SEF in which it has a material debt or equity interest, the Commission should promulgate rules that are narrowly tailored to address the conflicts of interest with which Congress was concerned in enacting Section 726. For the reasons discussed herein, any revised set of rules would be much narrower in scope and less intrusive into the day-to-day business operations of DCOs, DCMs and SEFs.

Sincerely,

Kathleen M Cronin

Kathleen M. Cronin
Managing Director
General Counsel and Corporate Secretary

cc: Chairman Gary Gensler
Commission Michael Dunn
Commissioner Jill Sommers
Commissioner Scott O'Malia
Commissioner Bart Chilton

APPENDIX A: CME GROUP'S RESPONSES TO THE COMMISSION'S QUESTIONS FOR COMMENTS

1. Questions on Conflicts of Interest

- **Has the release correctly identified the conflicts of interest that a DCO, DCM, or SEF may confront?**

The *Release* has not correctly identified the conflicts of interest faced by DCOs, DCMs or SEFs. First, the conflation of individuals with a membership interest in the registered entity with individuals associated with enumerated entities misses the point of Section 726. None of the motivations attributed to enumerated entities apply to individuals not associated with such entities, including members.

Moreover, with respect to DCOs, the *Release* contends that enumerated entities will have a motivation to exclude swaps from the clearing requirement because they profit from such swaps. This contention, however, ignores the anticipated role of both the Commission and the DCO in the administration of the clearing requirement. The Commission contemplates that it will be the final arbiter with regard to application of the clearing requirement; moreover, Dodd-Frank contemplates that a DCO may refuse to clear a swap to which the Commission has applied the requirement only if it threatens the financial integrity of the DCO. Consequently, given this statutory framework, the potential conflict of interest the *Release* contemplates does not exist. Clearing members continue to have the motivation to preserve the financial stability of the DCO, the board of such a DCO has the duty to act in its best interests, and any untoward actions by an enumerated entity attempting to exclude swaps from clearing for its own benefit will be counterbalanced by the Commission's already existent powers regarding the clearing requirement.

As to DCMs and SEFs, the *Release* identifies no potential conflicts that did not exist prior to the passage of Dodd-Frank. DCMs have always faced competition from each other, from the OTC swap market and from DTEFs. Additionally, the *Release* provides no support for the assertion that increased competition between DCMs and SEFs will cause DCMs to restrict access in a discriminatory manner. Indeed, it seems quite the opposite – increased competition for both futures and swaps would lead DCMs to seek to make their markets open and accessible to the most participants. Additionally, any increased competition brought about by the trading of swaps on DCMs and SEFs would have no effect on the interaction between a DCM's commercial and regulatory obligations. DCMs such as CME have always been tasked with fulfilling their regulatory obligations pursuant to their core principles while pursuing their commercial interests, and now, as always, it is in a DCM's commercial interests to properly fulfill its regulatory obligations. If a DCM does not properly fulfill its obligations, it faces CFTC investigation, loss of its DCM status and litigation, all of which reputationally affect its market, discourage the use of its market and have unquestionably negative financial consequences for the company.

- **Has the release accurately specified the possible effects of such conflicts of interest on DCO, DCM, or SEF operations? What are other possible effects?**

The *Release* incorrectly identifies as conflicts structures that do not constitute conflicts of interest. The *Release* does not accurately catalogue the possible effects of such mischaracterized conflicts of interest. As noted above, with regard to DCOs, the suggested conflicts of interest, assuming, *arguendo*, that they exist, are fully addressed by provisions of Dodd-Frank. That is, the Dodd-Frank gives the Commission power with regard to the application of the clearing requirement. As such, these conflicts of interest are fully addressed and will have no effect. Additionally, directors of a DCO are required to act in the best interests of the DCO and its shareholders – not in their own best interests – pursuant to state law and Core Principle P. As such, any potential conflicts of interests should have no effect where the directors fulfill their state law duties as well as their duties under the current regulations.

The *Release* also has not accurately specified the possible effects of the enumerated conflicts of interest on DCMs and SEFs. As noted above, the *Release* provides no support for the assertion that increased competition between DCMs and SEFs will cause DCMs to restrict access in a discriminatory manner. Indeed, it seems quite the opposite – that increased competition for both futures and swaps would lead DCMs to seek to make their market attractive to the most participants. Additionally, any increased competition brought about by the trading of swaps on DCMs and SEFs would have no effect on the interaction between a DCM's commercial and regulatory obligations. DCMs such as CME have always been tasked with pursuing their commercial interests while fulfilling their regulatory obligations pursuant to Core Principle 16, and now, as always, it is in a DCM's commercial and reputational interests to properly fulfill its regulatory obligations. If a DCM does not properly fulfill its obligations, as always, it faces CFTC investigation, loss of its DCM status and litigation, all of which reputationally affect its market, discourage the use of its market and have unquestionably negative effects on its commercial interests.

- **What other conflicts of interest may exist? What are the effects of such conflicts?**

CME does not anticipate any additional conflicts of interest, and any potential conflicts of interest are already adequately addressed by Core Principles 16, analogous Core Principles and state law fiduciary duties and, consequently, will not have any detrimental effect.

2. Questions on Composition

- **Would such composition requirements be equally valid in mitigating conflicts of interest concerning a privately-held DCO, DCM, and SEF, as opposed to a publicly-held DCO, DCM, and SEF?**

Directors of a publicly-held corporation are already subject to fiduciary duties, most notably the duty of loyalty, that requires the directors to act in the best interests of the corporation rather than their own best interests. These fiduciary duties are traditionally creatures of state law. As such, the composition requirements are unnecessary to ensure an objective board and represent an improper intrusion into the traditional purview of state law. Regardless, the Commission's concerns giving rise to the composition requirements are already addressed by Core Principle 16 and analogous Core Principles.

- **As mentioned above, would providing for fair representation on DCO, DCM, or SEF Board of Directors be preferable to, or complementary to, mandating specific percentages of public directors? Also, if the main purpose of the 35 percent composition requirement is to introduce an independent perspective into DCO, DCM, and SEF governance, would requiring one or two public directors be sufficient, regardless of the size of the DCO, DCM, or SEF Board of Directors?**

"Fair representation" in this question is an improper and erroneous construct. Fair representation on the board of a public company must be seen as the directors chosen by the public shareholders and others entitled to vote. The Commission has not been empowered by Congress to choose a different measure for "fair representation." It is unnecessary and improper either on its own or as a complement to requiring specific percentages of public directors. Both options amount to an improper intrusion into internal corporate affairs as governed by state law. Additionally, both are unnecessary because pursuant to state law, board members, regardless of their perspectives or other affiliations, are not permitted to act to further their own interests over those of the corporation and because these concerns are already addressed by Core Principle 16.

- **As mentioned above, the Commission is seeking to mitigate potential conflicts of interest that may influence a DCO regarding (i) whether a swap contract is capable of being cleared, (ii) the minimum criteria that an entity must meet in order to become a swap clearing member, and (iii) whether a particular entity satisfies such criteria. Because the DCO Board of Directors would make ultimate decisions implicating (i), (ii), and (iii), is the 35 percent composition requirement sufficient to ensure that the private, competitive interests of certain DCO members do not capture DCO risk assessments with respect to both products and membership? Or should the Commission increase the required percentage of public directors to 51 percent? Or is there a number less than 51 percent but greater than 35 percent that would be more appropriate?**

To begin, there is no preexisting 35 percent requirement. Pursuant to the Acceptable Practices, there is rather a 35 percent composition safe harbor. Regardless, not even the 35 percent composition requirement suggested in the *Release* is necessary – in fact no composition requirement is necessary. Each member of a DCO's board is required by state law to act in the best interests of the DCO. This includes acting in the best interests of the DCO with regard to deciding whether clearing a given swap is profitable for the DCO or will lead to unnecessary risk and whether allowing membership for a given entity is profitable for the DCO or will bring unnecessary risk upon it. As such, no particular board composition is necessary to address these potential conflicts. Any such requirements represent an improper intrusion into internal corporate affairs, which are traditionally governed by state law. Additionally, these concerns are otherwise addressed by Core Principle P. The Commission has adequate authority to act if the board of a DCO fails to act in accordance with the Core Principles.

- **As described above, the Dodd-Frank Act envisions (i) a DCM competing with a SEF to list the same swap contract, and (ii) a DCM listing a commodity futures or options contract that competes with a swap contract listed on a SEF. In both cases, a DCM would be competing against an entity with lesser self-regulatory obligations. Such competition may place increased stress on the manner in which the DCM aims to satisfy its self-regulatory responsibilities. In light of such stress, is the 35 percent composition requirement still sufficient to protect the DCM self-regulatory function?**

A DCM must operate in conformity with a comprehensive set of Core Principles and, going forward, regulations interpreting those Core Principles. No DCM has the option of evading its self-regulatory responsibilities to meet a competitive threat. To the contrary, it is in the interest of DCMs to enhance their self-regulatory programs and establish themselves as meeting or exceeding industry best practices as a competitive advantage to attract business. DCMs have faced direct competition from entities with less onerous regulatory obligations, *e.g.*, ECMs and EBOTS, which the Commission allowed to operate without any significant regulation, yet it is clear that DCMs did not treat that competition as an excuse or motive to lessen their regulatory programs. Indeed, DCMs trading exclusively futures contracts faced competition from swaps, which until Dodd-Frank, were traded OTC or on markets with minimal, if any, self-regulatory obligations.

The regulatory advantage currently enjoyed by the OTC market, ECMs and EBOTs will be lessened, not increased under the new statutory scheme. Moreover, there is no preexisting 35 percent requirement. Pursuant to the Acceptable Practices related to Core Principle 16 for DCMs, there is rather a 35 percent composition safe harbor. The 35 percent composition safe harbor is meaningless in relationship to the performance of a DCM or DCO of its statutory duties. The Public Directors as defined by the Commission have no greater incentive to ensure compliance with the requirements of the CEA than any other director.

- **As referenced above, the Dodd-Frank Act anticipates that a SEF would face a more competitive environment at inception than a DCM currently listing commodity futures and options. As the DCM Conflicts of Interest Release notes, increased competition may be detrimental to self-regulation. Therefore, the 35 percent composition requirement appropriate to ensure that a SEF discharges its self-regulatory functions in the first instance?**

As noted above, there is no pre-existing 35 percent requirement applicable to DCMs but rather a 35 percent safe harbor. Regardless, SEFs will be governed by Core Principle 12, which is identical to Core Principle 16 for DCMs and Core Principle P for DCOs. SEFs must minimize conflicts of interest in decision-making and additionally, are required to have in place a Chief Compliance Officer that ensures their compliance with the Core Principles. Additionally, directors of SEFs, if they are public companies, will be bound by the same fiduciary duties that bind other directors, and it is in the commercial interests of new SEFs to properly abide by their regulatory obligations.

3. Questions on Substantive Requirements

- **What substantive requirements, other than those identified above, should the Commission consider imposing on a DCO, DCM, or SEF Board of Directors to mitigate the potential conflicts of interest described in Section II, as well as any potential conflicts of interest not specified herein? For example, should the Commission consider any additional requirements related to (i) the fiduciary duties that a DCO, DCM, or SEF Board of Directors may owe or (ii) policies or charters that the DCO, DCM, or SEF Board of Directors may adopt?**

The Commission should not impose any substantive requirements on DCO, DCM, and SEF boards of directors, including those suggested in the *Release*. Any composition requirements imposed upon members of the board represents an improper intrusion into internal corporate affairs and, as such, an improper intrusion into an area traditionally regulated by state law. Additionally, the Commission's concerns are already addressed by Core Principle 16 and the Acceptable Practices.

Nonetheless, assuming, *arguendo*, that any intrusion of the Commission into internal corporate affairs is proper, which the CME does not believe it is, many of the Commission's concerns regarding DCO, DCM, and SEF observance of their regulatory duties in a potentially more competitive environment could be addressed by simply specifically stating that directors of regulated entities have a duty to see to it that the regulated entity performs its regulatory duties. This is unnecessary, however, because, as discussed above, a director's duty to ensure that a regulated entity abides by its regulatory duties overlaps with its duty of loyalty generally due to the detrimental effect that a failure to abide by regulatory obligations would have on the business of the regulated entity.

4. **Questions on Committees and the Definition of Public Director**

- **Is each of the committees or panels specified above necessary or appropriate for the mitigation of the conflicts of interest described in Section II, or of any conflict of interest not identified herein? If so, are the composition requirements applicable to such committees necessary or appropriate to effect such mitigation?**

The specified committees and panels are neither necessary nor appropriate to mitigate any conflicts of interest. First, as noted repeatedly above, the requirement of such committees and panels represents an improper intrusion into internal corporate affairs, which are traditionally governed exclusively by state law. Regardless, the concerns addressed by such committees and panels are already contemplated and addressed by Core Principle 16, and as a result, CME already has similar independent committees and panels in place. Additionally, it is worthy of note that in its discussion of composition requirement applicable to committees, the Commission mischaracterizes some of its previous Acceptable Practices pursuant to Core Principle 16 as "requirements." Specifically, the Commission suggests that it previously required DCM disciplinary panels to include one "public participant" and that it previously required DCM ROCs to be composed of only public directors. These "requirements" are actually and as such, any regulation requiring these elements of board composition to DCMs is new, not maintenance of a prior regulation.

- **What other ways should the Commission consider defining "public director"? Are there other circumstances that the Commission should include in the bright-line materiality tests? Are there circumstances that the Commission should remove from such tests?**

Assuming, *arguendo*, that the Commission had the power to control the composition of the board of a public company, which it does not, the Commission should not amend the definition of "public director" that it adopted in 2009. That definition adequately addressed the Commission's concerns, and keeping the current definition, which was very recently agreed upon, prevents any further disruption to governance arrangements for regulated entities.

5. **Questions on the First and Second Alternatives and the Waiver**

(a) **First and Second Alternatives:**

- **Are the First and Second Alternatives effective for mitigating, on a prophylactic basis, conflicts of interest arising from the control that (i) one member may exert as a dominant voting shareholder of a DCO and (ii) the enumerated entities may collectively exert as voting shareholders of a DCO (specifically with respect to the DCO risk assessments referenced above)? What methods, other than the First and Second Alternatives, should the commission consider to mitigate such conflicts of interest? What are the advantages and disadvantages of such methods?**

Neither the first nor second alternative, nor any other method, is necessary to mitigate conflicts of interest. Regardless of the extent to which any shareholder is dominant and thus has power to affect the voting for members of a Board of Directors, those elected directors are bound by their fiduciary duties under Delaware law not to act in their own self-interests, and regardless, the Commission's concerns are adequately addressed by Core Principle 16. As such, any limitations on equity ownership are unnecessary. Additionally, if the Commission determines that it should set limits as to equity ownership, such limits should apply only to enumerated entities, because Section 726 empowers the Commission to set such limits only with regard to enumerated entities.

- **Under what circumstances would the First and Second Alternatives not be appropriate for a DCO? For example, should the First and Second Alternatives apply equally to established DCOs and start-up DCOs?**

As noted above, neither the first nor second alternative is appropriate because the Commission is empowered to set ownership limits for DCOs only with regard to enumerated entities, not other members, and the Commission's concerns are already addressed by other means – state law and Core Principle 16. Regardless, the ownership limitations will cause challenges for both new and established DCOs. That is, established DCOs may need to seek alternative sources of funding, thus causing uncertainty as to their viability, and start-up DCOs will have trouble finding funding from enough sources outside of enumerated entities to start their businesses. As such, if the Commission determines that it should set limits on enumerated entity equity held in DCOs, it should use the waiver procedure liberally to allow established DCOs, such as CME, that have shown no signs of conflicts of interest in their management and/or start-up DCOs that cannot otherwise compile enough capital to operate to avoid both of the alternatives.

- **Are the percentages that the Commission specifies in the First and Second Alternatives effective for mitigating conflicts of interest arising from the control that (i) one member may exert as a dominant voting shareholder of a DCO and (ii) the enumerated entities may collectively exert as voting shareholders of a DCO? If not, what alternative percentages should the Commission consider to achieve such mitigation?**

The percentages specified in the First and Second alternatives are irrelevant to mitigate any conflicts of interest. Even if percentage limits were relevant, the Commission should decrease the percentages in the First and Second alternatives to help mitigate: 1) disruption and uncertainty in the market resulting from the need for established DCOs to alter their ownership structure, and 2) decreased competition due to difficulty for new DCOs to enter the market based on an inability to take more than a small percentage of funding from enumerated entities or other potential shareholders. Again, the Commission should consider doing away with the percentages all together because its concerns are already addressed by state law and Core Principle 16.

- **Would the First and Second Alternatives be effective to mitigate any potential conflicts of interest not discussed herein? If not, then what other equity ownership and voting limits should the Commission consider?**

No other potential conflicts need to be addressed, and to the extent any other such conflicts may arise, they are already adequately addressed by state law and Core Principle P, and are certainly more than amply addressed by the combination of state law, Core Principle P, and the First and Second alternatives.

- **Should the limits in the First and Second Alternatives only apply to clearing members, and not enumerated entities that are not clearing members? Should the limits in the First and Second Alternatives apply only to DCOs, and not to their parent companies?**

If the First and Second alternatives are to apply, they should apply to both clearing members and non-members. Indeed, if one relies on the potential conflicts of interest set out by the *Release*, such conflicts of interest are more likely to be caused by non-members than by clearing members. More specifically, clearing members, as noted in the *Release*, have a motivation to clear swaps and approve members so long as such decisions are not likely to have an adverse effect on the stability of the DCO, because allowing the participation of more clearing members decreases the amount paid by any one member – therefore the amount paid by them – in the event of default. Such motivation, which would counterbalance any potential desire to exclude clearing members and the clearing of swaps, is not present with regard to enumerated entities that are not clearing members. Indeed, if anything, the limits should apply only to enumerated entities that are not clearing members.

The First and Second Alternatives should not apply to the parent companies of DCOs. As noted above, the ownership requirements create uncertainty in the markets arising from the obligation of established DCOs to change their ownership structures as well as obstacles to market entry for start-up DCOs. This issue would be exacerbated by applying the requirements to parent companies of DCOs. Additionally, decisions regarding clearing of swaps and admittance of clearing members, the decisions about which the Commission is concerned, would take place at the DCO level, and thus ownership restrictions at the parent company level are unnecessary.

(b) Waiver:

- **The Commission seeks comment on (i) the circumstances which may require an alternative ownership structure for a DCO, (ii) the types of alternative ownership structures of DCOs that may require flexibility in setting ownership or voting rights levels consistent with achieving the goal of Section 726 of the Dodd-Frank Act to mitigate conflicts of interest, and (iii) the appropriate means to provide such flexibility to the Commission during the DCO application process if such an organization were to adopt an alternative structure.**

The appropriate means to provide such flexibility is to allow DCOs discretion pursuant to Core Principle A (ii) in complying with Core Principle P, which ensures that DCOs will minimize conflicts of interest in decision-making as it has allowed DCMs such discretion in complying with their analogous Core Principle 16 in the past.

6. Questions on DCM or SEF Limits on Ownership and Voting Power

- **Are the single-member limits on ownership and voting power effective for mitigating, on a prophylactic basis, the conflicts of interest that Section II identifies? What methods, other than such limits, should the Commission consider to mitigate such conflicts of interest? What are the advantages and disadvantages of such methods?**

The single-member limits on ownership will be effective to mitigate any potential conflicts of interest identified by Section II. However, such limitations are unnecessary. Directors of a DCM or SEF, regardless of who elected them, have a fiduciary duty to the DCM or SEF under state law. As such, any directors are already obligated not to restrict or burden access in a discriminatory manner because they are obligated to allow access in such a way that is beneficial to the DCM or SEF, and are already obligated not to disregard regulatory obligations, because ignoring such obligations will become detrimental to the operation of the DCM or SEF. Additionally, these potential conflicts are already adequately addressed by Core Principle 16.

- **Should the Commission also consider instituting a waiver procedure for DCMs and SEFs with respect to the single-member limitation?**

The Commission should consider instituting a waiver procedure for DCMs and SEFs. As is the case with DCOs, any ownership limitations placed upon DCMs and SEFs will cause uncertainty in the market and provide a barrier of entry to the market. A waiver procedure, in particular a waiver procedure for new DCMs and SEFs and for established DCMs that have adequately complied with Core Principle 16 and thus show no signs of conflicts of interest in their operation should have the option of applying for a waiver.

- **Should the single-member limitation be extended to the parent company of a DCM or SEF?**

The single-member limitation should not be extended to the parent company of a DCM or SEF. As noted above, such a limitation would exacerbate the uncertainty in established DCMs and barriers to market entry for new DCMs or SEFs caused by a potential introduction of the single-member limitation.