



March 12, 2009

Elizabeth M. Murphy
Secretary
Securities and Exchange Commission
100 F Street, NE
Washington, DC 20549

**Re: Request for Order Exempting Certain Persons from Broker-Dealer
Registration and Related Requirements, and from Clearing Agency
Registration and Related Requirements**

Dear Ms. Murphy:

Citadel Investment Group, L.L.C. ("Citadel") and Chicago Mercantile Exchange Inc. ("CME") request that, subject to the conditions and representations set forth below, the Securities and Exchange Commission ("Commission") issue certain exemptive orders related to certain credit default swap ("CDS") contracts to be cleared by CME. Specifically, we request that:

(1) pursuant to Section 15(a)(2) of the Securities Exchange Act of 1934 ("Exchange Act"), the Commission issue an order exempting any person that may be subject to broker or dealer registration pursuant to Section 15(a)(1) of the Exchange Act solely as a result of effecting any transactions in, or inducing or attempting to induce the purchase or sale of, certain CDS contracts to be cleared by CME (each such person, an "exempt BD") from the broker-dealer registration requirement under Section 15(a)(1) of the Exchange Act;

(2) pursuant to Section 36 of the Exchange Act, the Commission issue an order exempting such exempt BDs (but not registered broker-dealers) from the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6) of the Exchange Act), and the rules and regulations thereunder, that apply specifically to a broker or dealer whether or not registered with the Commission; and exempting CME from the clearing agency registration requirements set forth in Section 17A(b)(1) of the Exchange Act with respect to its performance of the functions of a clearing agency regarding CDS contracts (to the extent such instruments are treated as securities).

I. The Trading and Clearing Solution

To address the issues presented by the current credit default market, Citadel and CME have entered into a joint venture (to be named "CMDX") to provide a trading and clearing solution for CDS contracts. The solution involves the creation of an electronic trading, booking and migration platform for CDSs, paired with straight-through processing to CME's clearing facilities. In addition to its trading platform, CMDX will be capable of receiving and processing data for trades matched outside CMDX's trading platform, again straight through to clearing. CME itself will also accept for clearing directly from participants trades in CDS contracts that are not executed on or processed through CMDX, offering credit market participants a wide variety of clearing and risk management solutions. CME will accept for clearing (i) trades that are matched on the CMDX platform, (ii) pre-existing non-standard trades that are submitted to clearing through the CMDX migration facility, and (iii) new bilaterally-executed trades in standardized products that are submitted to CME for clearing directly by the participants (using CME's Clearing 360TM API or similar facility that CME makes available). CME will also be able to establish connectivity for clearing with other interested CDS execution venues and inter-dealer brokers. Non-standard trades that are migrated to CME will ultimately be converted to a standard, centrally cleared contract. Migration may only occur if both counterparties to a trade agree to the process and both are clearing members or have the appropriate relationship with a clearing member. CMDX will also supply participants a data file of the original bilateral positions that were accepted into clearing via the migration process, so that participants may send appropriate exit records to the DTCC Trade Information Warehouse.

Citadel and CME have designed this open architecture solution to replicate key aspects of the current over-the-counter ("OTC") CDS market as closely as possible to avoid unnecessarily disrupting the existing CDS market, while providing centralized clearing and the option to negotiate and execute CDS transactions on an electronic platform. We are prepared to launch our solution, facilitating substantial improvements in credit markets, as soon as the necessary exemptive relief is available.

A. CMDX

1 Eligible Participants

CMDX trading, booking and migration services will be available only to persons that satisfy the definition of an "eligible contract participant" in Section 1a(12) of the Commodity Exchange Act ("CEA") (other than paragraph (C) thereof). In addition, each participant on the CMDX platform must be a clearing member of CME or have a clearing relationship with a CME clearing member that agrees to assume financial responsibility for the participant's CDS contracts cleared by CME.

2. Eligible Contracts

Initially, CMDX will offer CDS contracts that mirror as closely as possible the terms of existing OTC CDS contracts. The coupons and maturities will be standardized to the extent necessary to permit centralized clearing. CMDX plans to offer trading, booking, and migration services for actively traded CDX and iTraxx indexes as well as their single name components, and certain other commonly traded single name contracts, and will add additional indexes and single name products as conditions warrant. At the time any CDS contract is traded, booked, or migrated to clearing via CMDX, or cleared directly by CME, the reference entity, the issuer of the reference security, or the reference security (or any tranche thereof) will be one of the following: (1) an entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available (that is, financial information is generally available to eligible contract participants through commercially reasonable sources); (2) a foreign private issuer whose securities are listed outside the United States and has its principal trading market outside the United States; (3) a foreign sovereign debt security; (4) an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; (5) an asset-backed security issued or guaranteed by Fannie Mae, Freddie Mac or Ginnie Mae; or (6) indexes comprised of these entities or securities, or tranches thereof, provided that an index will not be disqualified if, in the aggregate, reference entities (or reference securities) comprising not more than 20% of the index's weighting do not satisfy any of the above information conditions with regard to reference entities or reference securities ("Eligible CDS contracts").

3. Trading Facilities

The CMDX platform will consist of a migration facility, a matched-trade facility, and a request for quote ("RFQ") trading facility.¹ Using the migration facility, participants who are the counterparties to eligible existing bilateral non-standardized CDS contracts may migrate those contracts to become Eligible CDS contracts cleared by CME. The matched-trade facility will accept the submission of trades in CMDX's Eligible CDS contracts entered bilaterally by participants, or matched outside the CMDX platform on other trading facilities or by inter-dealer brokers. The matched-trade facility will accept contracts that meet all requirements for clearing by CME. On the RFQ facility, liquidity providers will provide liquidity to other market makers and participants through an RFQ process. Prices and trading volume for trades submitted to or executed on the CMDX platform will be made available to participants on the platform and to the market through customary data distribution arrangements.

B. CME Clearing and Settlement

CME will provide clearing and settlement services for transactions in Eligible CDS contracts submitted to or executed on the CMDX platform. Specifically, the trades submitted to or executed on the CMDX platform will be processed straight-through to CME for clearing and

¹ CMDX may build, or link to, additional trading facilities in the future.

settlement. CME only will accept for clearing and settlement transactions in Eligible CDS contracts between persons that satisfy the definition of “eligible contract participant” in Section 1a(12) of the CEA (other than paragraph (C) thereof). The relevant provisions for CME’s CDS clearing and settlement activities are described below.

CME Group Inc., a Delaware stock corporation, is the holding company for CME, Board of Trade of the City Of Chicago, Inc. (“CBOT”), New York Mercantile Exchange, Inc. (“NYMEX”), Commodity Exchange, Inc. (“COMEX”) and their subsidiaries. CME was founded in 1898 as a not-for-profit corporation. In 2000, CME demutualized and became a shareholder-owned corporation. In 2002, Chicago Mercantile Exchange Holdings Inc. completed its initial public offering of its Class-A common stock and became the first U.S. financial exchange to be publicly traded. In 2007, Chicago Mercantile Exchange Holdings Inc. completed its merger with CBOT Holdings, Inc. In 2008, CME Group completed its acquisition of NYMEX Holdings, Inc., the parent company of NYMEX and COMEX.

CME is a Designated Contract Market (“DCM”), regulated by the Commodity Futures Trading Commission (“CFTC”), for the trading of futures and options on futures contracts. In addition, CME Group operates its own clearing house, which is a division of CME. The CME clearing house is a Derivates Clearing Organization (“DCO”) regulated by the CFTC. The clearing house clears, settles and guarantees the performance of all transactions matched through the execution facilities and on third party exchanges for which CME Group provides clearing services. The clearing house operates with the oversight of the Clearing House Risk Committee (“CHRC”). The CHRC is made up of a group of clearing member representatives who represent the interests of the clearing house as well as clearing members of CME Group.

CME is required to comply with the 18 CFTC Core Principles applicable to registered DCMs and the 14 CFTC Core Principles applicable to DCOs.² The CFTC conducts regular audits or risk reviews of CME with respect to these Core Principles. CME is, and has always been, registered and in good standing with the CFTC. In addition, CME is notice registered with the SEC as a special purpose national securities exchange for the purpose of trading securities futures products. In the U.K., CME is a Recognised Overseas Investment Exchange and a Recognised Overseas Clearing House, subject to regulation by the U.K. Financial Services Authority.

1. Clearing Members

CME’s rules alone or in combination with laws and regulations applicable to CME and its clearing members require that any CME clearing member that purchases, sells, or holds CDS positions for other persons, solely as they relate to CDSs: (1) must be registered with the CFTC as a futures commission merchant (“FCM”); (2) effectively segregate funds and securities of other persons (except positions held in proprietary accounts of the clearing member, which may

² The DCM and DCO Core Principles are set forth in Sections 5(d) and 5b(c)(2) of the Commodity Exchange Act, 7 U.S.C. §§7(b), 7a-1(c)(2)(A).

include, for example, positions of employees or affiliates of the clearing member³) that it holds in its custody or control for the purpose of purchasing, selling, or holding CDS positions; (3) maintain adequate capital and liquidity; and (4) maintain sufficient books and records to establish (a) that the CME clearing member is maintaining adequate capital and liquidity, and (b) separate ownership of the funds, securities, and positions it may hold for the purpose of purchasing, selling, or holding CDS positions for other persons and those it holds for its proprietary accounts.

a. Segregated Funds and Securities

If we receive a 4d order from the CFTC, the segregation and protection of customer funds and property will be controlled by Section 4d of the CEA⁴ and the regulations pertinent thereto; all funds and property received from customers of FCMs in connection with purchasing, selling

³ Specifically, positions that may be held in proprietary accounts of a clearing member and therefore not segregated include positions held for persons or entities listed in the definition of "proprietary account" in CFTC Regulation 1.3(y), as follows:

(y) *Proprietary account*. This term means a commodity futures or commodity option trading account carried . . . (1) for one of the following persons, or (2) of which ten percent or more is owned by one of the following persons, or an aggregate of ten percent or more of which is owned by more than one of the following persons:

- (i) Such individual himself, or such partnership, corporation or association itself;
- (ii) In the case of a partnership, a general partner in such partnership;
- (iii) In the case of a limited partnership, a limited or special partner . . . whose duties include:
 - (A) The management of the partnership business or any part thereof,
 - (B) The handling of the trades or customer funds of customers or option customers of such partnership,
 - (C) The keeping of records pertaining to the trades or customer funds of customers or option customers of such partnership, or
 - (D) The signing or co-signing of checks or drafts on behalf of such partnership;
- (iv) In the case of a corporation or association, an officer, director or owner of ten percent or more of the capital stock, of such organization;
- (v) An employee of such individual [or entity] whose duties include:
 - (A) The management of the business of such individual [or entity] or any part thereof,
 - (B) The handling of the trades or customer funds of customers or option customers of such individual [or entity],
 - (C) The keeping of records pertaining to the trades or customer funds of customers or option customers of such individual [or entity], or
 - (D) The signing or co-signing of checks or drafts on behalf of such individual [or entity];
- (vi) A spouse or minor dependent living in the same household of any of the foregoing persons;
- (vii) A business affiliate that directly or indirectly controls such individual [or entity].
- (viii) A business affiliate that, directly or indirectly is controlled by or is under common control with, such individual [or entity]. Provided, however, That an account owned by any shareholder or member of a cooperative association of producers, within the meaning of sections 5(5) and 6a of the Act, which association is registered as a futures commission merchant and carries such account on its records, shall be deemed to be an account of a customer or option customer and not a proprietary account of such association, unless the shareholder or member is an officer, director or manager of the association.

⁴ 7 U.S.C. §6d.

or holding CDS positions will be subject to the requirements of CFTC Regulation 1.20, *et seq.* promulgated under Section 4d.⁵ Upon issuance of a 4d order, CFTC Regulation 1.20, *et seq.*, will apply to the purchasing, selling, and holding of CDS positions. Regulation 1.20, *et seq.*, requires that customer positions and property be separately accounted for and segregated from the positions and property of the FCM. Customer property will be deposited under an account name that clearly identifies it as such and shows it is appropriately segregated as required by the CEA and Regulation 1.20, *et seq.*

In accordance with CME Rule 8F03, prior to issuance of a 4d order, all CDS contracts submitted to CME for clearing for the account of a clearing member's customer must be assigned and held in an account subject to CFTC Regulation 30.7.⁶ Like Regulation 1.20, *et seq.*, Regulation 30.7 requires that customer positions and property be separately held and accounted for from the positions and property of the FCM, and that customer property be deposited under an account name that clearly identifies it as customer property. CME Rule 8F03 reiterates that “[a]ll collateral deposited as performance bond to support positions in such Regulation § 30.7 account and all positions, collateral or cash in such account shall be segregated from the Clearing Member's proprietary account.”

These CFTC regulations are designed to protect customers in the event of the insolvency or financial instability of the FCM through which they conduct business. Additionally, CME's Audit Department regularly inspects the books and records of clearing members to ensure, among other things, their compliance with these segregation requirements.

b. Adequate Capital and Liquidity

CME clearing members that are broker-dealers or FCMs maintain capital and liquidity in accordance with relevant SEC and CFTC rules and regulations. In addition, CME's requirements for minimum capital contribution, contribution to the guaranty fund based on risk factors, maintenance margin, and mark to market with immediate payment of losses assure adequate capital and liquidity for clearing member firms that are not broker-dealers or FCMs (*i.e.*, clearing members that only carry positions for proprietary or non-customer accounts), as

⁵ If CME secures a 4d order from the CFTC permitting customer funds to be held in segregation for CDS contracts, the segregation, segregation computation and segregation audit program will apply. The National Futures Association (“NFA”) describes the daily segregation computation requirements as follows: “In order to sustain the highest customer protection and market integrity, the regulations require that all customer funds received by an FCM be segregated from and accounted for separately from the FCM's own funds. Each day, an FCM must make a formal segregation computation detailing the amount of customer funds required to be on deposit in segregated accounts and the amount of funds on deposit in segregated accounts. This computation should be filed with NFA by noon of the following business day. In order to assist FCMs in meeting this reporting requirement, NFA developed a web-based Daily Segregation Reporting System.” NFA Home Page, <http://www.nfa.futures.org/compliance/dailysegregation.asp>. The instructions for completing the monthly 1-FR-FCM report, which includes extensive reporting requirements for FCMs pertaining to segregation requirements, can be found at on the web site of the CFTC, at <http://www.cftc.gov/stellent/groups/public/@joiintermediaries/documents/file/1fr-fcminstructions.pdf>. If a 4d order is not obtained, CME will rely on CFTC Regulation 30.7 as the source of authority to segregate customer funds. The reporting and accounting requirements for segregated funds, described herein, also apply to funds segregated pursuant to Regulation 30.7.

⁶ 17 C.F.R. § 30.7.

well as those that are broker-dealers or FCMs. Clearing members subject to CFTC regulations are required to maintain Adjusted Net Capital (“ANC”) at prescribed levels.⁷ CME and the CFTC have adopted a risk-based capital requirement as the regulatory minimum capital requirement. Capital requirements are monitored by CME’s Audit Department and ANC requirements vary to reflect the risk of each clearing member’s positions as well as CME’s assessment of each clearing member’s internal controls, risk management policies and back office operations.

Clearing members also will have tools to manage appropriate requirements with respect to their customers. CME Rule 982 requires clearing members to establish written risk management policies and procedures, including monitoring the risks assumed by specific customers. To facilitate such controls with respect to CDS transactions, CME’s clearing systems include functionality that permits clearing members to register customer accounts and specify customer credit limits. Control features of the migration facility and the RFQ trading platform will ensure that CDS transactions cannot be submitted to clearing for non-registered accounts or if the positions resulting from the transaction or transactions would cause the specified daily exposure limit to be exceeded.

CME will extend its current monitoring procedures to Eligible CDS contracts cleared by CME. CME will monitor for and investigate unusual trading patterns or volumes. Customer account reporting will allow CME to view the positions held by individual accounts. The positions of each account will be analyzed throughout the day to monitor any accounts that may have significant losses due to market moves. In addition, significant changes in positions from day to day will be analyzed and reported to CME clearing house senior management.

CME will include stress testing of the different CDS margin factors to capture moves beyond the one-day 99% standard on the macro and sector moves and the five-day 99% standard for the idiosyncratic shocks. This will be considered in designing the financial safeguards package, adding concentration types of margining and routine stress testing. Also, the CDS margin factor parameters will be reviewed daily as a back-testing procedure to ensure the parameters are providing the desired coverage. CME will also review on a daily basis the margin collected on CDS portfolios and compare those amounts to next-day market moves so that actual portfolio effects can be determined and gauged against the margin coverage. The concentration of CDS positions will also be evaluated beyond the margin factors and compared against overall open interest and liquidity in the CDS market.

Settlement prices will be determined each business day for each eligible product based upon pricing data from multiple origins. Sources of pricing data will include: (1) prices of OTC transactions submitted to CME for clearing; (2) prices of transactions executed on the CMDX platform; and (3) indicative prices contributed by members of the OTC Financial Data Exchange. The pricing data will be processed using standard validation, aggregation and valuation analytics.

⁷ CFTC Regulation 1.17 (17 C.F.R. § 1.17).

Updated settlement prices will be made available to clearing members on their open positions on a regular basis (typically twice a day, or more frequently in case of sudden market moves).

CME will extend its scenario based stress testing techniques for concentration margining to cleared CDS products. CME currently conducts independent stress testing on Equity, Interest Rate, Commodity, Energy and Foreign Exchange asset classes. The stress tests are calculated every night for assessment at mid-day and end-of-day. Consistent with current methodologies for cleared products, the stress tests for CDS products will be based on the net exposure of each segregated pool (customer segregated and non-segregated) for every clearing member, and CME will stress test margin price factors by 150%. For example, if the S&P 500 Future margins were based on stress testing the underlying index up and down 99 points, then the underlying index would be stress tested by 148.5 points for concentration margining. For CDS, we will utilize a similar methodology by stress testing the macro, sector idiosyncratic, and basis margin factors by 150%.

The concentration stress test results will be evaluated relative to excess ANC for each segregated pool. Both customer and house positions of the clearing member will be stress tested on a net basis. Non-segregated (house) hypothetical gains will offset customer segregated losses in stress tests, but not vice versa. If the hypothetical losses exceed the excess ANC for a clearing member's segregated pool, then an additional margin charge will be applied to the clearing member's position. The additional margin charge is calculated based on the magnitude of the hypothetical losses in excess of the clearing member's excess ANC. In particular, the additional margin charge is computed as follows:

- If any of the stress test losses are greater than the excess ANC, then the performance bond add-on margin would be 10% of the initial margin requirement on the entire CDS portfolio.
- If any of the stress test losses are 2 times greater than the excess ANC, then the performance bond add-on would be 25% of the initial margin requirement on the entire CDS portfolio.
- For clearing members with large excess ANC levels, we will cap the excess ANC at \$500 million for a 10% margin add-on and \$1 billion for a 25% margin add-on. Therefore, the concentration stress test amounts are compared to the lesser of excess ANC or the threshold levels above.

CME determines the acceptability of different collateral types and determines appropriate haircuts. A list of acceptable collateral and applicable haircuts is available at www.cme.com. Collateral requirements for Eligible CDS contracts will appropriately reflect the specific risks of CDS contracts, including jump-to-default and the consequences of a liquidity event caused by the defaults.

c. Sufficient Books and Records

Broker-dealers and FCMs that are clearing members must meet their respective SEC and CFTC recordkeeping requirements. CME Rule 8F04(7) requires each FCM that is a clearing member to keep the same books and records for OTC derivatives (including CDS contracts) submitted to CME for clearing as the FCM is required to keep under CFTC recordkeeping requirements. Clearing members that are not regulated by the SEC or CFTC will be audited on a regular basis by CME's internal auditors to insure that books and records are kept in accordance with CME requirements, unless such auditing function is separately performed by another primary financial regulator of that clearing member (e.g., a banking regulator, in the case of a clearing member that is a bank). CME reserves the right to examine clearing member books at all times. The same audit procedures would apply whether full CFTC segregation under Section 4d is in place or if alternate means of segregation are employed. Clearing members are required under CME Rules, the CEA and CFTC regulations to maintain adequate accounting systems, internal accounting controls and procedures for safeguarding customer and clearing member assets. These requirements will apply to CDS contracts cleared by CME. These systems, controls and procedures must be robust enough to allow the clearing member to accurately demonstrate to the CME Group Audit Department that it maintains adequate capital and liquidity. In addition, the systems, controls and procedures must be able to evidence the separate ownership of funds, securities and positions it may hold for the purpose of purchasing, selling or holding CDS positions for customers and those it holds for its own proprietary accounts. Audit Department staff routinely examine clearing members to ensure compliance with these standards. Further, Audit Department staff may prescribe additional accounting, reporting, financial and/or operational requirements for clearing members and clearing members must comply with such requirements.

2. Clearing and Settlement

CME clearing and settlement of CDS contracts will operate using the established systems, procedures and financial safeguards package that stand behind trading in CME's primary futures market, and such activities will be subject to CFTC oversight of risk management and collateralization procedures. CME Rulebook chapter 8F sets forth the rules governing clearing and settlement of all products, instruments, and contracts in OTC derivatives, including but not limited to CDS contracts, swaps and forward rate agreements that the CME clearinghouse has designated as eligible for clearing.

CME meets the standards set forth in the CPSS/IOSCO report "Recommendations for Central Counterparties" ("RCCP"). To demonstrate that CME satisfies the RCCP standards, it will submit a confidential self-assessment to the Commission using the RCCP Assessment Methodology.

II. Benefits of the Trading and Clearing Solution

As the Commission and its Staff have recognized, CDSs “can serve important purposes.”⁸
In particular, CDSs

can be employed to closely calibrate risk exposure to a credit or a sector. CDS can be especially useful for the business model of some financial institutions that results in the institution making heavily directional bets, and others — such as dealer banks — that take both long and short positions through their market-making and proprietary trading activities. Through CDS, market participants can shift credit risk from one party to another, and thus the CDS market may be an important element to a particular firm's willingness to participate in an issuer's securities offering.⁹

Yet, the recent financial crisis has highlighted the need to improve the transparency and oversight of the credit default market. Indeed, regulators have been working closely with various industry participants to develop central counterparties (“CCPs”) to address these issues.¹⁰ As Chairman Cox has stated, such a move would be “an important step toward preventing the failure of a single market participant from having a disproportionate effect on the overall market.”¹¹ Specifically, the services offered by CMDX and CME will benefit investors and the public by addressing concerns regarding systemic, counterparty and related risks, increasing transparency, assisting in the deterrence of fraudulent and manipulative practices, and reducing operational complexity, cost and risk.¹² As a result of these changes, it will help restore regulatory and investor confidence in the market.

CME, acting as CCP, will reduce counterparty risk inherent in the CDS market and mitigate the risk and potential systemic impacts of counterparty failures. By clearing and settling CDS contracts, CME will substitute itself as the purchaser to the CDS seller and the seller to the CDS buyer. As a result, CDS counterparties will no longer be exposed to each others' credit risk. Instead, each counterparty will receive the benefit of CME's extensive package of financial safeguards.

CME will also reduce the risk of collateral flows by netting positions in similar instruments and by netting gains and losses across different instruments. As a result, instead of a CDS market participant having a large volume of trades, some offsetting, with many

⁸ Erik Sirri, Director, Division of Trading and Markets, SEC, Testimony Concerning Credit Default Swaps before the House Committee on Agriculture (Nov. 20, 2008) (“Sirri Speech”). *See also* Order Exempting Certain Broker-Dealers from Broker-Dealer Registration, Exchange Act Rel. No. 35135 (Dec. 22, 1994).

⁹ *Id.*

¹⁰ *See* Speech by former SEC Chairman Christopher Cox: Opening Remarks at SEC Roundtable on Modernizing the Securities and Exchange Commission's Disclosure System (Oct. 8, 2008).

¹¹ *Id.*

¹² *See* Sirri Speech.

counterparties, participants will benefit from netting. Moreover, centralized clearing will provide more flexibility to trade in and out of positions, and will allow for the expeditious transfer or liquidation of the positions of a troubled or defaulting clearing member. If a clearing member is troubled (*i.e.*, it fails to meet minimum financial requirements or its financial or operational condition may jeopardize the integrity of the CME, or negatively impact the financial markets), then the CME may take action pursuant to Rules 974 (Failure to Meet Minimum Financial Requirements) or 975 (Emergency Financial Conditions). In the event of a default by a clearing member of CME, the process will be governed by applicable CME Rules, including Chapter 8-F (Over-the-Counter Derivative Clearing), including but not limited to Rules 8F06 (Clearing Member Default), 8F07 (Security Deposit) and 8F13 (Insolvency and Liquidation). Chapter 8-F further incorporates the general CME Rules relating to defaults, including but not limited to Rules 913 (Withdrawal From Clearing Membership), 974 (Failure to Meet Minimum Financial Requirements), 975 (Emergency Financial Conditions), 976 (Suspension of Clearing Members), 978 (Open Trades of Suspended Clearing Members), and 979 (Suspended or Expelled Clearing Members).

In the event of a member default, CME may access its financial safeguard package as necessary. CME's financial safeguards package is a combination of each clearing member's collateral on deposit to support its positions, the collateral of its customers to support their positions, CME surplus funds, security deposits and assessment powers. Excluding collateral supporting open positions, which total approximately \$116 billion, the total financial safeguards package is nearly \$7 billion, comprised of: (1) CME surplus funds of \$57 million; (2) clearing member security deposits of approximately \$1.751 billion; and (3) assessment powers of approximately \$4,816 billion.¹³ Pursuant to CME Rule 8F04 in Chapter 8-F of the CME Rulebook, clearing members that clear Eligible CDS contracts will be subject to an additional \$5 million security deposit requirement. Furthermore, the calculation of that portion of a clearing member's security deposit that is related to the risk of its CDS position will be scaled upward by a factor of three.

CME's financial safeguards package is measured and stress tested each month to ensure that CME can, at a minimum, cover its largest net debtor in addition to smaller defaults in a hypothetical stress-test situation. Changes to clearing member contributions to the financial safeguards package are calculated quarterly. Any changes to financial safeguard policies are reviewed and approved by CME's Clearing House Risk Committee.

The migration facility is operationally proven and prepared to accept a significant portion of market participants' existing CDS portfolios for conversion into standardized Eligible CDS contracts with the CME interposed as central counterparty. Migration of a participant's gross exposure to multiple bilateral counterparties into a single net exposure to the CCP will dramatically reduce that participant's counterparty exposure, and, replicated over numerous participants, achieve substantial systemic compression.

¹³ These amounts are as of Dec. 31, 2008.

In addition, a CCP will further reduce risk through margining and other risk controls over its exposures to its participants, including specific controls on market-wide concentrations that cannot be implemented effectively when counterparty risk management is uncoordinated.

The trading and clearing solution also will enhance significantly the transparency of the CDS market, through reporting of CDS prices, trading volumes, aggregate open interest and provide a complete audit trail for regulators. The availability of such information will improve the fairness, efficiency, and competitiveness of CDS markets, which, in turn, will enhance investor protection and facilitate capital formation.

The proposed solution also will reduce operational risk and costs by enhancing the efficiency of CDS trading and clearing. Providing the ability to integrate CMDX services and CME clearing with market participants' front and back office infrastructure, and thereby providing immediate confirmations of trades, and straight-through processing will reduce manual processes, operational risk, and the likelihood of costly errors. A CCP also will help ensure that eligible trades are cleared and settled in a timely manner, thereby reducing the operational risks associated with unconfirmed and failed trades.

Finally, CMDX and CME are ready to launch their CDS offering, once the necessary exemptive relief has been authorized. Therefore, we can provide immediate relief to the pressing problems in the credit markets, and thereby help facilitate the recovery of the U.S. economy.

III. Need for Exemptive Relief to Achieve Benefits for Investors and the Public

The immediate benefits of this solution, however, cannot be realized without providing legal certainty for participants in the proposed CDS market as well as for CME with regard to its role as CCP. Currently, the CDS market operates on a bilateral, OTC basis, thereby qualifying for the swap exclusion set forth in the Commodity Futures Modernization Act.¹⁴ As a result, trading and other activities related to CDS generally are not subject to the Exchange Act or the Securities Act of 1933.¹⁵

By offering centralized clearing, trade booking and migration services and a trading platform, our solution may call into question the current characterization of these instruments. To the extent that these instruments may be treated as securities as a result of these activities, persons engaged in the business of effecting transactions in those instruments may meet the definition of a broker or dealer, as set forth in Section 3(a)(4) and 3(a)(5) of the Exchange Act, respectively.¹⁶ Therefore, absent an exemption, market participants utilizing CMDX services

¹⁴ CEA §2(g), 7 U.S.C. 2(g).

¹⁵ See Section 206A of the Gramm-Leach-Bliley Act; Section 3A of the Exchange Act and Section 2A of the Securities Act.

¹⁶ Section 3(a)(4) of the Exchange Act generally defines a broker as "any person engaged in the business of effecting transactions in securities for the account of others," and Section 3(a)(5) of the Exchange Act generally defines a dealer as any person engaged in the business of buying and selling securities for its own account, whether through a broker or otherwise.

and CME clearing members facilitating the clearing of Eligible CDS contracts may be required to register as broker-dealers with the Commission pursuant to Section 15(a)(1) of the Exchange Act.¹⁷

Similarly, to the extent that these instruments are treated as securities, CME may meet the definition of a clearing agency, as set forth in Section 3(a)(23), if it clears and settles CDS trades.¹⁸ Therefore, absent an exemption, CME may be required to register as a clearing agency with the Commission pursuant to Section 17A(b)(1) of the Exchange Act.¹⁹

The imposition of the broker-dealer and clearing agency registration requirements, at best, would introduce significant delays in providing the much-needed trading and clearing solution to the CDS market. At worst, the currently unregistered CDS market participants may choose to remain unregistered and to continue to trade CDSs in the OTC market, without the benefit of centralized clearing. To ensure the expeditious introduction of these essential reforms to the CDS market, we urge the Commission to provide the requested relief from the broker-dealer and clearing agency requirements, as described below.

IV. Requested Exemptive Relief

A. Exemptive Relief for Brokers and Dealers

The Commission may provide exemptive relief from provisions of the Exchange Act pursuant to Sections 15(a)(2) and 36, among other provisions. Section 15(a)(2) of the Exchange Act authorizes the Commission to exempt, either conditionally or unconditionally, from the broker-dealer registration requirements of Section 15(a)(1) of the Exchange Act any broker or dealer or class of broker or dealer, by rule or order, as it considers consistent with the public interest and the protection of investors. Similarly, but more broadly, Section 36 of the Exchange Act authorizes the Commission to exempt, either conditionally or unconditionally, any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any

¹⁷ Section 15(a)(1) of the Exchange Act generally requires any broker or dealer that makes use of the mails or any instrumentality of interstate commerce to effect transactions in, or to induce the purchase or sale of, any security to register with the Commission.

¹⁸ Section 3(a)(23) of the Exchange Act defines a “clearing agency” as “any person who acts as an intermediary in making payments or deliveries or both in connection with transactions in securities or who provides facilities for comparison of data respecting the terms of settlement of securities transactions, to reduce the number of settlements of securities transactions, or for the allocation of securities settlement responsibilities. Such term also means any person, such as a securities depository, who (i) acts as a custodian of securities in connection with a system for the central handling of securities whereby all securities of a particular class or series of any issuer deposited within the system are treated as fungible and may be transferred, loaned, or pledged by bookkeeping entry without physical delivery of securities certificates, or (ii) otherwise permits or facilitates the settlement of securities transactions or the hypothecation or lending of securities without physical delivery of securities certificates.”

¹⁹ Section 17A(b)(1) of the Exchange Act states that “[e]xcept as otherwise provided in this section, it shall be unlawful for any clearing agency, unless registered in accordance with this subsection, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a clearing agency with respect to any security (other than an exempted security).”

provision or provisions of the Exchange Act or any rule or regulation thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

Accordingly, we request that, pursuant to Section 15(a)(2) of the Exchange Act, the Commission issue an order exempting any exempt BD from the broker-dealer registration requirement under Section 15(a)(1) of the Exchange Act. We further request that the Commission use its order authority under the Section 36 of the Exchange Act to provide exemptions for exempt BDs (but not registered broker-dealers) from the reporting and other requirements of the Exchange Act (other than Sections 15(b)(4) and 15(b)(6) of the Exchange Act), and the rules and regulations thereunder, that apply specifically to a broker or dealer whether or not registered with the Commission. To rely on this exemption, an exempt BD must be in material compliance with CME's rules and applicable laws and regulations related to CDS to the extent that such exempt BD is a clearing member of CME. As discussed above, such an exemption would be consistent with the public interest and the protection of investors, as required by Sections 15(a)(2) and 36.

B. Clearing Agency Exemptive Relief

The Commission may provide exemptive relief from the clearing agency registration requirements of the Exchange Act pursuant to Section 17A(b)(1) of the Exchange Act. Section 17A(b)(1) authorizes the Commission to "exempt any clearing agency or security or any class of clearing agencies or securities from any provisions of this section or the rules or regulations thereunder, if the Commission finds that such exemption is consistent with the public interest, the protection of investors, and the purposes of this section, including the prompt and accurate clearing and settlement of securities transactions and the safeguarding of securities and funds."

Accordingly, CME requests that, subject to the conditions and representations set forth below, the Commission issue an order, pursuant to Section 17A(b)(1) of the Exchange Act, exempting CME from the clearing agency registration requirements set forth in Section 17A(b)(1) of the Exchange Act, if CME would be subject to such clearing agency registration solely as a result of its performance of the functions of a clearing agency with respect to CDS (to the extent such instruments are treated as securities).

In relying on this exemption, CME will act in accordance with the following representations with respect to CDS CCP services:

(1) CME shall make available on its Web site annual audited financial statements, beginning with 2008 audited financial statements, which will be available by June 30, 2009.

(2) CME shall provide the Commission with annual reports and any associated field work concerning its CDS CCP services prepared by independent audit personnel that are generated in accordance with the annual risk assessment of the areas set forth in the Commission's Automation Review Policy Statements. CME shall provide the Commission

(beginning in its first year of operation) with its annual audited financial statements prepared by independent audit personnel.

(3) The documents required to be preserved and made available to the CFTC for inspection by CME in accordance with the CEA and regulations thereunder shall, to the extent that those documents pertain to the conduct of its CCP activity, which is related to the clearing and settlement of CDS contracts, be made available to the SEC. Such documents may include rules, regulatory submissions, risk management reports, audit documentation, clearing fee audit workpapers, clearing member firm risk reviews, member communications, accounts, books, contracts, correspondence, court records, memoranda, meeting minutes, and other such records. These records shall be kept for at least five years and for the first two years will be readily accessible.

(4) CME shall supply such information and periodic reports relating to its CDS clearance and settlement services as may be reasonably requested by the Commission. CME shall also provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment) and records related to its CDS clearance and settlement services. CME will provide the Commission with access to its personnel to answer reasonable questions during any such inspections related to its CDS clearance and settlement services.²⁰

(5) CME shall notify the Commission, on a monthly basis, of any material disciplinary actions taken against any CME clearing members utilizing CME's CDS clearance and settlement services, including the denial of services, fines, or penalties. CME shall notify the Commission promptly when CME involuntarily terminates the membership of an entity that is utilizing CME's CDS clearance and settlement services. Both notifications shall describe the facts and circumstances that led to CME's disciplinary action.

(6) CME shall provide the Commission with notification of all changes to rules as defined under the CFTC rules,²¹ fees, and any other material events affecting its CCP services with respect to CDS, including material changes to risk management models, one day prior to the effectiveness of these changes, or, in exigent circumstances, as promptly as reasonably practicable under the circumstances. We understand that these changes will not be deemed rule filings that require Commission approval. In addition, CME will post any rule or fee changes on the CME Web site.

(7) CME shall report to the Commission all significant outages of clearing systems having a material impact on CCP services for CDS. If it appears that the outage may extend for

²⁰ We understand that the SEC will conduct routine inspections no more often than annually, although it may inspect more frequently for cause. Moreover, the Commission will limit the scope of such inspections to confirming compliance with the requirements set forth in the Commission's order granting exemptive relief, including compliance with applicable federal securities laws in connection with CME CDS CCP services. Finally, we understand that the Commission will make reasonable efforts to coordinate any inspections with the CFTC or other regulatory bodies with jurisdiction in order to conduct joint inspections where possible.

²¹ CFTC Regulation 40.1(h).

30 minutes or longer, CME shall report the systems outage immediately. If it appears that the outage will be resolved in less than 30 minutes, CME shall report the systems outage within a reasonable time after the outage has been resolved.

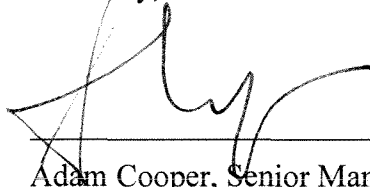
(8) CME, directly or indirectly, shall make available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (a) all end-of-day settlement prices and any other prices with respect to cleared CDS that CME may establish to calculate mark-to-market margin requirements for participants on the CMDX platform; and (b) any other pricing or valuation information with respect to cleared CDS as is published or distributed by CME.

(9) CME shall not materially change its methodology for determining margin levels for cleared CDS without prior written approval from the Commission, and from FINRA with respect to customer margin requirements that would apply to broker-dealers.

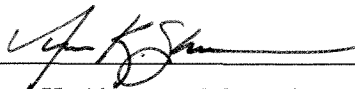
As discussed above, the proposed exemption would be consistent with the public interest, the protection of investors, and the purposes of Section 17A, including the prompt and accurate clearing and settlement of securities transactions and the safeguarding of securities and funds, as required by Section 17A(b)(1).

If you have any questions, please feel free to contact the undersigned, or John Nagel at 312.395.3115, Ann Shuman at 312.648.3851 or Soo Yim at 202.663.6958.

Sincerely,



Adam Cooper, Senior Managing Director and
General Counsel
Citadel Investment Group, L.L.C
131 South Dearborn Street
Chicago, IL 60603



Ann K. Shuman, Managing Director and
Deputy General Counsel
Chicago Mercantile Exchange Inc.
20 South Wacker Drive
Chicago, IL 60606

Elizabeth M. Murphy
March 12, 2009
Page 17 of 17

cc: Mary L. Schapiro, Chairman, Securities and Exchange Commission
Kathleen L. Casey, Commissioner, Securities and Exchange Commission
Elisse B. Walter, Commissioner, Securities and Exchange Commission
Luis A. Aguilar, Commissioner, Securities and Exchange Commission
Troy A. Paredes, Commissioner, Securities and Exchange Commission
Erik Sirri, Securities and Exchange Commission
James Brigagliano, Securities and Exchange Commission
Daniel Gallagher, Securities and Exchange Commission
Elizabeth King, Securities and Exchange Commission
Michael Hershaft, Securities and Exchange Commission
John Nagel, Citadel Investment Group, L.L.C.
Kathleen Cronin, Chicago Mercantile Exchange Inc.
Soo Yim, WilmerHale
Elizabeth Derbes, WilmerHale
Michael M. Philipp, Winston & Strawn
Jerrold Salzman, Skadden, Arps, Slate, Meagher & Flom