

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”).<sup>1</sup> To

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<sup>1</sup> 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.<sup>2</sup>

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.

<sup>2</sup> 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.<sup>3</sup> 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,



Kathleen M. Cronin  
Managing Director  
General Counsel and Corporate Secretary

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<sup>3</sup> CME disagrees with the substance of the Proposed Rules for the reasons stated herein.