



19 October 2010

VIA E-MAIL

Financial Regulation Strategy
HM Treasury
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London
SW1A 2HQ

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Dear Sirs,

CME Group Inc. ("CME Group") appreciates the opportunity to comment on HM Treasury's (HMT) Consultative Paper on "A new approach to financial regulation: judgment, focus, stability" (the "Consultative Paper").

CME Group is the holding company for four futures exchanges, including 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"). CME Clearing, a division of CME, is a central counterparty that provides clearing and settlement services for exchange traded contracts and over-the-counter ("OTC") derivatives transactions that are not traded on an exchange. Our principal regulator in the United States is the Commodity Futures Trading Commission ("CFTC").

In the United Kingdom, CME, CBOT and NYMEX are Recognised Overseas Investment Exchanges, and CME Clearing is a Recognised Overseas Clearing House, the recognitions having been granted by the Financial Services Authority (the "FSA"). In addition, CME Group has a wholly-owned subsidiary, CME Clearing Europe Limited ("CMECE"), whose application to operate as a Recognised Clearing House is nearing the end of the assessment process at the FSA.

CME Group's response to the Consultative Paper is focussed predominantly on the questions posed in Part 5 of the Consultative Paper (question 15) on the proposed division of responsibilities for markets and infrastructure regulation.

The Consultative Paper states that the Consumer Protection and Markets Authority ("CPMA") will regulate the "wholesale markets, including the conduct of all financial services firms in wholesale markets, firms providing market services (such as investment exchanges and providers of multilateral trading facilities) and market conduct generally." Whereas the regulation and supervision of central counterparty clearing houses ("CCPs") will be transferred to the Bank of England.

CME Group believes that under these proposals, there is a major risk that instead of focus and stability in the regulation of financial services and markets, the proposed regulatory split will constitute an unwieldy compromise which unnecessarily

complicates the regulatory framework whilst offering no additional clarity or systemic protection.

CME Group believes that it would be more appropriate for CCPs and exchanges to be regulated by a single regulator. This would ensure consistency of regulation and practice, reduce cost and create a strong body which has the expertise and resource to adequately represent both CCPs and market infrastructure firms (such as exchanges) in the UK and at the international level. This should either be the Bank of England (through a wholly owned subsidiary) or a new market regulator with its own statutory objective and its own voice.

Executive Summary

CME Group has the following main concerns in relation to the Consultative Paper:

- The independence and effectiveness of the Markets Division will be compromised by the CPMA's overriding consumer focus and that the interests of exchanges will not be represented adequately – particularly derivatives exchanges;
- The CPMA's statutory objective and style of regulation may not be adequately aligned with the role and objective of the Markets Division;
- There should be a distinction between the regulatory regime for exchanges and multilateral trading facilities, which adequately reflects the key differences in the services offered by both;
- The Bank of England may not represent the interests of CCPs adequately given its likely focus on the banking sector. Provision should be made for a standalone regulatory authority dedicated to CCPs and market infrastructure firms;
- The split between regulatory oversight of two parts of CME Group's business would potentially create serious internal consistency issues;
- If CCPs are to be regulated by the European Securities and Markets Authority (ESMA) at European level, it is unclear how or why the CPMA will be the lead authority representing the UK interests in ESMA given that it will possess neither the responsibility nor the expertise for the regulation of CCPs in the UK.

Regulation of Exchanges

The Consultative Paper states that exchanges will be regulated by the CPMA. Part 4.3 of the Consultative Paper states that the CPMA will be “a strong consumer champion in pursuit of a single objective”. As it stands, it is unclear how the CPMA will balance its consumer focus with its responsibility to promote the interests of wholesale markets. It is essential that the expertise and the focus of the FSA's Markets Division should not be diluted in the transference of elements of its responsibility to the CPMA.

Whilst the proposed Markets Division is designed to be operationally independent within the CPMA, CME Group is concerned that the Markets Division will not be able to establish its own identity within such a consumer-focused organisation. Without such an identity, the Markets Division will struggle to command the

confidence of the wholesale market sector. Unless the Markets Division is adequately resourced and able to ensure that it possesses the freedom to fulfil its responsibilities its effectiveness and impartiality will be called into question.

In its current form, the primary objective of the CPMA remains too retail focussed. Whilst the primary objective of the CPMA takes account of the need to ensure market integrity, CME Group does not consider this to take adequate account of the need to protect the interests of exchanges in addition to those of consumers. In particular, it fails to adequately take account of the unique interests of derivatives exchanges which are less accessible to consumers. It must have regard to the distinct needs of the wholesale industry and markets in addition to those of consumers.

As an exchange which operates predominantly in the derivative sphere, the risk profile of CME's business is vastly different to that of securities exchanges. Derivatives are complex financial products which are not aimed at the retail market. They are not used by regular retailers in the same way and require a more nuanced type of regulatory oversight. It is not clear how the regulation of these exchanges will be accommodated within the CPMA and whether or not the regulatory regime will be equipped to differentiate adequately between the different exchanges.

Multilateral Trading Facilities & Recognised Investment Exchanges

The CPMA will acquire responsibility for the regulation of Multilateral Trading Facilities (MTF) as well as Recognised Investment Exchanges (RIE). CME rejects the suggestion emanating from some quarters that the regulatory regimes for MTFs and RIEs should be merged. The MTF and RIE regulatory regimes should be kept separate to emphasise the fact that MTFs do not provide equivalent services and products as RIEs. The risk profile and the associated regulatory requirements of MTFs and RIEs are wholly different. To merge their hitherto separate regulatory regimes would compromise the proper perception that RIEs provide a 'golden standard' of service which MTFs cannot replicate.

Regulation of Clearing Houses

The Consultative Paper indicates that the Bank of England would be responsible for the supervision and regulation of CCPs. There is a lack of clarity as to which part of the Bank of England would hold this responsibility. If this responsibility is to sit within the Bank of England itself, CME Group is concerned that given the Bank's likely focus on the banking sector there will not be adequate resource or expertise to effectively represent the interests of CCPs. HMT has recognised that the PRA needs to be incorporated as a distinct subsidiary of the Bank of England. CME Group believes that likewise a single regulator for both CCPs and market infrastructure firms (such as exchanges) should be incorporated as a subsidiary of the Bank of England or as a standalone markets regulator. This would ensure that the regulator had sufficient independence, resource and expertise to effectively supervise these systemically important firms.

CME Group incorporates exchanges and clearing services within a single entity. The regulatory structure proposed by the Consultative Paper would lead such organisations being subject to dual regulation – by both the CPMA and the Bank of

England. Dual regulation can lead to potential duplication in reporting obligations and supervisory visits. It can also lead to overlap in areas where business conduct and prudential regulation are closely interwoven. There would be a significant cost implication of such duplication and a major operational challenge to ensure internal consistency. The split in responsibilities would necessitate a very close relationship and constant communication between the two regulators to ensure consistency and to reduce the burden of individual firms being regulated by two separate bodies. It is CME Group's view that this causes unnecessary additional expense and administrative burden to both the regulators and the firms concerned.

CME Group considers the notion of this regulatory split to be highly unusual given the obvious synergies between exchanges and clearing facilities. In no other country in which CME Group operates it is subject to such a regulatory split, importantly this has not caused any apparent detriment to global or regional financial stability. In the US, CME Group is regulated by the Commodity Futures Trading Commission, a single regulator for both exchanges and CCPs. It is our considered view that HMT's proposals as currently framed will create considerable confusion for those operating wholesale markets. This will have major internal structural repercussions which will make London a less attractive base due to the inconsistency of the UK regulatory approach to that of the rest of the world.

Representation of CCPs in the EU

Whilst HMT proposes that the Bank of England should have regulatory oversight of UK CCPs, at a European level it has been proposed that CCPs should be regulated by ESMA. Given this scenario, it seems perverse for the CPMA to represent the interests of UK CCPs on ESMA given that it has no responsibility for the regulation of CCPs in the UK. Without this responsibility, it is difficult to understand how the CPMA would be equipped to represent the interests of UK CCPs adequately in Europe.

There is also a risk that spreading UK representational responsibilities in Europe will weaken the single regulatory voice required to best represent the interests of the UK.

CME Group recognises the value of the consultative process undertaken by HMT during this key time of development of the UK regulatory structure, and appreciates the opportunity to play a part in offering its views. CME Group would be delighted to discuss the proposals and views offered in this response with HMT.

Yours sincerely,

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CME Group Inc.

