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December 5, 2006

Ms. Eileen Donovan
Acting Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: Chicago Mercantile Exchange Submission Under Rule 40.3,
Regarding a Proposal to List Credit Event Futures

Dear Ms. Donovan:

This letter is submitted by Chicago Board Options Exchange, Incorporated ("CBOE"), in response to the request for comments issued by the Commodity Futures Trading Commission (the "Commission") regarding the voluntary submission by the Chicago Mercantile Exchange ("CME") on October 17, 2006, as amended by a filing dated October 24, 2006, pursuant to Commission Rule 40.3, for review and approval by the Commission of a new credit default option product designated as "CME Credit Event Futures" (the "CME Product"). This letter supplements the comment letter submitted by CBOE on this matter, dated November 3, 2006 (the "Prior CBOE Letter"), and is in response to the letter submitted by the CME, dated November 9, 2006 (the "CME Letter").

As set forth more fully in the Prior CBOE Letter, CBOE believes that the CME Product is an option, not a futures contract, and that it is based on one or more securities. As a result, the CME Product is a security within the meaning of the Securities Act of 1933 (the "Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act"). Accordingly, the CME Product is excluded from the Commodity Exchange Act ("CEA") and the Commission's jurisdiction pursuant to Section 2(a)(1)(C)(i) of the CEA.

CME mischaracterizes CBOE's position by stating that CBOE would treat as a security any "options whose value may somehow be related to the fortunes of a public company." CME then argues that an option can only be considered a security if it either

provides for physical delivery of an underlying security or for cash settlement, with the amount of the payment to be made determined directly by reference to the prices of one or more securities. CME asserts that the CME Product exhibits neither of these attributes and therefore is not a security: "The purchaser of the futures contract does not acquire an ownership interest in the underlying corporation or any of the corporation's securities. The CME's proposed contract is not based on the value of any security issued by the reference entity. The seller of the contract undertakes no obligation to deliver a security or to make a payment based on the value of a single security or some basket of securities." For the reasons set forth in detail below, we believe that the CME product is indeed based on the value of a security, and that CME's reading of the definition of a security is in any event too narrow to meet the Supreme Court's "economic reality" test. Because the CME Letter mischaracterizes CBOE's position, misrepresents the nature of the CME Product, and relies upon an unjustifiably narrow definition of a security, its comments should be rejected.

CBOE's legal position is clear, unequivocal and mandated by the plain language of the Securities Act and the Exchange Act, and is not based solely on a connection to "the fortunes of a public company." As set forth in the Prior CBOE Letter, CBOE believes, based on the clear language of the Securities Act and the Exchange Act, that an option is a security if it either provides for physical delivery of a security or, in the case of cash-settled options, the payment requirement, or the amount of such payment, are determined in whole or part by reference to one or more specified securities or one or more securities of an identified issuer. Under such circumstances, in our view, the option is unquestionably "on" one or more underlying securities and must be considered a security. Accordingly, contrary to the CME's assertion, the definition of a security under the Securities Act and the Exchange Act does not require that an option result in physical delivery or that it explicitly provide for payments determined by reference to the value of a security, but only that it be "on" a security, "including any interest therein or based on the value thereof."

Under the terms of the CME Product, a "credit event" is defined in part by reference to an event of default under securities issued by the Reference Entity. These events of default can only be determined, in the case of securities issued by a Reference Entity, on the basis of the terms of the relevant securities. The options are therefore necessarily based "on" those securities. The CME Product also defines a credit event to include the bankruptcy of the Reference Entity and, in some cases, events of default on instruments that might not be securities under the Securities Act or the Exchange Act (such as certain types of bank loans). However, because of the cross-default provisions included in the terms of virtually every publicly traded debt security, a bankruptcy or a default on bank debt is necessarily an event of default under such securities and cannot be treated as a separate "event" having nothing to do with the Reference Entity's securities. Indeed, a reference to the "bankruptcy" of the Reference Entity is clearly just a proxy for referring explicitly to the Reference Entity's securities and the "economic reality" of the product dictates that it should be treated as such. As the United States Supreme Court has held, in determining whether a given instrument is a security, the emphasis must be on the "economic reality" of the instrument, rather than on mechanical tests or criteria. See, *Reves v. Ernst & Young*, 494 U.S. 56 (1990); *Tcherepnin v. Knight*, 389 U.S. 332 (1967). Here, the

"economic reality" is that the CME Product will be inextricably linked to securities of a specific reference entity and will therefore be "on" those securities.

This conclusion is sufficient on its own to result in the characterization of the CME Product as a security, regardless of the manner in which payments are determined. However, the payment terms of the CME Product make it clear that it should be considered a security on this basis as well. The CME contends that its "proposed contract is not based on the value of any security issued by the reference entity." This is not the case. As set forth in the CME's filing with the Commission, the CME Product calculates the payment due upon the occurrence of a credit event based on a "Final Settlement Rate," which is expressed as a percentage and is multiplied by the notional value of the option to yield the dollar amount of the payment. That "Final Settlement Rate" clearly represents an estimated recovery rate on an underlying security of the Reference Entity; in fact, the CME's filing states that the CME Product is intended to function in the same manner as a credit default swap, and that the recovery rate on an underlying security is one of two factors that are "key to pricing of a credit default swap." The price of a debt security reflects a discount applied to the principal and interest obligations of the issuer, with the discount rate equal to the risk free rate plus a risk premium, reflecting the probability of a default and the likely loss upon the occurrence of a default. Under the CME Product, the amount of the payment due (assuming a notional amount of \$100,000) will be $\$100,000 * (1 - \text{recovery rate})$, which in turn equals \$100,000 times the loss rate on the underlying security. Accordingly, although the CME attempts to conceal its true nature, the payment on the CME Product is clearly tied to the recovery rate and pricing of securities of the Reference Entity and, on this basis as well, the CME Product must be considered an option "on" one or more securities. Indeed, the CME Product would not be marketable as a surrogate for an over-the-counter credit default swap, which it is intended to be, if it did not assume a recovery rate on securities of the Reference Entity. The CME's "Final Settlement Rate" transparently represents a recovery rate that may or may not vary across Reference Entities. A contract based on a recovery rate on a security is ultimately on a valuation of that security whether the recovery rate varies or is the same for different Reference Entities.

The CME alternatively argues that "the underlier for the CME contract is not a security. It is a hypothetical, cash-settled, single reference entity, binary credit default swap," which the CME claims is not a security. In this respect as well, the CME's contention is simply false. As noted in the Prior CBOE Letter, a swap is excluded from the definition of a security under the Commodity Futures Modernization Act only if it is an actual swap that is individually negotiated and executed between "eligible contract participants," as defined in the Commodity Exchange Act. A "hypothetical" swap, by definition, cannot meet these criteria and cannot be considered a non-security. To the contrary, the fact that the CME refers to its underlying "swap" as "hypothetical" only serves to underscore the fact that the CME Product is based not on a credit default swap but on the reference securities that underlie a credit default swap, and that the Product is therefore itself a security.

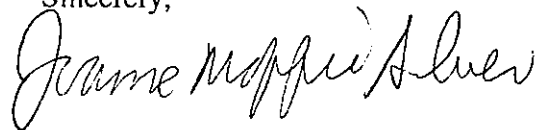
Finally, the CME Letter argues in passing, in the final section of the Letter, that the CME Product is a futures contract and not an option. Obviously, the CME does not actually believe that this argument has any significant merit or it would have given it more prominence.

Indeed, in the first section of its letter, the CME seeks to avoid this issue entirely, stating that the option issue "is not relevant to the central question of whether CME's proposed contract is subject to the CFTC's exclusive jurisdiction." When the CME finally reaches this issue, it argues only that the CME Product is not an option because it limits the purchaser's upside. The potential for unlimited upside, however, has never been cited as one of the criteria of an option and, as the CME well knows, there are many products in the market that limit the amount of a seller's payout but are clearly characterized as options. The CME's response on this point makes it apparent that it has conceded that the CME Product is an option.

For the foregoing reasons, and for the reasons set forth in the Prior CBOE Letter, the CME's comments should be rejected and the CME Product should not be permitted to trade on a designated contract market. We note that this issue, and the regulatory status of the CME Product, is a matter of great importance to CBOE and to market participants generally, and that CBOE is committed to ensuring that the CME Product is subject to the appropriate regulatory treatment. We also believe that the status of the CME Product should be resolved at the regulatory level rather than by the courts, which would clearly be contrary to the interests of market participants. We therefore strongly urge the Commission to take the appropriate action in this instance.

CBOE appreciates the opportunity to provide these supplemental comments. Should you require any further information, please do not hesitate to contact the undersigned.

Sincerely,

A handwritten signature in cursive script that reads "Joanne Moffic-Silver". The signature is written in dark ink and is positioned above the printed name.

Joanne Moffic-Silver