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December 19, 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 letters submitted by CBOE on this matter, dated November 3, 2006 and December 5, 2006 (the "Prior CBOE Letters"), and is in response to the letters submitted by the CME, dated November 9, 2006 and December 11, 2006 (the "CME December Letter" and, collectively, the "CME Letters").

As set forth more fully in the Prior CBOE Letters, the CME Product is an option, not a futures contract, and 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. In this regard, CBOE has filed with the Securities and Exchange Commission proposed rules to permit CBOE to list credit default options, because this product is a security and can only trade on a national securities exchange.

The Prior CBOE Letters primarily focused on the following points, certain of which are further elaborated on below:

- The CME Product is an option, not a futures contract, because it exhibits the characteristics of options identified by the Commission and the Courts, such as a non-refundable premium and limited one-way risk exposure for the holder.[1] The fact that the CME spreads the premium out over a period of time, and refers to it as margin, does not affect the characterization of the Product as an option. Indeed, while the CME refers to this amount as "margin," it clearly is not consistent with a good faith performance bond, which is characteristic of futures-style margin.

- The CME Product is an option "on" one or more securities because the payment obligation of the seller is triggered by a default on securities of the Reference Entity. Indeed, the CME Product is clearly designed to allow market participants to speculate on or hedge against the credit exposure arising from the holding of specified debt securities. Moreover, even if payment is triggered by the occurrence of, among other things, a "bankruptcy event" without an explicit reference to any securities, the Product still constitutes a security, given the fact that a "bankruptcy event" necessarily triggers defaults on debt securities and is merely a proxy for an express reference to such securities. In addition, the amount due to the holder of the CME Product is determined by a "Final Settlement Rate," which represents a "recovery rate" on the underlying securities. In its filing and its letters, the CME has described its proposed credit default option as mirroring the features of credit default swaps ("CDS's") traded in the over-the-counter market. The final settlement of a cash-settled CDS is based entirely on the estimated recovery rates of the underlying Reference Securities. In the case of some CDS's, the recovery rate is determined after the occurrence of a Credit Event with respect to the Reference Entity. However, so-called binary, or digital, CDS's typically establish the recovery rate up front and require that a payment be made in the event of a Credit Event on the basis of this rate. This is precisely the structure of the CME Product.

- The CME Product is based on the underlying Reference Securities and not on a swap. In fact, there is no underlying "swap" that is identified with respect to the CME Product at all and the CME's filing itself refers only to a "hypothetical" swap.

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1 This point was also made by the Options Clearing Corporation in its comment letter with respect to the CME Product, dated November 3, 2006.

- As a policy matter, a conclusion that the CME Product is not a security would mean that the Product is not subject to the antifraud provisions of the Securities Act or the Exchange Act. This would permit trading in the CME Product by persons with inside information regarding the Reference Entity without liability under the securities laws. This result is simply unacceptable from the perspective of public policy and protection of investors in a Reference Entity's securities.

Having had the opportunity to present our arguments and concerns in the Prior CBOE Letters, we are reluctant to respond yet again to the CME Letters, and would much prefer to let the matter rest. However, the CME December Letter is so replete with mischaracterizations of the CBOE Letters and the CME Product that we feel compelled to respond once more. We hope that this will be the last time we will need to do so.

The CME argues in the CME December Letter that the cases cited in the Prior CBOE Letters do not support the characterization of the CME Product as a security. That was not CBOE's contention in citing those cases, and the CME is well aware of that fact. CBOE cited the Missner and Caiola cases solely for the proposition that cash settled options on securities, or on features of securities, are themselves considered securities, even if no physical delivery of securities occurs. Similarly, CBOE cited the Reves and Tcherepnin cases for the point that, in analyzing the status of an instrument as a security, the "economic reality," rather than technical criteria, should govern. CBOE was very clear in its Letters as to its purpose in citing these cases and never contended that these cases directly support its ultimate conclusions with respect to the CME Product. To the contrary, these cases support discrete elements of that conclusion, but are integral to the analysis on those points. The CME of course knows this, and its attempt to distort and discredit CBOE's argument is transparent.

In fact, the CME's real point in attacking CBOE's citation of these cases is its assertion that CBOE has not cited any precedent to support its position that the CME Product is a security. That is hardly surprising. The CME Product is a novel instrument and, to our knowledge, neither it nor anything like it has ever been the subject of litigation, or at least reported decisions. That, however, in no way means that the CME Product cannot be characterized as a security. Indeed, although the CME conveniently overlooks this fact, the CME does not cite a single case that supports its proposition that the CME Product is not a security. Apparently, in the view of the CME, it is only the legal analysis and conclusions of others that must be disregarded in the absence of applicable case law; in contrast, the unsupported assertions of the CME must be considered settled law. We find such a duplicitous and one-sided view to be unacceptable.

The CME next asserts -- once again -- that the "Final Settlement Rate" used to calculate the amount required to be paid on the CME Product is not a "recovery rate" on the Reference Securities. The CME also states that its reference to a "recovery rate" in its filing with the Commission was only in the context of its "general discussion" of credit default swaps and was not intended to refer to the CME Product. This is yet another attempt by the CME to have it both ways. The CME seeks to characterize its Product as being substantially similar to credit

default swaps -- so that it will be attractive to market participants -- while still advancing the legal argument that it is not based on Reference Securities or a recovery rate. In fact, CBOE made it clear in its most recent letter that the CME's discussion of a "recovery rate" in its filing was in the context of its general discussion of credit default swaps. However, as CBOE explained in that letter, the CME's point in including the "general discussion" was that the CME Product will function in a manner similar to a credit default swap. Indeed, if the CME Product does not function like a credit default swap, it will not be attractive to the market. Accordingly, given that the recovery rate is a central feature of credit default swaps, it is clear that the "Final Settlement Rate" included in the CME Product terms is a recovery rate. The CME may, if it so chooses, engage in semantic gyrations, and can attempt to argue that the "Final Settlement Rate" is simply a fictitious number bearing no relationship to the Reference Securities. That, however, does not obscure the reality. The CME has a choice -- it can either link its Product to a recovery rate or it can undermine the market's acceptance of its Product. The choice it has made is clear.

Further, the CME states that the CME Product is based on a credit default swap, which is not a security and that the CME Product therefore cannot itself be a security. The CME notes that the CBOE Letters recognize that many credit default swaps traded in the over-the-counter market are excluded from the definition of a security under the Securities Act and the Exchange Act and asserts that there is "nothing to suggest that trading an instrument that has the exact same value and payment characteristics on the facilities of a designated contract market converts it into a security." In fact, CBOE identified the distinction between over-the-counter swaps clearly and unequivocally. Simply put, a credit default swap is excluded from the definition of a security ONLY when it is privately negotiated between eligible contract participants. Neither the CME Product nor the "hypothetical" (the term used by the CME) swap underlying the Product can possibly meet these criteria. Therefore, they are not excluded from the definition of a security. The CME unquestionably understands this, despite its feigned bewilderment and its attempt to distort and dismiss CBOE's argument.

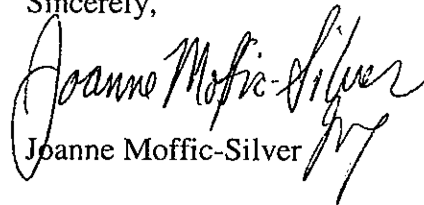
Finally, the CME contends that the CME Product is not an option because "unlike typical options," the CME Product limits the holder's upside. However, standard put options, which also exhibit this feature, are clearly "typical" options. Moreover, the CME Product in any event exhibits the fundamental characteristics of options -- a non-linear payout resulting in one-way risk exposure and payment of a non-refundable premium. The CME Product therefore clearly satisfies the legal tests established by the Commission and the Courts for an option. There can be no dispute that the CME Product is an option and the CME does not expend much thought or energy arguing to the contrary.

For the foregoing reasons, and for the reasons set forth in the Prior CBOE Letters, the CME's comments should be rejected and the CME Product should not be permitted to trade on a designated contract market. As noted, we sincerely hope that this will be the last time that CBOE is compelled to respond to distortions and disingenuous mischaracterizations advanced by the CME. As we pointed out in our most recent letter, 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,



Joanne Moffic-Silver