

Initial Written Statement  
of  
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before the  
Commodity Futures Trading Commission  
and  
Securities and Exchange Commission  
  
Hearing on Harmonization of Regulation

September 2, 2009

Chairmen Gensler and Schapiro, Commissioners, I am Craig Donohue, Chief Executive Officer of CME Group Inc. On behalf of CME, CBOT, NYMEX and COMEX, we appreciate the opportunity to provide our views respecting the appropriate scope for the harmonization of regulation between the CFTC and the SEC.

CME Group is the world's largest and most diverse derivatives marketplace. We operate four separate Exchanges, including 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"). The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options on futures based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products.

We also operate CME Clearing, one of the largest central counterparty clearing services in the world, which provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter derivatives contracts through CME ClearPort®. Using the CME ClearPort service, eligible participants can execute an OTC swap transaction, which can be transformed into a futures or options contract that is subject to the full range of Commission and exchange-based regulation and reporting. The ClearPort service mitigates counterparty credit

risks, provides transparency to OTC transactions and brings to bear the exchange's market surveillance monitoring tools.

The CME Group Exchanges serve the hedging, risk management and trading needs of our global customer base by facilitating transactions through the CME Globex® electronic trading platform, our open outcry trading facilities in New York and Chicago, as well as through privately negotiated transactions.

Harmonization of Regulation is the topic of this hearing, but there has been no agreement on what is meant by "harmonization." In our view, "harmonization" should be defined by its goal, and the goal of harmonization should be to assure that the regulatory regimes for derivatives, securities and security options work smoothly together to produce a net welfare gain through efficiently operating markets and clearing houses and the elimination of regulatory gaps. Although there is room for harmonization, as we define it, merger of the existing regulatory structures into a single set of one-size-fits-all rules administered by separate agencies will do substantially more harm than good.

Futures markets and securities markets serve different purposes and different classes of customers.

- Futures markets provide price discovery and an efficient means to hedge or shift economic risk for sophisticated market participants. Information is disclosed to the market through the trading of market participants and not through a disclosure regime.
- Regulation is price neutral and short selling and speculative buying are honored and effective means of facilitating price discovery.
- Most of the volume and open interest on futures markets is attributable to large commercials, banks and money managers.
- Terms and conditions of each futures contract are exchange specific -- designed based on market demands.
- The CFTC's customer segregation rules and the consequent portability of customer positions in the event of an intermediary's bankruptcy are essential for the class of customers and the type of contracts traded on futures exchanges. SIPA would not provide protection for derivative participants because of payment limits and because it does not focus on portability of customer positions in the event of an intermediary's failure.

In contrast, securities markets support capital formation by providing a secondary market for trading plain vanilla securities. Because the most relevant

information is company specific, regulation focuses on creating a level playing field where insiders are precluded from taking unfair advantage of uninformed investors.

The competitive environments in which futures and securities markets operate are distinct. Derivative markets face global competition. Inappropriate levels of regulation in the U.S. invites major market participants to migrate business to their off shore offices and off shore markets. On the contrary, competition among securities markets is local. Securities markets are not going anywhere. The only issue posed by overregulation of securities markets is whether the regulator creates a distorted playing field among its regulated entities; there is no threat that our securities markets will shift to jurisdictions with more rational regulatory regimes.

These significant, intrinsic differences between derivatives and securities markets are likely to be eviscerated by a one-size-fits-all regulatory regime, undermining the value of both markets. A powerful example of the adverse consequences of ignoring such differences is the SEC's efforts to regulate security options markets — a very simple derivative market — as if they were equity markets. Recall that the SEC created a costly artificial construct to treat options as if they were equity securities being issued by a private company, delayed trading put options for years, and imposed inefficient strategy, rather than portfolio margining. To avoid stifling innovation and competition in the U.S. marketplace again, we believe that the “harmonization” discussion between the CFTC and SEC must take account of the basic fact that these markets are highly dissimilar in many critical aspects and that the regulatory framework, by necessity, should be different.

In preparation for this hearing, we looked at the important matters that are regulated in significantly different manners by the SEC and CFTC. We thoroughly assessed the potential benefits of eliminating those differences. Although in the majority of cases, we could not identify an important regulatory policy that would be served by subjecting securities and futures exchanges and clearing houses to identical regulations or, even more, nearly identical regulations, we did identify a few discreet areas where we believe regulation could be improved if both the CFTC and SEC migrated slightly toward the middle. For example, the absolute freedom to self-certify new rules on the futures side that have a significant impact on open contracts and the stringent oversight of new rule making on the securities side might each move a bit toward the center if delay is limited. The definitions of a qualified investor and eligible contract participant and similar concepts can be unified. A two pot cross-margining regime between customer securities and

futures accounts would do no violence to either regulatory regime. We also agree with the suggestions for harmonization made by the National Futures Association. Additionally, there are regulations on the securities side that could safely move toward the comparable futures regulation, as noted in the Treasury's Report, *Financial Regulatory Reform: A New Foundation*, which suggested, "The SEC should recommend requirements to respond more expeditiously to proposals for new products and SRO rule changes and should recommend expansion of the types of filings that should be deemed effective upon filing."

We also favor mitigating jurisdictional wrangling over the undistributed middle between the Securities Act and the Commodity Exchange Act. We completely sympathize with efforts to eliminate the friction that has delayed efforts by options and securities exchanges to securitize some products, at the border between commodities and securities, and trade them subject to the SEC's jurisdiction. We believe that the correct approach to resolving this issue is to let the exchange or clearing house choose its regulator and limit subsequent regulation to the single agency chosen. The CFTC has effectively used its exemptive power to achieve such a result. Had the SEC granted a similar accommodation in respect of CME's efforts to create an effective clearing solution for credit default swaps it would have facilitated the process of bringing our offering to market. The arguments usually advanced against a choose-your-regulator regime — that there will be a race to the lowest regulatory standard — should not be a concern where both regulators are agencies of the same government and have implemented effective regulatory regimes.

We are concerned that "harmonization" may be interpreted to mean abandoning the principles-based regulation of the Commodity Futures Modernization Act. As evidenced by the growth in the derivatives sector, the CFMA has facilitated tremendous innovation and allowed the U.S. exchanges to compete effectively on a global playing field. Consequently, instead of moving toward this successful regime, the reaction against excesses in other segments of the financial services industry will generate pressure to force a retreat from the principles-based regulatory regime adopted by CFMA. It has been almost ten years since the CFMA was put in place, and it is easy to forget the disadvantage at which the U.S. regulated derivatives industry operated by reason of the wasteful, cumbersome statutory requirements that delayed innovation and required regulators to make business judgments for which they did not have the appropriate incentives.

The benefits of CFMA's principles-based regulatory regime are easily overlooked in the turmoil following the collapse of the housing market and major investment banks. We have said it before, but it bears repeating: derivative transactions conducted on CFTC-regulated futures exchanges and cleared by CFTC-regulated clearing houses did not contribute to the current financial crisis. Moreover, it was not unintentional gaps in the regulatory jurisdiction of the SEC and the CFTC that caused the meltdown. To the extent that regulatory gaps contributed to the problem, those gaps existed because Congress exempted broad classes of instruments and financial enterprises from regulation by either agency. Thus, a merger of the agencies or complete harmonization of their regulatory regimes would not have cured this problem.

Thank you again for holding this hearing and allowing us an opportunity to express our views. We believe that consensus among the industry, the CFTC and the SEC as to the purpose of harmonizing the regulatory regimes will lead to agreement on specific solutions that will enhance the effectiveness of both markets.