Written Testimony of
Terrence A. Duffy
Executive Chairman and President, CME Group, Inc.
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Committee on Financial Services
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Chairman Garrett, Ranking Member Waters, I appreciate the opportunity to submit written testimony for the hearing today on "Challenges Facing the U.S. Capital Markets to Effectively Implement Title VII of the Dodd-Frank Act." I am submitting this testimony to correct a number of inaccurate statements and implications contained in the testimony of one of the other witnesses before you today.

As the Committee knows, one objective of the Dodd-Frank Act ("Dodd-Frank") was to bring regulatory oversight to the unregulated OTC swap market. Many of the operational and risk safeguards established by futures exchanges were imposed on the OTC swaps market. These include reducing systemic risk through centralized clearing and enhancing transparency through a reporting regime that was intended to provide regulators with data analogous to that which they already received from the regulated futures market.

CME passionately believes in free markets. Congress gave customers the choice of trading in the OTC market, on a swap execution facility or on a designated contract market. Each trading arena carries its own regulatory burdens. It is a disservice to those customers for a participant in one of those markets to promote its private interests at the expense of customers who are quite capable of making a choice that best fits their needs. It would also be a disservice to those customers to accept the argument of two of the testimonies submitted to the Subcommittee today that customers should be denied access to innovative futures products that respond to their market and risk mitigation until the regulators have finalized their rules for swaps.

In the pages that follow, I correct some of the inaccurate statements in testimony submitted for today's hearing.

First, GFI says "Immediately upon the October 12 effective date for certain CFTC regulations, we observed an overnight migration of trading activity in U.S. natural gas and electric power markets from cleared swaps to economically equivalent futures products." This is false. NYMEX's natural gas and electric power contracts have always been listed for trading and clearing as futures.

Second, GFI says "There is no statutory mandate for the real-time reporting of futures trades to the public or to registered data repositories, nor is there any requirement for the direct registration, supervision, and accountability of traders of futures products." This is false. Futures do have real-time reporting rules. U.S. listed futures contracts trade by a two-sided public auction process -- whether in a central limit order book or in a trading pit -- where all market

participants have the transparency of executable prices in the market. Real time prices are streamed to hundreds of thousands of subscribers and the financial press. Moreover, futures contracts have always been required to be cleared. All futures contracts are cleared and every derivatives clearing house functions as a data repository for the CFTC and other regulators.

Third, GFI says "The CFTC has determined that DCOs must utilize a one-day liquidation time horizon for futures and a five-day liquidation time horizon for most swaps." This is false. Under final CFTC regulations, a DCO may margin financial futures and commodity futures and swaps with a minimum of one-day liquidation time and financial swaps with a minimum of five-day liquidation time. The DCO has an obligation to set margins at a level appropriate for the risk profile of the instrument – which may exceed these minimum levels. For example, if a swap futures contract has the risk characteristics of a typical OTC swap, which is not likely, a DCO would be required to impose a similar level of margin. CME's Clearing House margins many of its futures products with a liquidation time greater than one day. Prior to Dodd-Frank or the CFTC's final margin rules, financial swaps were margined by several clearing houses across the globe utilizing a liquidation time of 5-days or greater.

Fourth, GFI makes a number of incorrect assertions about swap futures. Among these is the statement that "Swap futures do not allow for specific exercise dates, unlike swaps which are infinitely customizable." This is neither true nor relevant. While futures have historically been characterized as standardized (as opposed to "infinitely customizable"), cleared instruments that are traded primarily by means of transparent, open and competitive execution resulting in deep, liquid markets with tight bid ask spreads and high turnover, futures markets also offer futures to the day and flexible futures. The standardized features of these products are the very features that make futures easy to port or liquidate in a default situation. This helps to explain the differential in margin coverage for easily liquidated contracts versus those that are thinly traded and have low turnover.

Fifth, GFI's statement that, "The U.S. Department of Justice has deemed the structure of the U.S. futures market to be one marked by vertical monopolies" is not just false, but an outright fabrication. The DOJ expressed no concern respecting the structure of energy markets about which GFI is complaining. The DOJ never referred to any segment of the market as a "vertical monopoly." While the DOJ suggested structural changes to certain financial markets to expand entry, it never accused any participant of any violation of law.

We have similar concerns about the testimony of “Companies Supporting Competitive Derivatives Markets,” a coalition that includes GFI and others. Their written submission to the Committee is based on the erroneous assertion that swap futures are in fact swaps that are converted for trading and clearing into futures, thereby avoiding swap regulation and suggest that such products remove customer choice. (“Importantly, by removing choice of product and venue farmers, corporates, pension funds, insurance companies, and consumers will be subject to increasingly higher costs for execution and clearing. Competition has been further impacted by the delay in the SEF rules as compared with the rules for exchanges.”) This is not the case.

Innovation and the availability of new products at multiple trading venues and cleared by different clearing houses does not remove customer choice, rather it increases customer choice. For example, CME recently introduced a deliverable swap futures product, which is a fully standardized futures product that is listed for trading in our central limit order book – which matches buyers and sellers anonymously by best bid and offer. This futures product is no different than any other futures product listed in our market – whether it be a corn futures or a treasury futures contract—where a market participant agrees to buy or sell a futures contract based on what they believe to be the price of the underlying commodity at some future date. It is subject to the full panoply of futures regulation. Moreover, we anticipate that market participants will not exit the interest rate swap market, which is the underlying commodity for this new product.

I thank the Committee for its time and attention to this important matter and would be happy to further discuss the subject of this hearing or any other issues related to the futures markets.