EXHIBIT A

U.S. COMMODITY FUTURES TRADING COMMISSION
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June 5, 2007

Mr. John Labuszewski
Managing Director
Research and Product Development
Chicago Mercantile Exchange
20 South Wacker Drive
Chicago, Illinois 60606-7499

Re: Request for approval of the Chicago Mercantile Exchange Credit Index Event futures contract, based upon the North American Investment Grade High-Volatility Index, CME Submission #07-17

Dear Mr. Labuszewski:

In correspondence to the Commission dated March 7, 2007, the Chicago Mercantile Exchange (CME) requested product review and approval of a new CME Credit Index Event futures contract (the Contract), based upon the North American Investment Grade High-Volatility Index, pursuant to Section 5c(c)(2) of the Commodity Exchange Act (Act) and Commission Regulation 40.3. On May 16, 2007, the CME amended the Contract's terms and conditions to clarify CME Rule 45402.E and correct various typographical errors. The Commission requested public comment on the CME's Contract, and received responsive comments from the Chicago Board Options Exchange, the Options Clearing Corporation, and the CME.

Section 5c(c)(3) of the Act provides that the Commission shall approve any new contract or rule unless the Commission finds that the contract or rule would violate the Act. After having reviewed in detail the entire record in this matter, including the comments received and the May 31, 2007, Memorandum of the Division of Market Oversight, the Commission adopts the product analysis and legal reasoning set forth in the staff memorandum. For the reasons set forth in the staff memorandum, the Commission has no basis on which to find that the proposed Contract and the rules associated with that Contract would violate the Act. Accordingly, please be advised that the proposed Contract and the rules associated with that Contract were approved by the Commission as of the date of this letter.

For the Commission,

Eileen Donovan

Eileen Donovan
Acting Secretary of the Commission

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Division of
Market Oversight

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OFC. OF THE SECRETARIAT

May 31, 2007

MEMORANDUM

TO: The Commission

FROM: The Division of Market Oversight

SUBJECT: Request for Commission Approval of the Chicago Mercantile Exchange's North American Investment Grade High Volatility Credit Index Event contract, submitted pursuant to Section 5c(c)(2) of the Commodity Exchange Act and Commission Regulation 40.3.

CONCLUSION AND RECOMMENDATION: The proposed contract appears to comply with the requirements of the Commodity Exchange Act and the Commission's regulations and policies thereunder and is complete under the Commission's approval process. Accordingly, the Division of Market Oversight recommends that the Commission approve the proposed CME contract, and the associated new rules, pursuant to Section 5c(c)(3) of the Commodity Exchange Act.

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OFFICES CONSULTED: Office of the Chief Economist
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I. INTRODUCTION

In correspondence dated March 7, 2007, the Chicago Mercantile Exchange (CME or Exchange) voluntarily requested Commodity Futures Trading Commission (Commission or CFTC) review and approval of the North American Investment Grade High Volatility Credit

Index Event[1] (Credit Index Event or Index) futures contract. The approval request was made pursuant to Section 5c(c)(2) of the Commodity Exchange Act (CEA or Act) and Commission Regulation 40.3.

In accordance with Section 2(a)(9)(B)(i) of the Act, on March 8, 2007, the Division of Market Oversight (DMO or Division) forwarded the proposed new contract filing to the Securities and Exchange Commission (SEC), the U.S. Department of Treasury (Treasury) and the Board of Governors of the Federal Reserve System (Fed). No written comments were received from those agencies.[2] The Commission posted the filing on its website on March 7, 2007 with a request for public comment due by March 28, 2007. The Commission received four responsive comment letters that are summarized in the last section of this memorandum.

Subsequent to the comment period, the CME amended the terms and conditions of its contract in a filing dated May 16, 2007, pursuant to the request of Division staff.[3] The amendments made various non-substantive clarifications and corrected typographical errors.[4] That filing was forwarded to the SEC, the Treasury, and the Fed on May 17, 2007.

The 45-day Fast-Track review period for the CME's proposal, under Commission Regulation 40.3, was scheduled to end on April 23, 2007. The Exchange noted its intention to list for trading the Credit Index Event contract on April 23, 2007. On April 23, 2007, however, the Director of DMO, acting pursuant to authority delegated in Commission Regulation 40.7(a)(1),

[1] The CME refers to the subject contract as a digital index futures contract. As discussed below, in view of the characteristics of the contract, the Division of Market Oversight believes the subject contract is a futures contract based on an index or bundle of binary credit event options.

[2] The Division notes that Commission staff did consult with SEC staff during the pendency of the approval process. This Memorandum, however, solely reflects the opinion of the Division.

[3] That amendment filing was posted on the Commission's website on May 17, 2007.

[4] The terms and conditions of the proposed CME Credit Index Event contract are attached to this Memorandum. The CME filings are available upon request from the Secretariat or the Division.

extended the review period.[5] The extended Fast-Track review period for the CME's proposal, as well as the statutory review period,[6] is scheduled to end on June 5, 2007.

II. BACKGROUND

A credit derivative may be defined as "a derivative designed to assume or shift credit risk, that is, the risk" that a particular borrower will experience an event included within a specific set of credit events, such as loan defaults or bankruptcy filings, within a specified interval of time.[7] Credit derivatives emerged in the mid-1990s as bilateral over-the-counter (OTC) instruments that allow one party (the protection buyer) to transfer credit-related risks associated with the actual or synthetic ownership of a "reference asset" to another party (the protection seller) for a price.[8] The reference asset associated with an OTC credit derivative may be a corporate debt obligation, such as a bond or a bank loan, a sovereign debt obligation, an asset-backed security, such as commercial mortgage-backed securities, or any other obligation of debt. Credit derivatives transfer only the credit risks attendant to the actual or synthetic ownership of a reference debt obligation. Other important risk factors, such as liquidity risk and interest rate risk, are not transferred by the derivative.

Credit derivatives include a category of OTC traded instruments commonly known as credit default swaps (CDS). An OTC traded CDS is quoted in basis points, and each quote typically is a firm quote for a minimum notional value of $10 million. CDS pricing is based on the probability that the reference entity will experience a credit event and the expected recovery

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[5] Commission Regulation 40.3(c) allows the Commission to extend the 45-day Fast-Track review period by an additional 45 days if the product raises novel or complex issues requiring additional time for review.

[6] Section 5c(c)(2)(C) of the Act provides that the Commission "shall take final action" on contracts submitted for approval no later than ninety days after submission of the contract, unless the contract market submitting the contract agrees to an extension of the review period.

[7] *See, e.g.* CFTC Glossary *available at* (http://www.cftc.gov/opa/glossary/opaglossary_a.htm.)

[8] In the OTC market, the terminology "protection seller" and "protection buyer" is used to refer to the seller and buyer of a credit derivative.

rate.[9] The expected recovery rate is the fractional amount of par value that the protection seller can expect to recover upon taking possession and liquidating the devalued asset.[10] The recovery rate is often defined as a percentage of the face value of the reference asset.[11]

According to the CME, credit derivatives based upon indexes or "bundles" of reference entities were introduced in the OTC markets in 2001 with the TRACERS product line issued by JP Morgan and Morgan Stanley. Current credit index brand names include the Dow Jones CDX and the International Index Company iTraxx. Credit index products generally are designed to provide exposure to specific credit market segments, such as the investment grade and high-yield sectors, or specific geographic regions such as North America, Europe and Asia. Such derivative products typically are based on a fixed index of reference entities, and they are offered with a specific maturity, commonly five years. Changes to the composition of a credit index typically are made at specified intervals (*e.g.*, semiannually) and result in a new, sequentially numbered series of the underlying index. Thus, when an index provider alters the composition of a credit index, credit index derivatives that are based on the older version of that index would continue to be based on the older version of the index, while newly issued credit index derivatives would be based on the reconstituted credit index.

III. CME's CREDIT INDEX EVENT CONTRACT

A. General Description

[9] The recovery rate is the amount the protection seller expects to recover if a credit event occurs. Changes in the expected probability of a credit event and/or the recovery rate will have an impact on CDS valuation. The larger the anticipated probability of default, the larger the credit default swap premium will be. If the market perceives that a reference entity's financial condition is improving, the CDS swap premium will tighten, i.e., the CDS swap price will cheapen. If the price for CDS protection on a specific name is widening significantly, this is generally an indication that perceived credit quality is rapidly deteriorating. The CDS market often responds more quickly than the cash market to changes in credit perception. Hence, prices in the CDS market may serve as an important leading indicator that credit spreads on a particular bond issue are likely to change.

[10] *See* Hull, J. C. and A. White, *Valuing Credit Default Swaps I: No Counterparty Default Risk*, Journal of Derivatives, vol. 8, no. 1 (Fall 2000); *see also*, Hull, J.C. and A. White, *The Valuation of Credit Default Swap Options*, (Jan. 2003).

[11] For a more complete description of the CDS market, see the Division's Memorandum to the Commission dated January 26, 2007, regarding the CME's Credit Event contracts.

The proposed Credit Index Event contract is a futures contract based on an index or bundle of reference entities that might experience a CME-defined credit event. The value of the contract at expiration would depend on the number of reference entities that do experience such a credit event during the life of the contract. For the proposed Index contract, the CME defines the triggering credit events, which are bankruptcy and failure to pay, as follows:[12]

> (1) "Bankruptcy" means the filing under the United States Bankruptcy Code in a United States Bankruptcy Court of: (a) a voluntary petition by the Reference Entity that has not been dismissed by the expiration date of the Contract; or (b) an involuntary petition against the Reference Entity with respect to which an order of relief has been issued by the Court prior to the Final Termination of Trading Date of the Contract (irrespective of whether such order of relief is subsequently reversed on appeal, nullified, vacated, dismissed or otherwise modified after the expiration date of the Contract).
>
> (2) "Failure to Pay" means, after the expiration of any applicable Grace Period, the failure by a Reference Entity to make, when and where due, any payments in an aggregate amount of not less than the Payment Requirement under one or more Obligations, in accordance with the terms of such Obligations at the time of such failure. For the avoidance of doubt, if the applicable Grace Period cannot expire on or prior to the expiration date of the Contract, then there will be no Declaration of Credit Event with respect to the CME Credit Index Event Contract.

The Index is owned and maintained by the CME. The CME noted in its filing that component reference entities are selected based on several factors, including representation across several general industrial sectors, liquidity of CDSs associated with the corporate reference entities, and conformance with index composition practices in the OTC index derivatives market. The Index includes 32 reference entities, and it is equally weighted, that is, upon listing, each component represents 1/32 or 3.125 percent of the Index. In addition, the CME assigns to each component reference entity a "Final Settlement Rate" upon listing of a contract on the Index. For the subject Index, that Final Settlement Rate is fixed at 60 percent for each reference entity. The Index may be

[12] The CME defines various contract terms in the "Interpretations to Chapter 454." The definitions were adapted with permission from copyrighted material published by the International Swaps & Derivatives Association, Inc. (ISDA), (see Article IV, Section 4.5 of the 2003 ISDA Credit Derivatives Definitions).

revised during the life of a contract to reflect succession events such as mergers, consolidations, amalgamations, transfers of assets or liabilities, demergers, spin-offs or other similar events.

Only those entities that experience a CME-specified credit event would be counted in the final Index value. Component reference entities that do not experience a credit event would have a value of zero in the calculation of the final Index value. Thus, if only one component reference entity experiences a credit event, then that one reference entity would account for 100 percent of the final value of the Index. Similarly, if two component reference entities experience a credit event, then each of those entities would account for 50 percent of the final value of the Index, and so on. Therefore, the Index represents essentially a count of, and depends solely on, the number of component reference entities that have experienced or are expected to experience a specified credit event by the contract's expiration. The price of any debt obligation issued by any reference entity or entities would be irrelevant to the Index calculation.

B. The CME Credit Index Event Contract

The Index underlying the proposed contract is the CME North American Investment Grade High-Volatility Index. The Index is comprised of 32 reference entities and thus represents the bundled credit risk of multiple reference entities. This Index includes investment grade corporate names with ratings of BBB- (or equivalent rating) or better from rating agencies such as Standard & Poor's and Fitch.[13] Currently, the reference entities' long-term debt is investment grade or just below investment grade, and is classified as medium- to high-risk.[14] The subject reference entities underlie some of the most actively traded CDS contracts in the OTC market.

[13] These reference entities are considered to be high volatility because they may be close to the investment grade/high-yield rating barrier and because they have experienced high volatility and activity in the CDS market.

[14] Credit ratings are used to establish credit spreads for the relative default or non-payment risk associated with corporate debt instruments. Credit spreads are a function of both credit rating and time to maturity. Debt that is rated BBB- or higher is considered investment grade debt; debt rated BB+ or lower is considered to be non-investment grade debt. Non-investment grade bonds are often referred to as high yield bonds. Lower rated high yield bonds are often referred to as junk bonds. U.S. Treasury securities are generally viewed as the U.S. dollar benchmark for default-free or risk-free fixed income securities. U.S. Treasury securities will always imply an element of market risk associated with interest rate fluctuations but they are viewed as implying zero credit risk.

The CME plans to reconstitute the Index on a semi-annual basis in March and September, with the next Index in the series to be numbered sequentially. Thus, the Index as currently composed is the "CME North American Investment Grade High Volatility, Series 1." Following the next revision, the Index would be, for example, the "CME North American Investment Grade High Volatility, Series 2."[15] A reconstituted Index would apply to newly listed contract months only.

The proposed contract would be cash settled based on the Notional Value of the contract and the sum of the products of a Binary Credit Event Indicator, Weight, and Final Settlement Rate for each Index component.[16] Except for the Binary Credit Event Indicator, each of the variables is fixed upon listing of the contract. Specifically, the contract's Notional Value would be $100,000, the Weight for each component in the Index would be 3.125 percent and the Final Settlement Rate for each component would be 60 percent. For each reference entity, the Binary Credit Event Indicator would be set to one if a credit event occurred or to zero if a credit event did not occur.

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[15] This method of sequentially numbering reconstituted indexes conforms to OTC derivative market practices, as noted above. The CME indicated that it subsequently may compose indexes whose reference entities are selected from other popular credit market segments including investment grade, crossover, high-yield, industrial sector, European and Asian corporate reference entities.

[16] The final settlement value is expressed in basis points based on the CME's assignment of the contract's Notional Value (NV):

Final Settlement Value = NV x Final Settlement Price

$$\text{Final Settlement Price} = \sum_{i=1}^{n} E_i \times W_i \times F_i$$

Where:

n = Number of reference entities referenced in the Index

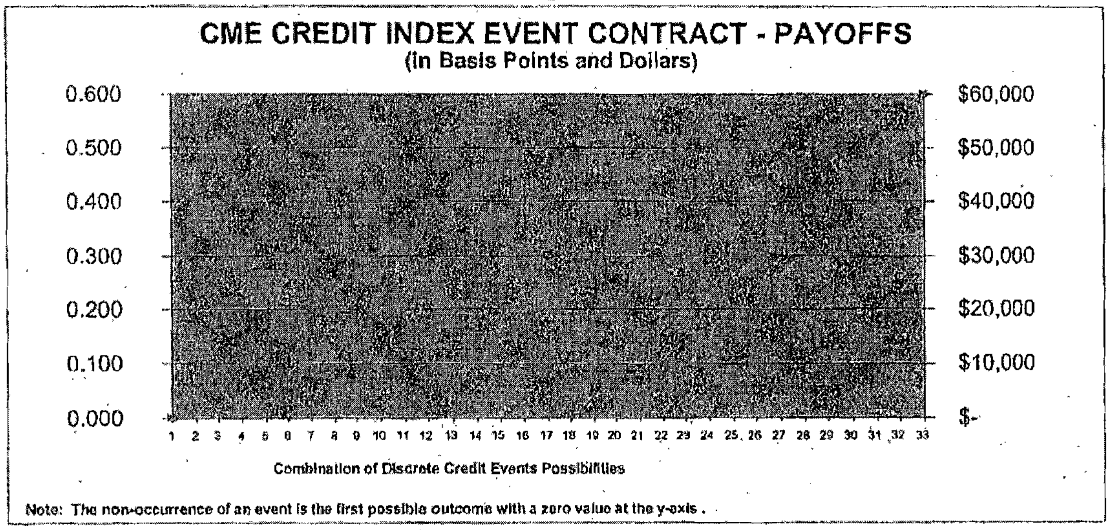
E_i = Binary Credit Event Indicator
} 1 if a credit event is declared for reference entity i or
} 0 if a credit event is not declared for reference entity i

W_i = Weight of Index Component i

F_i = Final Settlement Rate for Reference Entity i

The Index contract's final cash settlement price would be based on the total number of reference entities that had experienced a credit event during the life of the contract, and therefore could take a finite number of values.[17] For each Index reference entity, the CME determines whether a credit event has occurred. If no reference entity had experienced a credit event, then the final settlement value would be zero. If every reference entity had experienced a credit event, then the final settlement price would be $60,000. The payoff structure shows all the possible outcomes between zero and $60,000 (see Figure 1).

Figure 1



This payoff structure resembles that of a futures contract. If one reference entity experienced a credit event, then the final settlement price would be $1,875; if two reference entities experienced credit events, then the final settlement price would be $3,750, and so on.

C. Economic Purpose and Benefits of Hedging

The CME noted that its Credit Index Event contract is "intended to provide a transparent, liquid and facile means of acquiring protection against the risk of a bankruptcy, or failure to pay credit event." In addition, the CME noted that this subject contract plus other similar Credit Event contracts would introduce the benefits of exchange-traded products to the credit derivatives

[17] Specifically, the final settlement price could take on 33 different values – zero plus one for each possible total number between 1 and 32 of reference entities that had experienced a credit event.

industry where trading is conducted OTC. The CME Credit Index Event contract could provide hedging benefits for holders of debt and other securities issued by the reference entities.

IV. COMPLIANCE WITH THE ACT AND COMMISSION REGULATIONS

As noted, the CME requested approval pursuant to Section 5c(c)(2) of the Act and Commission Regulation 40.3. Section 5c(c)(3) of the Act requires the Commission to "approve any such new contract or instrument ... unless the Commission finds that the new contract or instrument...would violate this Act."

The proposed Credit Index Event contract appears to meet the requirements of the Act, including Core Principles 3 and 5 and the acceptable practices for these core principles including Commission Guideline No. 1 and all other applicable Commission policies. Core Principle 3 states that a "board of trade shall list on the contract market only contracts that are not readily susceptible to manipulation." The Acceptable Practices for Core Principle 3 state that Guideline No. 1 (Appendix A under Part 40 of the Commission's regulations) may be used to determine whether proposed contracts satisfy this requirement. As discussed below, it appears that the terms and conditions of the Credit Index Event contract meet the standards for cash settled contracts in Guideline No. 1.

Terms and Conditions of the Proposed CME Credit Index Event Contract

Term	Exchange Proposal	Comment/Analysis
Unit of Trading/Commodity Specification	The North American Investment Grade High Volatility Index, which measures the occurrences of credit events (bankruptcy or failure to pay) by the component reference entities over a specific time period.	Acceptable for hedging credit risk associated with the Index reference entities.
Contract Size	The final settlement value would be equal to the Notional Value, set initially at $100,000 per contract, times the sum of the products of the component Weight (equal weights of 3.125%) times the Final Settlement Rate (set initially at 60%), times the Binary Credit Event Indicator. This is equivalent to $1,875.00 times the number of reference entities that experience a credit event. The Notional Value and Final Settlement Rate	Acceptable. Although smaller than typical institutional transactions in credit derivatives, the smaller contract size would enable hedgers to more precisely hedge their exposure to credit risk of the reference entities. There are no impediments to settlement given the cash settlement provision.

Term	Exchange Proposal	Comment/Analysis
	are fixed at initial listing and may not vary through expiration. The Notional Value and Final Settlement Rate may differ across contracts, but they are fixed initially for each contract.	
Cash Settlement Procedure	The occurrence of a credit event must be confirmed by the Exchange. Early expiration and settlement would be triggered if <u>every</u> Index reference entity experiences a specified credit event prior to the expiration date. If none of the reference entities experience a credit event prior to expiration, then the final settlement price would be zero.	Acceptable. The cash settlement price is reliable, acceptable, publicly available, and timely (see table below).
Pricing Basis and Minimum Tick	The price would reflect the market's expectation of the collective probabilities that one or more Index reference entities will experience a credit event, i.e., bankruptcy or failure to pay, prior to expiration. Pricing would be quoted in basis points of the contract's assigned Notional Value, in increments of 0.5 basis points. Based on the Notional Value of $100,000, the value of the minimum tick would equal $5.00 per contract.	Acceptable. There is no cash market for credit events per se. Thus, the minimum tick is a business decision of the Exchange.
Speculative Position Limit	5,000 contracts in all contract months combined.	Acceptable. Because there is no cash market for the underlying credit events, no position limit is routinely required. Therefore, the CME speculative position limit provision is more conservative than necessary.
Aggregation Rule	Same as CFTC Regulation 150.5(g).	Consistent with Guideline No. 1 standard and therefore acceptable.
Reporting Level	25 contracts.	Acceptable. Equal to the reporting level specified in Commission Regulation 15.03.
Last Trading Day *(Chicago Time)*	Trading terminates at 12:00 noon on the second London bank business day before the third Wednesday of the contract month. If every Index reference entity experiences a credit event, then trading would terminate at the end of the trading day following the final credit event confirmed by the Exchange.	Acceptable. It is reasonable to terminate trading early if every component reference entity experiences a credit event. In that regard, the contract's final settlement value would be known.
Trading/Expiration Month	Contract months of June and December listed five (5) years in the future.	Any expiration month would be acceptable from an economic standpoint.
Trading Hours (Chicago Time)	Offered exclusively on the CME Globex® electronic trading platform Sundays through Thursdays from 5:00 p.m. to 4:00 p.m. the following day.	Any hours are acceptable.
Price Limit/Premium	None.	Acceptable.

Term	Exchange Proposal	Comment/Analysis
Fluctuation Limits		

Commission Guideline No. 1 Requirements for Cash Settlement Price Series

Requirement	Comment/Analysis
Not readily susceptible to manipulation.	The final settlement price should not be readily susceptible to manipulation or distortion for several reasons: • Determination of whether a credit event occurred is the only variable in calculating the final settlement price. All other values used in the calculation of the final settlement price are fixed at the time of listing. • A bankruptcy or failure to pay must be confirmed by the Exchange. The information required to determine whether such a credit event has occurred relates to actions by independent third parties, such as the corporations referenced in the Index or a U.S. Bankruptcy Court. Thus, traders would be able to independently confirm the occurrence of a credit event. • There is no underlying cash market *per se*, so the contract would not rely upon any cash price series or cash market activity for purposes of determining whether a credit event had occurred. • The specified credit events typically are not within the control of any individual.
Reflective of underlying cash market.	There is no underlying cash market per se. The CME must confirm that a bankruptcy or failure to pay has occurred. Information to make such a confirmation is publicly available. Therefore, the CME's declarations of a credit event would be reflective of credit events related to bankruptcy or failure to pay by the reference entities.
Reliable indicator of cash market and acceptable for hedging.	As noted, there is no underlying cash market per se. The Exchange must confirm whether a credit event has occurred based on public sources of information. Therefore, a credit event announcement by the Exchange would be a reliable indicator that a bankruptcy or failure to pay has occurred, and thus the proposed contract would be acceptable for hedging the credit risk associated with bankruptcy or failure to pay by the Index reference entities.
Publicly available and disseminated on a timely basis.	Information used for confirmation of a credit event typically is made through several public sources, including U.S. Bankruptcy Courts and major financial news media. The CME will announce on its website when a credit event has occurred, and that information also will be readily available from public sources on a timely basis. Therefore, the CME Index contract appears to meet the public availability and timeliness requirements.

V. SUMMARY OF COMMENTS AND STAFF EVALUATION

A. General Overview

The Commission, in accordance with its long standing internal policy, posted the CME Credit Index Event contract approval request on its website in order to give interested persons the opportunity to submit comments. The Chicago Board Options Exchange (CBOE) and the

Options Clearing Corporation (OCC) submitted comment letters opposing the CME's approval request. In addition, the CME submitted a comment letter in support of its request for approval and in response to the comment letters of CBOE and OCC.

In its comment letter, the CBOE generally argues that the CME Credit Index Event contract is not subject to the CFTC's jurisdiction and is improper for listing on the CME because the contract should be considered either a group of individual options on various securities or a single option on a group of securities.[18] In its responsive comment letter, the CME asserts that the Credit Index Event contract comes within the CFTC's exclusive jurisdiction because it is a futures contract based on commodities that are not securities.[19] The OCC comment letter, without providing substantive analysis, expressly concurs with the CBOE's jurisdictional conclusions.[20]

B. Particular Issues Raised by the Commenters

1. Whether the CME Credit Index Event Contract is an Option or a Futures Contract

The CBOE contends that the CME's proposed Index contract is an option contract and not a futures contract. First, the CBOE notes that in approving the CME Credit Event contracts, the Commission found those contracts to be binary options. The CBOE states, without substantive analysis, that the structure of the pending CME Credit Index Event contract is identical to the CME Credit Event contracts previously approved by the Commission. As a consequence, the

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[18] The OCC and the CBOE cite and incorporate by reference their comment letters regarding the CME's Credit Event contract. (The CME Credit Event contract was approved by the Commission on January 31, 2007. *See* Letter from Eileen Donovan, Acting Secretary of the Commission, to John Labuszewski, Managing Director of the CME, dated January 31, 2007.) The staff responded to the prior CBOE and OCC comments in recommendation memoranda submitted to the Commission. Staff incorporates its responses to those comments by reference herein. For a summary of the comment letters submitted pursuant to the CME's prior request for contract approval, see the Division's Memoranda to the Commission dated January 26 and 30, 2007.

[19] In its initial filing, the CME also provided an analysis to show that the underlying Index would meet the standards for a broad-based debt index under Commission Regulation 41.15. The CBOE disputed the CME's characterization of the underlying instrument as an index. Because the contract's underlier, whether or not characterized as an index, is not composed of debt securities, the issue is not discussed in this memorandum.

[20] Because the brief OCC comment letter expresses concurrence with the CBOE, the remainder of this section will summarize and evaluate the CBOE and the CME comment letters without directly addressing the OCC letter.

CBOE concludes that the CME, by arguing that the CME Credit Index Event contract is a futures contract, is asking the Commission to contradict itself and reject its own prior findings.

The CME contends that its Credit Index Event contract does not include any of the features that distinguish options from futures. The CME states that an option purchaser typically pays for the benefit of price movements above or below a strike price and has no liability other than the premium paid. An option seller assumes the opposite risk profile. The CME notes that its Credit Index Event contract does not involve any strike prices or premium payments. The CME thus concludes that its contract is better characterized as a cash-settled index futures contract that settles to the value of a digital index.

2. Whether the CME Credit Index Event Contract is a Security

The CBOE, in its comment letter, argues that the CME Credit Index Event contract is a security because it includes failure to pay in the definition of a credit event and refers to a list of Reference Obligations that are securities. The CBOE implies that Commission staff's request of the CME to remove failure to pay from the terms of the previously submitted and approved CME Credit Event contracts reflected a recognition on the part of Commission staff that an option that references a security and is based on a failure to pay is itself a security.[21]

The CBOE also contends that Congress defined "credit risk or measure" as an excluded commodity in the CEA solely for the purpose of establishing legal certainty for OTC credit derivatives.[22] According to the CBOE, Congress's inclusion of credit risk or measures within the definition of excluded commodity was not and could not have been for the purpose of allowing credit derivatives to trade on Commission regulated markets. In addition, the CBOE also criticizes Commission staff's analysis of the previously-approved CME Credit Event contracts for

[21] By filings dated January 12, 2007 and January 17, 2007, the CME amended the terms and conditions of it Credit Event contracts then pending before the Commission by, among other things, limiting the list of triggering credit events to bankruptcy.

[22] CEA Section 1a(13)(i).

considering an option not to be based on a security unless it provides for delivery or cash settlement based on the value of a security. The CBOE states that while an option requiring delivery of a security is a security, and while there is case law that appropriately finds that an option based on the value of a security is also a security, there is no precedent that supports the conclusion that an option must provide for delivery or be based on the value of a security in order to be considered a statutory security. The CBOE also is critical of Commission staff's comparison of the functional similarities between CDS agreements (which are explicitly excluded from the definition of a security) and the CME Credit Event contracts. The CBOE concludes that the swap agreement exclusion from the definition of a security enacted as part of the Commodity Futures Modernization Act of 2000 (CFMA) is irrelevant to any jurisdictional inquiry because it applies only to "actual swaps" that satisfy specific statutorily delineated criteria. Finally, the CBOE points out that one consequence of the CME Credit Index Event not being considered a security is that insiders and tippees could actively trade the contract without being subject to the legal prohibitions against insider trading imposed under the securities laws. The CBOE further argues that such activity would not violate any provision of the CEA and would not otherwise be subject to Commission sanction.

The CME asserts that its Credit Index Event contract is based on commodities, not securities. In this regard, the CME argues that the contract's trigger events, bankruptcy or a failure to pay, are events whose occurrence is independent of the price or value of any security. The CME also points out that the proposed contract would not require delivery of any security or basket of securities or cash settlement based on the value of any security or basket of securities. The CME further notes that the payout for each reference entity that experiences a credit event is fixed in advance of listing and would not vary in relation to the price of any security of an Index reference entity.

C. Staff Evaluation of Comments and Commission Jurisdiction

1. The CME Credit Index Event Contract is a Futures Contract

Commission staff previously determined that the CME's Credit Event contracts were binary option contracts. Binary options, like the CME Credit Event contracts, can provide for a payment of a premium by the purchaser and for a payment of a fixed amount by the seller if certain events occur. Staff found that the limited risk of transactions structured similarly to the CME Credit Event contracts, the lack of variation in the loss or profit that may result independent of trading, and the fact that such contracts can incorporate certain characteristics of vanilla put or call options rendered such transactions binary option contracts.

In contrast to the CME Credit Event contracts, however, the proposed CME Credit Index Event contract incorporates a payoff structure that is not dependent on a single occurrence. The contract's payoff structure, independent of gains and losses realized through trading, is dependent on the variable number of Index reference entities that experience credit events. Unlike the CME Credit Event contracts, the subject Index contract's payoff structure resembles that of a futures contract with an upward slope for a long position and a downward slope for a short position (see Figure 1 in Section III). This is because position holders in the Index contract have both an opportunity for continual gain as well as an exposure to continual loss.[23] Moreover, the CME Credit Index Event contract has no traditional option terms such as strike prices, strike conditions, or premium payments. Based on the foregoing and the staff's analysis of the contract, the CME

[23] The Division notes, however, that each reference entity that experiences a credit event establishes a new floor in the contract price. In this regard, as noted, the final settlement value reflects a count of reference entities that experience a CME-specified credit event, and that count can not be reversed. The contract structure is similar to that of the CME's Quarterly Bankruptcy Index (QBI) futures contract, which was deemed approved by the Commission on April 14, 1998. In that regard, the QBI reflects a count of new bankruptcy filings. *See* the Memorandum to the Commission from the Division of Economic Analysis dated April 10, 1998. The QBI measured the number of new bankruptcy filings in federal courts during a specified calendar quarter.

Credit Index Event contract can properly be described as a futures contract for regulatory purposes.[24]

2. The CME Credit Index Event Contract is Based on a Commodity and is not a Security

CEA Section 1a(4), a definitional provision for the term "commodity," includes certain agricultural commodities as well as "all other goods and articles ... and all services, rights, and interests in which contracts for future delivery are presently or in the future dealt in." CEA Section 1a(13) identifies with specificity "credit risk or measure" and certain occurrences or contingencies associated with financial, commercial, or economic consequences, including changes in the price or value of credit risks or measures, as excluded commodities. The Commission has previously determined that the occurrence of a credit event that materially impacts a corporation's ability to make good on its debt obligations is a commodity under the CEA. In accordance with that Commission precedent, staff concludes that the proposed CME Credit Index Event contract overlies a group or index of commodities that, in the aggregate, measures the market's perception of the number of reference entities that are likely to experience a credit event by a specified date.[25]

Also, as discussed above, staff concludes that the CME Credit Index Event contract is a futures contract. Any futures contract on a security or a narrow-based security index (including any interest therein or based on the value thereof) is a security future that may be subject to joint

[24] The Division notes that it would be a relatively simple matter for an organized exchange to design an option contract that would resemble the subject proposed futures contract by specifying as strike prices the number of reference entities that will experience a credit event on or before the expiration date.

[25] *See* the Commission's January 31, 2007 letter approving the CME's Credit Event contracts. The Commission's January 31, 2007 letter explicitly adopted the product analysis and legal reasoning of DMO's January 26, 2007 memorandum, as well as DMO's January 30, 2007 memorandum and the Office of the General Counsel's (OGC) January 12, 2007 memorandum regarding that CME contract. The Commission's letter, and aforementioned DMO and OGC memoranda, are incorporated by reference herein.

regulation by the CFTC and the SEC under CEA Section 2(a)(1)(D).[26] On the other hand, futures contracts based on commodities or commodity indexes that are not securities or composed of securities are subject to the exclusive jurisdiction of the CFTC under CEA Section 2(a)(1)(A). Accordingly, the Commission must determine whether the CME Credit Index Event contract, although not an option, is nonetheless a security future.[27]

The CBOE argues that the CME Credit Index Event contract "is expressly and directly based on one or a group of securities (including any interest therein or based on the value thereof)..."[28] In doing so, the CBOE emphasizes the CME Credit Index Event contract's reference to specific debt securities and the contract's inclusion of failure to pay as a credit event. As explained in the staff's previous memoranda regarding the CME Credit Event contracts, derivatives based on credit events and measures of credit risk, which would include the CME Credit Event and Credit Index Event contracts, are not instruments designed to transfer the price or value of a security from buyer to seller. They are instruments that isolate, measure, and price credit risk. Thereby, such contracts facilitate the accurate pricing of related debt obligations by giving value to debt instruments as opposed to being economic equivalents that are based on, or take on, the value of the debt instruments. Accordingly, the CME's Credit Index Event contracts are not security futures.

3. The CBOE's Remaining Arguments Do Not Alter the Conclusion

The CBOE argues that, irrespective of the potential of not being based on the value of a security, the CME Credit Index Event contract is nonetheless an option "on" a security. Even if the CME's Credit Index Event contract could be considered an option, which staff does not view

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[26] The Division notes, however, that if the securities were found to be something other than common stock or debt securities, then the contract would be prohibited.

[27] CEA Section 1a(31) defines a security future as any futures contract on a single security or narrow-based security index, including any interest therein or based on the value thereof.

[28] Although CBOE characterizes the CME Credit Index Event contract as an option, the condition that defines an option as a security is identical to the condition that defines a futures contract as a security future.

to be the case, CBOE's argument is without merit. Staff observes that the CBOE's expansive interpretation of "on" a security would make the parenthetical "including any interest therein or based on the value thereof" in the definition of a security redundant and unnecessary. Indeed, Court opinions that have interpreted the definition of a security have not relied on an expansive reading of "on" a security to determine whether a non-standard option is a security.[29] Instead, they have looked to the economic reality of transactions and considered whether the relevant instrument is pegged to the "value" of a security or securities in a manner that would make them the economic equivalent of standard put or call options. Notably, in discussing the concept of "value", the court in *Caiola* focused on whether or not a derivative instrument is pegged to the market value of any security in a manner that would make it an economic equivalent of standard options.

The CBOE's comment letter also questions the Commission's consideration of the functional similarities between CDS agreements, which are explicitly excluded from the definition of a security, and the CME Credit Event contracts previously approved by the Commission. The CBOE concludes that the swap agreement exclusion from the definition of a security is irrelevant to any jurisdictional inquiry, since it applies only to "actual swaps" that satisfy specific statutorily delineated criteria. Staff notes, however, that one of the statutorily delineated criteria that an actual swap agreement must satisfy specifically prohibits the agreement from being the functional equivalent of a security option. The parties to a particular transaction as well as the manner and venue of a transaction's purchase and sale have nothing to do with whether or not a financial instrument is structured functionally as a security option. The fact that certain exempt swap agreements with material links to securities can take on some of the fundamental attributes of option contracts without being deemed to be securities is indicative of the need to read the definition of security narrowly with respect to option-like derivatives,

[29] *See, e.g., Caiola v. Citibank NA*, 295 F.3d 312 (2d Cir. 2002); *Stechler v. Sidley Austin Brown & Wood LLP*, 382 F.Supp. 2d 580 (S.D.N.Y. 2005).

particularly in light of the fact that exchange-traded commodity option and futures contracts that are offered to retail market participants are regulated under the regulatory structure established by the Act.

Furthermore, according to the CBOE, Congress's inclusion of credit risk or measures (and presumably occurrences with financial or economic consequences) within the definition of excluded commodity was for the purpose of creating legal certainty for OTC products and not for the purpose of allowing credit derivatives to trade on Commission regulated markets. CBOE is correct in that a prime objective of the CFMA was to create legal certainty for OTC derivatives. However, the assertion that Congress could not have included credit risk within the definition of excluded commodity for the purpose of permitting contracts based thereon to trade on Commission regulated markets is not persuasive.

The Commission's acceptance of the CBOE's assertion would mean that Congress put credit risk or measures, and occurrences with economic or commercial consequences, in a category of commodities which separately identifies and includes interest rates, currencies, exchange rates, securities, measures of inflation, and statistical measures of economic and commercial activity – all of which have been trading on designated contract markets for years – for the sole purpose of facilitating the OTC trading of credit derivatives.

Staff notes that, in fact, Congress has used the excluded commodity definition in instances other than with respect to OTC derivatives. For example, CEA Section 5a(g), a provision enacted in the CFMA, explicitly states that derivatives transaction execution facilities (DTEF) may elect to list contracts for trading based on excluded commodities, other than securities that are not exempt securities. Section 5a(g) of the Act applies to all excluded commodities not specifically exempted, including instruments based on credit risk or measures and occurrences with economic or commercial consequences. In that provision, Congress pointedly identified securities and exempt securities as commodities that could or could not qualify for trading on Commission-regulated DTEFs. Congress could have, but chose not to, explicitly prohibit security linked derivatives based on measures of credit risk and credit events from trading on DTEFs. Use of the term excluded commodity in Section 5a(g) belies a Congressional intent that the excluded commodity definition was added solely to facilitate OTC trading. Congress, by defining credit risk or measure and occurrences as commodities, without providing any indication that option transactions based on them are for jurisdictional purposes securities when traded publicly on organized exchanges, gave rise to the reasonable assumption that Commission regulated derivatives markets could properly list and offer credit derivatives linked to securities without being subjected to the full panoply of the securities laws. Moreover, CEA Section 2(c)(2)(A) explicitly states that futures contracts on repurchase agreements involving any excluded commodity can be listed and traded on organized exchanges – including designated contract markets.

Finally, staff notes the CBOE's argument that a consequence of the CME Credit Index Event not being considered a security is that insiders and tippees could actively trade the contract without being subject to the legal prohibitions against insider trading imposed under the securities laws. In making this argument, the CBOE fails to observe, however, that as with any other exchange traded commodity futures or option contract, the trading of credit event contracts on a designated contract market would be subjected to a comprehensive regulatory regime established by Congress for the express purpose of regulating derivative transactions. The CBOE's reliance on the potential inapplicability of certain securities laws ignores the fact that credit derivatives, when traded subject to the rules of a designated contract market, would be traded openly, competitively, and under the surveillance of derivatives markets that are self-regulatory bodies operating pursuant to the provisions of the CEA and the oversight of the Commission.

D. CONCLUSION

The Division believes that the structure, design, purpose and use of the CME Credit Index Event contract collectively represents a commodity futures contract that is based on commodities that are not securities. Accordingly, the Division concludes that the CME's Credit Index Event contract is subject to the CEA and the Commission's jurisdiction thereunder. Based on its economic and legal analysis of this request for approval, as described in detail herein, the Division recommends that the Commission approve the CME Credit Index Event contract and the rules applicable thereto pursuant to Section 5c(c)(2) and Section 5c(c)(3) of the CEA and Commission Regulation 40.3.

ATTACHMENTS:

A. CME Credit Index Event Contract Terms and Conditions.
B. CBOE Credit Index Event Contract response letter dated March 28, 2007.
C. OCC Credit Index Event Contract response letter dated March 28, 2007.
D. CME Credit Index Event Contract response letter dated April 11, 2007.
E. CBOE Credit Index Event Contract response letter dated April 19, 2007.
F. Draft Commission Approval and Speculative Position Letter to CME.

ATTACHMENT A

CME Credit Index Event Contract Terms and Conditions

4. Contract Specifications for CME Credit Index Event Contracts

CHAPTER 454: CME Credit Index Event Contract

45400. SCOPE OF CHAPTER

This chapter is limited in application to trading in CME Credit Index Event Contracts. The procedures for trading, clearing, settlement, and any other matters not specifically covered herein shall be governed by the rules of the Exchange.

45401. COMMODITY SPECIFICATIONS

CME Credit Index Event Contracts shall represent a Notional Value as determined by the Board of Directors or its delegates (hereinafter the "Board") as depicted in Rule 45402.B. The Board may determine to list multiple contracts based on a specific CME Credit Event Index with varying Notional Values (NV), minimum increments, Final Settlement Rates (F), or terms to maturity as depicted in Rule 45402.B.

45402. FUTURES CALL

45402.A. Schedule

CME Credit Index Event Contracts shall be scheduled for trading during such hours and delivery in such months as may be determined by the Board.

45402.B. CME Credit Event Indexes

CME Credit Index Event Contracts shall be based upon the following Indexes.

Index Designation	Notional Value (NV)	Minimum Increment	Position Limit
CME NA IG HV1	$100,000 (USD)	0.5 basis points ($5.00)	5,000 contracts

45402.C. Trading Unit

CME Credit Index Event Contracts shall be based on a Notional Value and denominated in such currency as determined by the Board as depicted in Rule 45402.B.

45402.D. Minimum Increments

CME Credit Index Event Contracts shall be traded with a minimum price increment as determined by the Board as depicted in Rule 45402.B. Bids and offers shall be quoted in terms of basis points of Notional Value. *E.g.*, If the minimum price increment of a contract with a Notional Value of $100,000 is established at 0.5 basis points, then the minimum price increment equates to $5.00. A quotation of 405.5 basis points based on a contract with a Notional Value of $100,000 equates to $4,055.00.

45402.E. Position Limits

A person shall not own or control more than a specified number of contracts net long or short in all contract months combined in any single Index as determined by the Board as depicted in Rule 45402.B.

45402.F. Accumulation of Positions

For the purposes of this rule, the positions of all accounts directly or indirectly owned or controlled by a person or persons, and the positions of all accounts of a person or persons acting pursuant to an expressed or implied agreement or understanding, and the positions of all accounts in which a person or persons have a proprietary or beneficial interest, shall be cumulated.

45402.G. Exemptions

The foregoing position limits shall not apply to (1) bona fide hedge positions meeting the requirements of Regulation 1.3(z)(1) of the CFTC and the rules of the Exchange, and (2) other positions exempted pursuant to Rule 543.

45402.H. Final and Early Termination of Trading Date

Trading shall terminate at 12:00 p.m. (Chicago Time) on the Final Termination of Trading Date. The Final Termination of Trading Date shall be the second London bank business day immediately preceding the third Wednesday of the contract expiration month. For purposes of determining whether a Credit Event has occurred, the Final Termination of Trading Date shall end at 12:00 p.m. (Chicago Time) on the relevant day.

If Credit Events have been Declared ("Declaration of Credit Event") per Rule 45403.C., on or prior to the Final Termination of Trading Date, with respect to all Reference Entities included in a CME Credit Index Event Contract then such Contract shall be subject to Early Termination of Trading. The Early Termination of Trading Date shall be the first business day following the final Declaration of Credit Event that is possible under such Credit Index Event contract. Trading shall terminate at the regularly scheduled time, on the Early Termination of Trading Date.

45402.I. Final Settlement Date
The Final Settlement Date shall be the first business day following the Final Termination of Trading Date. However, if a Contract is subject to Early Termination of Trading per Rule 45402.H., then the Final Settlement Date shall be the first business day following the Early Termination of Trading Date.

45402.J. Contract Modifications

Specifications shall be fixed as of the first day of trading of a Contract. If any U.S. governmental agency or body issues an order, ruling, directive or law that conflicts with the requirements of these rules, such order, ruling, directive or law shall be construed to take precedence and become part of these rules, and all open and new contracts shall be subject to such government orders.

45403. CASH SETTLEMENT

Delivery of CME Credit Index Event Contracts shall be by cash settlement.

45403.A. Final Settlement Procedures

The Final Settlement Price (FSP) shall be rounded to the nearest 1/10000th of a percentage point. (Decimal fractions ending in a five (5) are rounded up. For example, a FSP equal to 4.06246% would be rounded to 4.0625%.) The Final Settlement Value (FSV) quoted in the currency designated per Rule 455A02.B. with respect to a CME Credit Index Event Contract shall be calculated as follows.

$$FSV = NV \times FSP$$

$$FSP = \sum_{i=1}^{n} [E_i \times F_i \times W_i]$$

Where:

NV = Notional Value of Contract per Rule 455A02.B.

Ei = Binary Event Indicator which equals
1 if a Credit Event has been declared with respect to Reference Entity i
0 if a Credit Event has not been declared with respect to Reference Entity i

F_i = Final Settlement Rate assigned to Reference Entity i

W_i = Weight assigned to Reference Entity i

E.g., if no Credit Events have been declared with respect to the Reference Entities included in an Index, then FSP = 0 and FSV = \$0.

If a Credit Event has been declared with respect to one Reference Entity included in an Index where NV = \$100,000, F_i = 60% and W_i = 3.125% then FSP = 187.5 basis points [= 1 x 0.60 x 0.03125] and FSV = \$1,875 [= \$100,000 x 187.5 basis points].

If a Credit Event has been declared with respect to two Reference Entities included in an Index where NV = \$100,000, and both Reference Entities have Final Settlement Rates of F_i = 60% and Weights of W_i = 3.125% then FSP = 375 basis points [= 2 x 0.60 x 0.03125] and FSV = \$3,750 [= \$100,000 x 375 basis points].

If a Credit Event has been declared with respect to all 32 Reference Entities in an Index of 32 constituents where NV = \$100,000, and all 32 Reference Entities have Final Settlement Rates of F_i = 60% and Weights of W_i = 3.125% then FSP = 6,000 basis points [= 32 x 0.60 x 0.03125] and FSV = \$60,000 [= \$100,000 x 6,000 basis points].

45403.B. Credit Events

Credit Event means, with respect to CME Credit Index Event Contracts, one or more of Bankruptcy or Failure to Pay in accordance with the INTERPRETATIONS TO CHAPTER 454.

45403.C. Declaration of Credit Events

The Exchange shall issue a Declaration of Credit Event, when a Credit Event is confirmed by the Exchange with Publicly Available Information, which may occur after the Final Termination of Trading Date. Final Settlement may be postponed indefinitely pending Exchange confirmation of a Credit Event.

45403.D. Final Mark-to-Market

Following the determination of the Final Settlement Price and Final Settlement Value, clearing members holding open positions in CME Credit Index Event Contracts at the time of termination of trading in that contract shall make payment to or receive payment from the Clearing House in accordance with normal variation margin procedures based on a settlement price equal to the Final Settlement Price.

45404. ADJUSTMENTS TO CME CREDIT INDEX EVENT CONTRACTS

CME Credit Index Event Contracts shall be subject to adjustments upon the occurrence of a Succession Event as defined in Section II(l)(i)-(vi) in the INTERPRETATIONS TO CHAPTER 454. Determinations as to whether and how to adjust the terms of CME Credit Index Event Contracts to reflect events affecting Reference Entities and their Successor(s) shall be made by the Board based on its judgment as to what is appropriate for the protection of investors and the public interest, taking into account such factors as fairness to the buyers and sellers of CME Credit Index Event Contracts on the underlying interest, the maintenance of a fair and orderly market, efficiency of CME Credit Index Event Contract settlement, and consistency of interpretation and practice in accordance with the INTERPRETATIONS TO CHAPTER 454.

Adjustments to CME Credit Index Event Contracts may include, but are not limited to, assigning a Successor Reference Entity or Successor Reference Entities to a CME Credit Index Event Contract, attachment of a cash payment from longs to shorts or shorts to longs as appropriate; early cash settlement of retiring CME Credit Index Event Contracts at a fair and reasonable price; or such other provisions or combinations of provisions as deemed appropriate by the Board.

Every determination by the Board in respect of CME Credit Index Event Contracts pursuant to this Rule shall be within the discretion of the Board and shall be conclusive and binding on all investors and not subject to review.

45405. FAILURE TO PERFORM

If the clearing member fails to perform all acts required by this chapter, then that clearing member shall be deemed as failing to perform which may be punishable as a major violation. The Board may also assess such penalties as it deems appropriate.

45406. ACTS OF GOVERNMENT, ACTS OF GOD AND OTHER EMERGENCIES

(Refer to Rule 701. – ACTS OF GOVERNMENT, ACTS OF GOD AND OTHER EMERGENCIES)

INTERPRETATIONS TO CHAPTER 454

I. Credit Events

Credit Event means, with respect to CME Credit Index Event Contracts, one or more of Bankruptcy, or Failure to Pay.

(a) "Bankruptcy" means the filing under the United States Bankruptcy Code in a United States Bankruptcy Court of: (i) a voluntary petition by the Reference Entity that has not been dismissed by the Final Termination of Trading Date of the Contract; or (ii) an involuntary petition against the Reference Entity with respect to which an order of relief has been issued by the Court prior to the Final Termination of Trading Date of the Contract (irrespective of whether such order of relief is subsequently reversed on appeal, nullified, vacated, dismissed or otherwise modified after the expiration date of the Contract).

(b) "Failure to Pay" means, after the expiration of any applicable Grace Period, the failure by a Reference Entity to make, when and where due, any payments in an aggregate amount of not less than the Payment Requirement under one or more Obligations, in accordance with the terms of such Obligations at the time of such failure.[1] For the avoidance of doubt, if the applicable Grace Period cannot expire on or prior to the Final Termination of Trading Date, then there will be no Declaration of Credit Event with respect to the CME Credit Index Event Contract

II. Definitions.[2]

(c) Grace Period. "Grace Period" means if a Reference Entity fails to make, when and where due, any payment in an aggregate amount of not less than the Payment Requirement under one or more Obligations, the shorter of (i) the applicable grace period with respect to payments under the relevant Obligation under the terms of such Obligation in effect as of the date of such payment failure and (ii) 30 calendar days.

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[1] Section I.(b) has been adapted with permission from copyrighted material as published by the International Swaps & Derivatives Association, Inc. (ISDA). Specifically Section I.(b) is adapted from Article IV, Section 4.5 of the 2003 ISDA Credit Derivatives Definitions.

[2] Section II. has been adapted with permission from copyrighted material as published by the International Swaps & Derivatives Association, Inc. (ISDA). Specifically Section II.(c) is adapted from Article IV, Section 4.8(c); Section II. (e)(i)-(iv) is adapted from Article III, Section 3.5(a)-(d); Section II.(f) is adapted from Article III, Section 3.7; Section II.(g) is adapted from Article II, Section 2.1; Section II.(j) is adapted from Article II Section 2.2(c); Section II.(k) is adapted from Article II Section 2.2(b); Section II.(l) is adapted from Article II Section 2.2(a)(i)-(vi) of the 2003 ISDA Credit Derivatives Definitions.

(d) Obligation. "Obligation" means each obligation of each Reference Entity that is a Bond and has each of the following characteristics: Not Subordinated, Not Sovereign Lender, and Specified Currency.

(i) "Bond" means any obligation for the payment or repayment of borrowed money in the form of or represented by a bond, note (other than notes delivered pursuant to obligations that are typically documented by term loan, revolving loan, letter of credit reimbursement, or similar credit agreements), certificated or uncertificated debt security or other debt security, in each case that is assigned an identification number such as a CUSIP number, International Securities Identification Number (ISIN), or a similar number of a successor to either of such identification systems.

(ii) "Not Subordinated" means an obligation that is not Subordinated to the most senior Reference Obligation in priority of payment. For determining whether an obligation is "Not Subordinated," the ranking in priority of payment of each Reference Obligation shall be determined as of the date on which such Reference Obligation was issued or incurred and shall not reflect any change to such ranking in priority of payment after such date.

(iii) "Subordination" means, with respect to an obligation (the "Subordinated Obligation") and another obligation of the Reference Entity to which such obligation is being compared (the "Senior Obligation"), a contractual, trust or similar arrangement providing that (1) upon the liquidation, dissolution, reorganization or winding up of the Reference Entity, claims of the holders of the Senior Obligation will be satisfied prior to the claims of the holders of the Subordinated Obligation or (2) the holders of the Subordinated Obligation will not be entitled to receive or retain payments in respect of their claims against the Reference Entity at any time that the Reference Entity is in payment arrears or is otherwise in default under the Senior Obligation. "Subordinate" will be construed accordingly. For purposes of determining whether Subordination exists or whether an obligation is Subordinated with respect to another obligation to which it is being compared, the existence of preferred creditors arising by operation of law or of collateral, credit support or other credit enhancement arrangements shall not be taken into account.

(iv) "Not Sovereign Lender" means any obligation that is not primarily owed to a Sovereign or Supranational Organization, including without limitation, obligations generally referred to as "Paris Club debt."

(v) "Sovereign" means any state, political subdivision or government, or any agency, instrumentality, ministry, department or other authority (including, without limiting the foregoing, the central bank) thereof.

(vi) "Supranational Organization" means any entity or other organization established by treaty or other arrangement between two or more Sovereigns or the "Sovereign Agencies of two or more Sovereigns and includes, without limiting the foregoing, the International Monetary Fund, European Central Bank, International Bank for Reconstruction and Development and European Bank for Reconstruction and Development.

(vii) "Sovereign Agency" means any agency, instrumentality, ministry, department or other authority (including, without limiting the foregoing, the central bank) of a Sovereign.

(viii) "Specified Currency" means an obligation that is payable in any of the lawful currencies of Canada, Japan, Switzerland, the United Kingdom, and the United States of America, and the euro and any successor currency to any of the aforementioned currencies.

(e) Obligation Currency. "Obligation Currency" means the currency or currencies in which an Obligation is denominated.

(f) Payment Requirement. "Payment Requirement" means USD 5,000,000 or its equivalent in the relevant Obligation Currency, in the occurrence of the relevant Failure to Pay.

(g) Publicly Available Information. "Publicly Available Information" means:

(i) Information that reasonably confirms any of the facts relevant to the determination that the Credit Event has occurred and which (1) has been published in or on not less than two Public Sources, regardless of whether the reader or user thereof pays a fee to obtain such information; provided that, if either of the parties or any of their respective Affiliates is cited as the sole source of such information, then such information shall not be deemed to be Publicly Available Information unless such party or its Affiliate is acting in its capacity as trustee, fiscal agent, administrative agent, clearing agent or paying agent for an Obligation, (2) is information received from or published by (A) a Reference Entity that is not a party to the relevant CME Credit Index Event Contract or (B) a trustee, fiscal agent, administrative agent, clearing agent or paying agent for an Obligation, (3) is information contained in any petition or filing instituting a Bankruptcy proceeding against or by a Reference Entity or (4) is information contained in any order, decree, notice or filing, however described, of or filed with a court, tribunal, exchange, regulatory authority or similar administrative, regulatory or judicial body.

(ii) In the event that with respect to the CME Credit Index Event Contract in which the Buyer is (1) the sole source of information in its capacity as trustee, fiscal agent, administrative agent, clearing agent or paying agent for an Obligation and (2) a holder of the Obligation with respect to which a Credit Event has occurred, the Buyer shall be required to deliver to the Exchange a certificate signed by a Managing Director (or other substantively equivalent title) of the Buyer, which shall certify the occurrence of a Credit Event with respect to a Reference Entity.

(iii) In relation to any information of the type described in Section (II)(e)(i)(2), (3) and (4) of "Publicly Available Information", the Exchange may assume that such information has been disclosed to it without violating any law, agreement, or understanding regarding the confidentiality of such information and that the party delivering such information has not taken any action or entered into any agreement or understanding with the Reference Entity or any Affiliate of the Reference Entity that would be breached by, or would prevent, the disclosure of such information to third parties.

(iv) Publicly Available Information need not state (1) in relation to an affiliate, the percentage of voting shares owned, directly or indirectly, by the Reference Entity and (2) that such occurrence (A) has met the Payment Requirement or Default Requirement, (B) is the result of exceeding any applicable Grace Period or (C) has met the subjective criteria specified in certain Credit Events.

(h) Public Source. "Public Source" means a source of Publicly Available Information such as Bloomberg Service, Dow Jones Telerate Service, Reuters Monitor Rates Services, Dow Jones News Wire, Wall Street Journal, and New York Times (and successor publications), the main source(s) of business news in the country in which the Reference Entity is organized and any other internationally recognized published or electronically displayed news sources.

(i) Reference Entity. "Reference Entity" means the entity or entities specified as such in a CME Credit Index Event Contract, and in each case any Successor.

(j) Reference Obligations. "Reference Obligations:" means each Obligation specified as such in a CME Credit Index Event Contract.

(k) Relevant Obligations. "Relevant Obligations" means the Obligations constituting Bonds of the Reference Entity outstanding immediately prior to the effective date of the Succession Event, excluding any debt obligations outstanding between the Reference Entity and any of its Affiliates as determined by the Exchange.

(l) Succeed. In this section II, "Succeed" means, with respect to a Reference Entity and its Relevant Obligations, that a party other than such Reference Entity (1) assumes or becomes liable for such Relevant Obligations whether by operation of law or pursuant to any agreement or (2) issues Bonds that are exchanged for Relevant Obligations, and in either case such Reference Entity is no longer an obligor (primarily or secondarily) or guarantor with respect to such Relevant Obligations. The determinations required pursuant to Section II(l) shall be made in the case of an exchange offer, on the basis of the outstanding principal balance of Relevant Obligations tendered and accepted in the exchange and not on the basis of the outstanding principal balance of Bonds for which Relevant Obligations have been exchanged.

(m) Succession Event. "Succession Event" means an event such as a merger, consolidation, amalgamation, transfer of assets or liabilities, demerger, spin-off or other similar event in which one entity succeeds to the Relevant Obligations of another entity, whether by operation of law or pursuant to any agreement. Notwithstanding the foregoing, "Succession Event" shall not include an event in which the holders of Relevant Obligation of the Reference Entity exchange such obligations for the obligations of another entity, unless such exchange occurs in connections with a merger, consolidation, amalgamation, transfer of assets or liabilities, demerger, spin-off or other similar event.

(n) Successor. "Successor" means in relation to a Reference Entity under a CME Credit Index Event Contract, the entity or entities, if any, determined as set forth below:

(i) If one entity directly or indirectly succeeds to seventy-five per cent or more of the Relevant Obligations of the Reference Entity by way of a Succession Event, that entity will be the sole Successor in respect of such Reference Entity.

(ii) If only one entity directly or indirectly succeeds to more than twenty-five per cent (but less than seventy-five per cent) of the Relevant Obligations of the Reference Entity by way of a Succession Event and not more than twenty-five per cent of the Relevant Obligations of the Reference Entity remain with the Reference Entity, the entity that succeeds to more than twenty-five per cent of the Relevant Obligations will be the sole Successor in respect of such Reference Entity.

(iii) If more than one entity each directly or indirectly succeeds to more than twenty-five per cent of the Relevant Obligations of the Reference Entity by way of a Succession Event, and not more than twenty-five per cent of the Relevant Obligations of the Reference Entity remain with the

Reference Entity, the entities that succeed to more than twenty-five per cent of the Relevant Obligations will each be a Successor in respect of such Reference Entity.

(iv) If one or more entities each directly or indirectly succeeds to more than twenty-five per cent of the Relevant Obligations of the Reference Entity by way of a Succession Event, and more than twenty-five per cent of the Relevant Obligations of the Reference Entity remain with the Reference Entity, each such entity and the Reference Entity will each be a Successor in respect of such Reference Entity.

(v) If one or more entities directly or indirectly succeed to a portion of the Relevant Obligations of the Reference entity by way of a Succession Event, but no entity succeeds to more than twenty-five per cent of the Relevant Obligations of the Reference Entity and the Reference Entity continues to exist, there will be no Successor and the Reference Entity and the CME Credit Index Event Contract will not be changed in any way as a result of the Succession Event; and

(vi) If one or more entities directly or indirectly succeed to a portion of the Relevant Obligations of the Reference Entity by way of a Succession Event, but no entity succeeds to more than twenty-five per cent of the Relevant Obligations of the Reference Entity and the Reference Entity ceased to exist, the entity which succeeds to the greatest percentage of Relevant Obligations (or, if two or more entities succeed to an equal percentage of Relevant Obligations, the entity from among those entities which succeeds to the greatest percentage of obligations of the Reference Entity) will be the sole Successor in respect of such Reference Entity.

The Exchange will be responsible for determining the number of Successors as soon as reasonably practicable after it becomes aware of the relevant Succession Event.

III. CME Credit Event Index Adjustment following a Succession Event

Where pursuant to Section II(l)(i)-(vi), one or more Successors have been identified, the relevant Reference Entity of the CME Credit Event Contract will be replaced by one or more Successors with the following terms:

(a) Each Successor will be a Reference Entity for the purposes of a CME Credit Index Event Contract;

(b) In respect of each Successor, the "Final Settlement Rate" will be equal to the "Final Settlement Rate" of the original Reference Entity in the CME Credit Index Event Contract. Each Successor will be assigned a Weight. The Weight assigned to a Successor shall be equal to the original Reference Entity's Weight multiplied by one divided by the number of Successors. Each Successor will have equal or approximately equal Weights.

(c) The Weight assigned to the Successors in a CME Credit Index Event Contract shall be rounded to four decimal places (e.g. 1.5625%, 1.0416% or 1.0427%). If rounding is necessary in order for the Successor Weights to sum to the Weight assigned to the original Reference Entity, the Reference Entities representing the Successors shall be listed in alphabetical order. The Weight of the Successor at the top of the list shall be rounded higher in the fourth decimal place. The Successors at the bottom of the list shall be rounded down in the fourth decimal place until all Successor Weights have been rounded, and the sum of the Successor Weights is equal to Weight of the original Reference Entity.

(d) The sum of the Weights assigned to the Successors in a CME Credit Index Event Contract shall be equal to the Weight of the original Reference Entity.

(e) All other terms and conditions of the original CME Credit Index Event Contract will be replicated following the substitution of Successors except to the extent that modification is required, as determined by the Exchange to preserve the economic effects of the original CME Credit Index Event Contract (considered in the aggregate).

IV. Designated Indexes

CME North American Investment Grade High Volatility Series 1 ("CME NA IG HV, Series 1")

	Reference Entity	CUSIP	Reference Obligation	Weight (W)	Final Settlement Rate (F)
1	Arrow Electronics, Inc.	DD117613	ARW 6.875 01Jun2018	3.125%	60%
2	Autozone, Inc.	EC727763	AZO 5.875 15Oct2012	3.125%	60%
3	CBS Corporation	EC972759	CBSCOR 4.625 15May2018	3.125%	60%
4	Centex Corp	ED963786	CTX 5.25 15Jun15	3.125%	60%
5	CenturyTel, Inc.	EC904163	CTL 7.875 15Aug12	3.125%	60%
6	Cox Communications, Inc.	EC011995	COX-CommInc 6.8 01Aug2028	3.125%	60%
7	Embarq Corporation	EF420252	EMBRQ 7.082 01Jun16	3.125%	60%
8	Expedia, Inc.	EF641825	EXPD 7.456 15Aug18	3.125%	60%
9	Federated Department Stores, Inc.	EF863592	FD 5.9 12/01/16	3.125%	60%
10	IAC/INTERATIVECORP	EC910090	IACI 7 15Jan13 (2)	3.125%	60%
11	International Paper Company	EC955391	IP 5.85 30Oct12	3.125%	60%
12	J.C. Penney Corporation, Inc.	DD110759	JCP 7.95 04/01/17	3.125%	60%
13	Jones Apparel Group, Inc.	ED950861	JNY 5.125 15Nov14 (2)	3.125%	60%
14	The Kroger Co.	EC077595	KR 6.8 12/15/18	3.125%	60%
15	Lennar Corporation	EC845599	LEN 5.95 01Mar13	3.125%	60%
16	Limited Brands. Inc.	EC773327	LTD 6.125 01Dec12	3.125%	60%
17	MeadWestvaco Corporation	EC545468	MWV 6.85 01Apr12	3.125%	60%
18	Pulte Homes, Inc	ED290855	PHM 5.25 15Jan14	3.125%	60%
19	R. R. Donnelley & Sons Company	ED611402	DNY 4.95 01Apr14 (2)	3.125%	60%
20	RadioShack Corporation	EC430698	RSH 7.375 15May11	3.125%	60%
21	Residential Capital Corp	EF365507	GM-ResCap 6.5 17Apr13	3.125%	60%
22	Safeway Inc.	EC649985	SWY 5.8 15Aug12	3.125%	60%
23	Sara Lee Corporation	ED000107	SLE 3 7/8 06/15/13	3.125%	60%
24	The Sherwin-Williams Company	DD011257	SHW 7.375 01Feb27	3.125%	60%
25	Sprint Nextel Corporation	852061AA	S 9 1/4 04/15/22	3.125%	60%
26	Starwood-Hotels & Resorts Worldwide, Inc.	EC946551	HOT 7.875 01May12 (2)	3.125%	60%
27	Temple-Inland Inc.	EC562588	TIN 7.875 01May12	3.125%	60%
28	The Gap, Inc	EC571913	GPS 8.8 15Dec08	3.125%	60%
29	Time Warner Inc	EC548229	TW 6.875 01May12	3.125%	60%
30	Toll Brothers, Inc	ED107919	TOL-FinCorp 6.875 15Nov12	3.125%	60%
31	Viacom Inc.	EF721897	VIA 6 1/4 04/30/16	3.125%	60%
32	Whirlpool Corporation	DD107145	WHR 7.75 15Jul16	3.125%	60%

ATTACHMENT B

CBOE Credit Index Event Contract Comment Letter Dated March 28, 2007

CBOE
CHICAGO BOARD OPTIONS EXCHANGE

Joanne Moffic-Silver
Executive Vice President
General Counsel &
Corporate Secretary

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March 28, 2007

Via Electronic Mail

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

Re: Chicago Mercantile Exchange Submission (07-17) Under Rule 40.3, Regarding a Proposal to List CME Credit Index Event Contracts

Dear Ms. Donovan:

This letter is submitted by Chicago Board Options Exchange, Incorporated ("CBOE"), in response to the voluntary submission by the Chicago Mercantile Exchange ("CME"), dated March 7, 2007 (the "CME March 7 Filing"), pursuant to Commission Rule 40.3, for review and approval by the Commission of a new credit default option product designated as "CME Credit Index Event Contracts" (the "New CME Product"). CBOE has previously commented, in letters dated November 3, 2006, December 5, 2006, December 19, 2006 and January 26, 2007 (the "Prior CBOE Letters"), on a prior proposal regarding credit event products (the "First CME Product") made by the CME, as set forth in the CME's filing dated October 17, 2006, as amended by filings dated October 24, 2006 and January 12, 2007 (the "Prior CME Filings").

For the same reasons set forth in the Prior CBOE Letters, and for the additional reasons identified below, the New CME Product is an option, not a futures contract, and is based on one or more securities. As a result, the New CME Product is a security within the meaning of the Securities Act of 1933 ("Securities Act") and the Securities Exchange Act of 1934 ("Exchange Act") and subject to the exclusive jurisdiction of the U.S. Securities and Exchange Commission ("SEC"). Accordingly, the New 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.

The CME March 7 Filing reflects three significant modifications from the First CME Product, which CBOE continues to believe is a security outside of the Commission's jurisdiction. First, the CME proposes to define a "Credit Event," for purposes of the New CME

Product, to mean a bankruptcy or a "failure to pay" associated with any "Index constituent." This is much broader than the definition of "Credit Event" for the First CME Product, which defined "Credit Event" to mean bankruptcy only. Second, "failure to pay" is determined in the New CME Product by reference to a list of specified Reference Obligations, all of which are securities of identified Reference Entities. Third, the New CME Product is based on a group of securities, rather than on a single security. Regardless of the Commission's prior characterization of the First CME Product (with which CBOE disagrees), the proposed modifications made to the terms of the New CME Product clearly demonstrate that it is: (1) an option; (2) based on securities; and is therefore (3) excluded from the Commission's jurisdiction. Accordingly, the Commission should deny the request for approval of the CME March 7 Filing.

First, as CBOE has argued in the Prior CBOE Letters, the First CME Product is an option, not a futures contract and must be analyzed as such. In fact, the Commission itself, in approving the First CME Product, expressly and unequivocally concluded that the product was an option. "Moreover, because of the nature of the proposed contracts, the Commission has concluded that they are binary options rather than futures contracts."[1] This issue, therefore, is not in dispute. Because the structure of the New CME Product (leaving aside the differences in the underlyer) is identical to the First CME Product in these respects, the New CME Product is also an option.

Second, the New CME Product is clearly based on one or more securities. In approving the Prior CME Filings, the Commission expressed the view that, although the First CME Product is an option, it is based on "Credit Events," which the Commission characterized as a "commodity."[2] This was apparently due to the fact that the definition of a "Credit Event" in connection with the First CME Product was limited to bankruptcy.[3] In contrast, the New CME Product includes "failure to pay" in the definition of a Credit Event and requires that a failure to pay be determined by reference to an identified list of Reference Obligations, all of which are

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1 See Letter from Eileen Donovan, Acting Secretary of the Commission, to John Labuszewski, Managing Director of the CME, dated January 31, 2007.

2 CBOE disagrees with the characterization that options based on a "credit event" fall within the definition of a commodity as a "credit risk or measure" under the CEA with regard to the First and New CME Products. The reference in the CEA to "credit risk or measure" was included solely for the purpose of excluding certain off-exchange transactions from the CEA and not for the purpose of authorizing the listing of derivatives on "credit risk or measure" on a designated contract market. Further, the New CME Product is in any event an option based on securities and is therefore outside the scope of the Commission's jurisdiction. The inclusion of "credit risk or measure" in the definition of an "excluded commodity" does not affect this conclusion.

3 In fact, the CME, in its original filings with the Commission in connection with the First CME Product, had included "failure to pay" in the definition of a "Credit Event." The Commission's staff, however, requested that the CME eliminate "failure to pay" as a Credit Event and it was therefore deleted from terms of the First CME Product. "Subsequent to the comment period, the CME, pursuant to the request of the Commission, amended the terms and conditions of its contracts in filings dated January 12, 2007 and January 26, 2007. Those amendments limited the list of credit events to bankruptcy and amended the definition of bankruptcy that the CME intends to use." See Memorandum of the Division of Market Oversight, dated January 26, 2007 (footnotes omitted).

securities. Indeed, "failure to pay" necessarily links the New CME Product to specific securities and dictates that the payout on the Product can only be determined by reference to those securities. That is the reason, of course, that the Commission expressly requested the CME to remove "failure to pay" from the terms of the First CME Product. Accordingly, the New CME Product is an option that is expressly and directly based on one or a group of securities (including any interest therein or based on the value thereof) and is clearly a security.[4]

The CME argues that the New CME Product is based on an "index" and that the index is not a "narrow-based index," pursuant to Commission Rule 41.15 and SEC Rule 3a55-4. As a result, the CME claims that the New CME Product is based on a "broad-based index" and is within the exclusive jurisdiction of the Commission. This characterization, however, is simply a transparent attempt to obfuscate the true nature of the New CME Product. Because the New CME Product is an option that is based on one or more securities, the question of whether the underlying securities constitute an "index" is irrelevant -- an option on an index of securities is within the definition of a security, which falls under the exclusive jurisdiction of the SEC and is by definition excluded from the Commission's jurisdiction. Moreover, the CME cannot transform this product from an option to a futures contract by basing it on a group or "index" or securities, rather than on individual securities. This is because even if the underlyer proposed by the CME is considered an index, the Product itself would still be an option on an index of securities (i.e., a security) and subject to the SEC's exclusive jurisdiction.

In any event, the New CME Product is not based on an index (including any interest therein or based on the value thereof) of any kind, either "broad-based" or "narrow-based." The New CME Product is based on an identified group of securities and the amount required to be paid by the seller is computed simply by adding the amount required to be paid in respect of each security included in the group. There is no computation methodology or formula associated with the group of securities and no index value that can be determined. Indeed, it is significant to note that the CEA and federal securities laws identically define "security" to mean an option on a "group or index of securities (including any interest therein or based on the value thereof)."[5] However, the term "group" is noticeably absent from the joint regulations that describe the concurrent jurisdiction of the Commission and the SEC with respect to futures on narrow-based security indices. As such, the New CME Product is either: (1) a group of individual options on various securities (i.e., Reference Obligations); or (2) a single option on a "group" of securities. Under either alternative, the New CME Product underlyer cannot be characterized nor qualify as a "broad-based index" under Commission Rule 41.15 and SEC Rule 3a55-4.

In approving the First CME Product, the Commission adopted the position that an option is not based "on" a security unless it provides either for delivery or cash settlement based on the value of the security. CBOE respectfully disagrees. In our view, this position is contrary to the language of the statutes and is unsupported by any precedent. The CEA excludes from the

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4 See Section 2(a)(1) of the Securities Act and Section 3(a)(1) of Exchange Act.

5 See Section 1a(30) of CEA, Section 2(a)(1) of the Securities Act and Section 3(a)(10) of the Exchange Act

Commission's jurisdiction, and the federal securities laws include within the definition of a security within the SEC's jurisdiction, an "option . . . on any security . . . or group or index of securities (including any interest therein or based on the value thereof)." In order to be considered a security, therefore, an option need only be "on" a security or group or index of securities. There is no requirement that the option require delivery or be based on the price or value of the security. To the contrary, the statutes clearly state that the definition of a security *includes* options on a security (including any interest or based on the value thereof) but does not *limit* the definition to those based on value. While an option requiring delivery of a security is clearly a security, and there is case law that appropriately finds that an option based on the value of a security should be considered a security, there is not, to our knowledge, any precedent that supports the conclusion that an option must provide for delivery or be based on value in order to be encompassed within the definition of a security.[6]

The Commission also concluded in connection with the First CME Product, that, because it is functionally similar to a credit default swap, which is excluded from the definition of a security, the First CME Product should not be deemed to be based on a security. As CBOE has previously explained, however, the exclusion of credit default swaps from the definition of a security applies only to actual swaps that satisfy certain specified criteria. It does not and cannot apply to every instrument that may be functionally similar to credit default swaps. The New CME Product, like the First CME Product, is not itself a credit default swap and there is no actual swap underlying the Product. In addition, the exclusion from the definition of a security does not apply to every instrument that is functionally similar to a swap.

Further, as is the case with the First CME Product, if the Commission exercises jurisdiction and determines that the New CME Product is a futures contract and not a security, the New and First CME Products will trade without being subject to the prohibitions against illegal insider trading provided for under the federal securities laws.[7] Absent these statutory safeguards, insiders and tippees can trade on inside information based on, among other things, the financial condition (e.g., non-public information concerning an impending bankruptcy or default) of the issuers of the securities underlying the New CME Product without repercussion under the federal securities laws. Importantly, such activity would not violate any provision of the CEA and would not otherwise be subject to Commission sanction. This result is clearly contrary to the purpose of the insider trading provisions of the federal securities laws. As such, it is important to the principles of market fairness, integrity and public policy that the SEC regulate products such as those proposed by the CME, that are options based on securities.

The New CME Product is unquestionably an option based "on" securities (including any interest therein or based on the value thereof) and is therefore excluded from the CEA and outside of the Commission's jurisdiction. Accordingly, the Commission has no

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6 In any event, as set forth in the Prior CBOE Letters, the New CME Product, like the First CME Product is in fact based on the value of the Reference Obligations. For example, this is illustrated because the "Final Settlement Rate" used to calculate the payment due under the Product represents a "recovery rate" on the Reference Obligations.

7 See e.g., Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder.

authority to approve the CME March 7 Filing, which falls exclusively within the SEC's jurisdiction.

CBOE appreciates the opportunity to provide these comments. We believe that the status of the New 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. Should you require any further information, please do not hesitate to contact the undersigned.

Sincerely,

Joanne Moffic Silver (JKK)

Joanne Moffic-Silver

ATTACHMENT C

OCC Credit Index Event Contract Comment Letter Dated March 28, 2007

THE OPTIONS CLEARING CORPORATION
ONE N. WACKER DRIVE, SUITE 500, CHICAGO, ILLINOIS 60606

WILLIAM H. NAVIN
EXECUTIVE VICE PRESIDENT, GENERAL COUNSEL, AND SECRETARY
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March 28, 2007

Electronically and by Courier

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

Re: Chicago Mercantile Exchange Submission
Proposing to Trade Credit Index Event Contracts

Dear Ms. Donovan:

The Options Clearing Corporation ("OCC") is submitting this letter in response to the request for comments issued by the Commodity Futures Trading Commission (the "Commission") relating to the filing by the Chicago Mercantile Exchange ("CME") dated March 7, 2007, proposing to trade a product that it calls "credit index event contracts" (the "New CME Product"). CME seeks Commission approval for the proposed contracts under Commission Rule 40.3. The Commission has requested that comments be submitted by March 28, 2006.

OCC is a securities clearing agency registered as such under Section 17A of the Securities Exchange Act of 1934 as well as a derivatives clearing organization registered under Section 5b of the Commodity Exchange Act (the "CEA"). As such, OCC has the ability to clear securities options and security futures contracts subject to the jurisdiction of the Securities and Exchange Commission (the "SEC") and commodity futures and commodity options subject to the Commission's jurisdiction under the CEA.

OCC acts as the clearing agency for options traded on the Chicago Board Options Exchange ("CBOE"). As the Commission staff is aware, CBOE has proposed to trade "credit default options" ("the CBOE Product"), which are binary options that are automatically exercised whenever a "credit event" occurs with respect to "reference obligations" of a "reference entity." OCC has submitted a rule filing with both the SEC and the Commission seeking approval from both agencies to clear these options as securities options.

By letter dated November 3, 2006 (the "November OCC Letter"), OCC submitted comments on a previous rule filing by CME seeking approval of a product that was, in its original form (prior to being amended by CME), highly similar to the New CME Product except that the product proposed in the earlier letter (the "First CME Product") was based on a single underlying reference entity and would pay a fixed amount upon the occurrence of a credit event affecting that entity. The present product is based on a group consisting of multiple reference entities and would pay a fixed amount upon the occurrence of a credit event affecting any one of the reference entities. By an order dated January 31, 2007, the Commission approved the First CME Product, but only after the CME, at the request of the Commission's staff, amended its original proposal to limit its definition of a "credit event" to the bankruptcy of the reference entity. The definition of "credit event" for the New CME Product includes not only the bankruptcy of the reference entity, but also the failure of the reference entity to make required payments on certain debt securities—an event stricken at the Commission's request from the definition of "credit event" for the First CME Product.

OCC is familiar with the content of a comment letter that has been or will be submitted by CBOE with respect to the New CME Product. OCC concurs in CBOE's conclusion that the New CME Product is an option rather than a future and, in its present form, should be regarded as a securities option subject to the jurisdiction of the SEC rather than as a commodity futures contract or a commodity option. We stated our views on these matters in the November OCC Letter, and we see no need to repeat them here. Clearly, however, the CME's filing cannot be approved or allowed to become effective in its present form.

OCC appreciates the opportunity to make its views known to the Commission. I would be happy to discuss any aspect of this matter with the Commission's staff.

Sincerely,

William H Navin

William H. Navin

WHN:mmp

ATTACHMENT D

CME Credit Index Event Contract response letter Dated April 11, 2007

cme
Chicago Mercantile Exchange

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Chicago, IL 60606-7499
www.cme.com

312/930.1000 tel
312/466.4410 fax

April 11, 2007

VIA ELECTRONIC DELIVERY

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

Re: Chicago Mercantile Exchange Inc. Submission (07-17) Regarding a Proposal to List CME Credit Index Event Contracts

Dear Ms. Donovan:

The Chicago Mercantile Exchange Inc. ("CME") made a voluntary submission of CME Credit Event Futures for Commodity Futures Trading Commission ("CFTC") review and approval pursuant to section 5c(c)(2) of the Commodity Exchange Act ("CEA") and CFTC Regulation §40.3 thereunder.[1] The Chicago Board Options Exchange ("CBOE") and the Options Clearing Corp. ("OCC") (collectively, the "Objectors"), filed comment letters dated March 28, 2007, with the Commission. We are submitting this letter in response to the comment letters filed by CBOE and OCC.

The Objectors claim the Credit Index Event Contracts (the "Index Event Contracts" or "Contracts") are options, based largely upon the Commission's prior statement with respect to CME's single name credit event contracts. The submitted Index Event Contracts do not include any of the features used by financial analysts to distinguish options from futures. Ordinarily the purchaser of an option pays for the benefit of price movements above or below a predetermined strike price and has no liability in addition to the premium paid in order to secure the option. Option sellers assume an opposite risk profile. While some options operate pursuant to an automatic exercise feature, such a feature may generally be overridden at the discretion of the buyer. Buyers and sellers of the Contracts enjoy no such optionality. Moreover, the Contracts do not involve any strike prices or premium payments. We thus believe that the Contracts are most properly characterized as a cash-settled index futures contract tied to a digital index upon final settlement.

The Objectors attempt to deconstruct the index to demonstrate that the same result may be engineered by stitching together a series of digital options. Every standard futures contract can be engineered by combining the correct pair of put and call options. Also, the fact that each name in the index will, at the conclusion of trading, be valued at zero or at full value is not

[1] CME Submission # 07-17.

relevant to the question of whether this is a futures contract. Hurricane contracts are valued at zero or some higher amount depending on whether the hurricane strikes. During the life of the Contract its value will vary based on the market's expectations regarding the prospects of the component companies.

Moreover, consider that at any given point in time, an index value may fluctuate either upward or downward generally constrained to tick increments. Thus, movements in any index value at a given temporal point assume a certain binary character. In the aggregate, these binary movements assume a certain digital character and in the limit they approach the analog. Accordingly, the inventive mind may suggest that the index constitutes a bundle of binary options. But this level of inventiveness is unwarranted and inappropriate.

In addition, despite the Objectors' ongoing protestations to the contrary, CME believes that the Contracts are based on commodities, not securities. The events that may trigger a payment—bankruptcy or a failure to pay—are events that are not dependant upon the price or value of any security. At the same time, the Contract does not provide for the future delivery or cash settlement of a security or for the delivery of any measure of value based on a security or an index of securities. The payout is fixed in advance of the listing of the contract and does not vary in relation to the price of any security of the referenced entity. Accordingly, the underlier for the CME contract is not a security – it is an index of hypothetical cash-settled binary credit default swaps such as those that are traded on an over-the-counter basis.

CME appreciates the opportunity to respond to CBOE's and OCC's comments. Please do not hesitate to contact me at 312-466-7469 if we can provide any additional information.

Sincerely,

John W. Labuszewski, Managing Director
Research & Product Development

ATTACHMENT E

CBOE Credit Index Event Contract response letter Dated April 19, 2007

CBOE
CHICAGO BOARD OPTIONS EXCHANGE

Joanne Moffic-Silver
Executive Vice President
General Counsel &
Corporate Secretary

Phone: 312-786-7462
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April 19, 2007

Via Electronic Mail

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

Re: Chicago Mercantile Exchange Submission (07-17) Under Rule 40.3, Regarding a Proposal to List CME Credit Index Event Contract

Dear Ms. Donovan:

This letter is submitted by Chicago Board Options Exchange, Incorporated ("CBOE"), in response to the voluntary submission by the Chicago Mercantile Exchange ("CME"), dated March 7, 2007, pursuant to Commission Rule 40.3, for review and approval by the Commission of a new credit default option product designated as "CME Credit Index Event Contract" (the "New CME Product"). CBOE has previously commented on the CME's March 7, 2007 filing by letter dated March 28, 2007; and the CME responded to CBOE's comments, and those of The Options Clearing Corporation, by letter dated April 11, 2007. CBOE has also submitted letters dated November 3, 2006, December 5, 2006, December 19, 2006 and January 26, 2007 (together with the March 28, 2007 CBOE letter, the "Prior CBOE Letters"), on the prior proposal regarding credit event products (the "First CME Product") made by the CME, as set forth in the CME's filing dated October 17, 2006, as amended by filings dated October 24, 2006 and January 12, 2007.

The CME's April 11, 2007 letter once again mischaracterizes the New CME Product, as well as CBOE's arguments and is based on a number of unsupported assertions. For the same reasons set forth in CBOE's March 28, 2007 letter, and in the Prior CBOE Letters, the CME's comments should be rejected and the New CME Product should not be approved. As we have previously demonstrated in the Prior CBOE Letters, the New CME Product is an option, not a futures contract, and is based on one or more securities. As a result, the New CME Product is a security within the meaning of the Securities Act of 1933 and the Securities Exchange Act of 1934 (collectively, the "Securities Laws"). Accordingly, the New 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 its April 11, 2007 letter, the CME asserts that the New CME Product is a futures contract and is not an options contract. This assertion is without basis because it directly contradicts the Commission's express finding in its January 31, 2007 order that the First CME Product is an option. The New CME Product is structured in all relevant respects in a manner that is virtually identical to the First CME Product, which the Commission expressly found to be an option. Moreover, the CME offers no reasons or support for its assertion that the New CME Product is not an option and should be considered a future or why the conclusion here should be distinguishable from the First CME Product. To the contrary, after outlining its view of the traditional characteristics of options, the CME states only, "Buyers and sellers of the [CME] Contracts enjoy no such optionality. Moreover, the Contracts do not involve any strike prices or premium payments." In other words, the CME is asking the Commission to reject its own conclusion regarding the character of the First CME Product simply because the CME disagrees. Unfortunately for the CME, it cannot make something a future simply by labeling it that way.

Second, the CME mischaracterizes CBOE's argument that the New CME Product is not based on an index but rather constitutes a series of individual options. The CME notes initially, "[e]very standard futures contract can be engineered by combining the correct pair of put and call options." As the CME is well aware, that is a completely different point that has nothing to do with CBOE's argument. CBOE's point was that the New CME Product, unlike any other index futures contract, requires an individual determination as to whether a credit event has occurred with respect to each issuer in the "index." The payout is then calculated as the simple sum of the binary option settlement amounts due with respect to each issuer that has experienced a credit event. In short, the New CME Product does not settle to an index value. Additionally, that a futures contract may be decomposed into a long call option and a short put option is an irrelevant issue that the CME raises simply to deflect focus from CBOE's point. The CME then goes on to argue, "movements in any index value at a given temporal point assume a certain binary character." Again, this point is totally irrelevant and is not responsive to CBOE's argument, which was that the "index" on which the New CME Product is based has no index value at all -- it is simply computed as the sum of the amounts required to be paid with respect to each of the underlying issuers. It is unclear what the CME considers "unwarranted and inappropriate" in CBOE's contention that this does not constitute an index, other than the fact that the CME disagrees with it.

Third, the CME claims that the New CME Product is not based on one or more securities because the "credit events" used to determine the payouts "are events that are not dependent upon the price or value of any security," the New CME Product "does not provide for the future delivery or cash settlement of a security or for the delivery of any measure of value based on a security or an index of securities," and the payout "does not vary in relation to the price of any security." CME's argument fails. First, we disagree with CME's assertions because the reference credit events of bankruptcy and failure-to-pay are directly linked to specific securities and the New CME Product provides for a cash settlement amount equal to a fixed recovery amount on those securities. In any event, as CBOE explained in its March 28, 2007 letter, none of these features or terms is required in order for an option on a security to be included within the definition of a security under the Securities Laws. Rather, the relevant definitions require only that the option be "on" a security; in fact, it is clear that the definitions were intended to encompass options other than those providing for delivery or payments expressly linked to the value of securities, based on the operative language in the definitions -- "option . . . on any security or group or index of securities (including any interest therein or based on the value thereof)." Had Congress intended to limit the definitions in the manner suggested by the CME, it would have made it clear that they apply only to options that are physically settled or cash settled based on the value of the underlyers. Even if one were to accept CME's incorrect contention that the New CME Product would not provide for physical settlement or for payments based on value (which it clearly would as described in the Prior CBOE Letters), the New CME Product is still unquestionably "on" securities, as evidenced by the long list of "Reference Securities" underlying the New CME Product.

Finally, we note that, as set forth in the Prior CBOE Letters, because the New CME Product is a security, it should be subject to the antifraud prohibitions of the Securities Laws, including the prohibitions against insider trading. In particular, products structured like the First and New CME Products are susceptible to insider trading. In fact, this issue is a very real concern that has recently been cited by commentators. In an article in the Wall Street Journal, for example, it was noted that academic researchers had found evidence of insider trading in the over-the-counter credit derivatives market and that there were indications that prices of such derivatives had "climbed in the weeks before news of major acquisitions became public." Wall Street Journal, August 31, 2006, p. C1. The Wall Street Journal similarly noted just a few weeks ago that the credit derivative prices on a particular issuer, and the trading volumes of listed options on its stock, "surged" in advance of the announcement of a possible acquisition of the issuer. "First Data Trades Suggest Leaks," Wall Street Journal, April 3, 2007. The article stated that the Securities and Exchange Commission was investigating the trading activity. Exchange-traded options are of course subject to the antifraud prohibitions of the Securities Laws, including the prohibitions against insider trading, and over-the-counter credit derivatives, to the extent that they constitute "security-based swaps," are subject to the prohibitions against insider trading as well. Because the New CME Product is a security, it should be subject to these same provisions, which serve to protect the integrity of the marketplace, investors, and the public interest.

The New CME Product is unquestionably an option based "on" securities (including any interest therein or based on the value thereof) and is therefore excluded from the CEA and outside of the Commission's jurisdiction. Accordingly, the Commission has no authority to approve the CME March 7, 2007 filing, which falls exclusively within the SEC's jurisdiction.

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

Sincerely,

Joanne Moffic-Silver

Joanne Moffic-Silver

ATTACHMENT F

Draft Commission Approval Letter to CME