

ALBERTA SECURITIES COMMISSION

**RECOGNITION ORDER
FOREIGN DERIVATIVES EXCHANGE**

Citation: New York Mercantile Exchange, Inc., Re, 2012 ABASC 173 Date: 20120430

New York Mercantile Exchange, Inc.

Background

New York Mercantile Exchange, Inc. (the **Applicant**) has applied to the Alberta Securities Commission (the **Commission**), pursuant to section 62 of the *Securities Act* (Alberta) (the **Act**), for recognition as an exchange and, pursuant to section 213 of the Act, for certain exemptive relief.

Interpretation

Terms defined in the Act or in National Instrument 14-101 *Definitions* have the same meaning in this order unless otherwise defined herein.

Representations

1. The Applicant represents as follows:

- (a) The Applicant is a for-profit corporation organized under the laws of Delaware, United States of America (**US**) and is a wholly-owned subsidiary of CME Group Inc. (**CME Group**), a publicly traded for-profit corporation organized under the laws of Delaware and listed for trading on the NASDAQ National Market. CME Group is the parent company of four futures exchanges:
 - (i) the Applicant;
 - (ii) Board of Trade of the City of Chicago, Inc.;
 - (iii) Chicago Mercantile Exchange Inc. (**CME**); and
 - (iv) Commodity Exchange, Inc.
- (b) The Applicant offers a variety of derivative contracts, including without limitation commodity futures contracts and futures contract options (collectively, **Derivatives Contracts**), transactions in which are executed by or through clearing members or other participants of the Applicant (each ultimately cleared by a clearing member) on the electronic trading platform (the **Exchange Platform**) owned, operated, leased, licensed or otherwise made available by the Applicant in accordance with rules promulgated by the Applicant.
- (c) CME operates a clearing house (the **Clearing Agency**), a division of CME, which clears, settles and guarantees to its members the performance of all transactions in Derivatives Contracts executed on the Exchange Platform.

- (d) The Applicant is a designated contract market (a **DCM**) and each of the Applicant and CME is a registered derivatives clearing organization (a **DCO**), within the meaning of those terms under the US *Commodity Exchange Act* (the **US Act**), and is subject to regulatory supervision by the Commodity Futures Trading Commission (the **CFTC**), a US federal regulatory agency. The Applicant is in good standing as a DCM and DCO. The US Act obligates the Applicant to give the CFTC access to all records maintained in connection with the conduct of its business as a DCM and DCO unless prohibited by law or such records are subject to solicitor-client privilege. The Applicant, in the ordinary course of business, cooperates with other regulatory authorities, including making arrangements for information sharing. The CFTC reviews, assesses and enforces the Applicant's adherence to the US Act and the CFTC's core principles for DCMs and DCOs relating to, among other things, financial resources, systems and controls, maintenance of an orderly market, execution and settlement of transactions, rule-making and investor protection. CFTC supervision of the Applicant addresses similar public interest concerns in respect of the execution and clearing of Derivatives Contracts to those of interest to the Commission in the exercise of its jurisdiction under the Act.
- (e) All Derivatives Contracts are cleared through clearing members of the Clearing Agency (**Clearing Members**) each of which, to qualify as such: (i) maintains a minimum of US\$5 million of working capital determined in accordance with the US Act; and (ii) maintains funds on deposit in a guarantee fund maintained by the Clearing Agency (the **Guarantee Fund**) in accordance with the rules of the Clearing Agency. The Guarantee Fund will be available to ensure the clearing of Derivatives Contracts in the event that a Clearing Member is unable to satisfy its obligations to the Clearing Agency. The Clearing Agency provides clearing services to the Applicant pursuant to the terms of an intercompany agreement between CME and the Applicant. The Applicant retains the ultimate responsibility to ensure that it continues to meet its regulatory responsibilities to the CFTC as a DCO and all trades in the Applicant's products are cleared through the Applicant's DCO license. However, the Clearing Agency is the only US-based clearing house owned by CME Group that remains operational. As such, the Clearing Agency is interposed as a central counterparty for all transactions in Derivatives Contracts and acts as counterparty and guarantor to each transaction executed on the Exchange Platform. Market participants that wish to clear Derivatives Contracts through the Clearing Agency maintain an appropriate account relationship with a Clearing Member. The Clearing Member clears the transactions and posts margin directly with the Clearing Agency and serves as the customers' agent and guarantor in respect of cleared Derivatives Contracts. Clearing Members require market participants to deposit a specified amount of assets as initial and maintenance margin as security for performance of their obligations.
- (f) As part of its regulatory oversight of DCOs, including the Applicant, CME and the Clearing Members, the CFTC conducts, among other things, ongoing

assessments of DCOs' regulations, procedures and practices to confirm that they satisfy the applicable requirements under the US Act and the regulations thereunder.

- (g) Clearing Members are required to register under the US Act as "Futures Commission Merchants" (**FCMs**) and, as such, must be members of the National Futures Association (the **NFA**) and may also be members of DCMs. The NFA and DCMs must enforce CFTC-approved financial and reporting requirements imposed on NFA and DCM members, including minimum capital, restrictions on how customer funds are held (for example, segregation of customer funds from FCM house accounts), disclosure and financial and other reporting requirements.
- (h) The CFTC engages in ongoing regulatory supervision and oversight of the Applicant, CME and the Clearing Agency, and the Clearing Members, intermediaries and other participants of the Applicant, CME and the Clearing Agency, with respect to, among other things, market integrity, customer protection, clearing and settlement and the enforcement by the Applicant, CME and the Clearing Agency of their respective rules.
- (i) The CFTC requires that an intermediary who acts on behalf of another person in connection with futures and options trading register with the CFTC. Depending on the nature of their activities, intermediaries are subject to various financial disclosure, reporting and record-keeping requirements.
- (j) The CFTC has implemented and enforces procedures that empower it to: (i) prosecute violations of the US Act; (ii) provide protections to parties accused of such violations according to fair and clear standards; and (iii) impose sanctions for such violations.
- (k) The Applicant and the Clearing Agency have implemented and enforce procedures that empower them to: (i) prosecute violations of their respective rules; (ii) provide protections to parties accused of such violations according to fair and clear standards; and (iii) impose sanctions for such violations.
- (l) As part of its regulatory oversight of the Applicant, the CFTC, among other things, reviews, assesses and enforces the Applicant's ongoing compliance with the registration requirements under rules of the CFTC relating to financial resources, fitness and propriety of its members, systems and controls, maintenance of an orderly market, investor protection, rule-making and other matters including the Applicant's rules, procedures and practices.
- (m) The Applicant provides to Clearing Members and to certain other market participants (the **Participants**) direct access to the Exchange Platform, whereby a Participant may transmit orders and enter trades directly into the Exchange Platform without intermediation by a Clearing Member (**Direct Access**). In order to obtain Direct Access, a Participant must enter into a customer connection

agreement with the Applicant which, among other things, requires the Participant to comply with all applicable laws pertaining to the Participant's use of the Exchange Platform.

- (n) The Applicant maintains adequate rules to govern conflicts of interest and maintains and enforces rules which prohibit the disclosure of material non-public information obtained as a result of a Clearing Member's or Participant's performance of duties as a director or member of a significant committee of the Applicant.
- (o) Derivatives Contracts made available for trading by Direct Access are cleared by the Clearing Agency.
- (p) The Applicant is subject to a US Act requirement to list only Derivatives Contracts that are not readily susceptible to manipulation.
- (q) The Clearing Agency complies with the *Recommendations for Central Counterparties* issued jointly by the Committee on Payment and Settlement Systems (**CPSS**) and the Technical Committee of the International Organization of Securities Commissions (**IOSCO**), as the same may be amended, or any successor standards, principles and guidance for central counterparties and financial market infrastructures adopted jointly by CPSS and the IOSCO Technical Committee (collectively, the **CPSS/IOSCO RCCPs**).
- (r) The Applicant has:
 - (i) implemented and enforces rules and procedures to ensure compliance with the undertakings herein;
 - (ii) the capacity to detect, investigate, and sanction persons who violate its rules; and
 - (iii) sufficient compliance staff and resources, including by delegation or outsourcing to third parties or both, to fulfil its regulatory responsibilities, including appropriate trade practice surveillance, real time market monitoring, market surveillance, financial surveillance, protection of customer funds, enforcement of clearing and settlement provisions and other compliance and regulatory responsibilities.
- (s) The Applicant has:
 - (i) implemented and enforces rules concerning: (A) access to the Exchange Platform and the means by which the connection thereto is accomplished; (B) prohibited trading practices; and (C) market manipulation, attempted manipulation, price distortion and other disruptions of the market;

- (ii) implemented and enforces rules and procedures that ensure a competitive, open and efficient market and mechanism for executing transactions on the Exchange Platform; and
 - (iii) the capacity to deter and detect market manipulation, attempted manipulation, price distortion and other disruptions of the market.
- (t) The Applicant and the Clearing Agency are authorized by rule or by contract to obtain from Clearing Members and Participants any information and cooperation necessary to conduct investigations, to effectively enforce their respective rules, and to ensure compliance with the undertakings herein.
- (u) The Applicant's transaction data system captures and retains sufficient order and trade-related data to allow its compliance staff to detect trading and market abuses and to reconstruct all transactions in Derivatives Contracts within a reasonable period of time.
- (v) The Exchange Platform:
 - (i) complies with IOSCO's *Principles for the Oversight of Screen-Based Trading Systems for Derivative Products*, as the same may be amended, or any successor thereto;
 - (ii) employs a trade-matching algorithm that matches trades fairly and in a timely manner;
 - (iii) maintains a transaction data system that captures all relevant order and trade-related data, including changes to orders, and transaction data is securely maintained and available for an adequate time period;
 - (iv) has demonstrated reliability;
 - (v) employs systems designed to ensure that access to the Exchange Platform is secure and protected;
 - (vi) backs up trade data to prevent loss of data; and
 - (vii) possesses adequate provisions for emergency operations and disaster recovery.
- (w) The Applicant reports to the public, directly or indirectly through an information vendor, data (including price and volume) relating to each transaction in Derivatives Contracts, as soon as technologically practicable after execution of the transaction.
- (x) The CFTC is signatory to IOSCO's *Multilateral Memorandum of Understanding Concerning Consultation and Cooperation and the Exchange of Information*, the

Futures Industry Association's *Declaration on Cooperation and Supervision of International Futures Exchanges and Clearing Organizations* and companion *International Information Sharing Memorandum of Understanding and Agreement* (the **Information-Sharing MOU**) and the Commission's *Memorandum of Understanding Concerning Cooperation and the Exchange of Information Related to the Supervision of Cross-Border Clearing Organizations*.

- (y) Clearing Members and Participants are required to satisfy financial and other standards set by the Applicant and the Clearing Agency intended to ensure that Clearing Members and Participants are fit and proper.
- (z) The CFTC has the power to share information directly with the Commission, upon request, including information reasonably necessary for the Commission to evaluate and assess the accuracy of, and compliance with, the representations and undertakings herein.
- (aa) The CFTC has the power to intervene in the market.
- (bb) The Applicant has executed, or commits to execute, the Information Sharing MOU.
- (cc) The Applicant proposes to offer Direct Access to certain Participants resident in Alberta (**Alberta Participants**) by entering into customer connection agreements. Only Participants of the Applicant will have Direct Access in Alberta.

Undertakings

2. The Applicant undertakes:

- (a) to continue to observe the representations and to satisfy the undertakings herein;
- (b) to maintain its status as a DCM and as a DCO, and to ensure that, while receiving clearing services from the Clearing Agency, CME maintains its status as a DCO, in good standing in all material respects with the CFTC;
- (c) to not provide, and to take reasonable steps to prevent third parties from providing, Direct Access to persons other than Clearing Members and Participants;
- (d) to ensure that, while receiving clearing services from the Clearing Agency, the Clearing Agency continues to comply with the CPSS/IOSCO RCCPs;
- (e) to require each Alberta Participant that is granted Direct Access and is not registered with the Commission as a dealer to:
 - (i) file with the Applicant a written representation, executed by a person with the authority to bind the Alberta Participant, stating that, as long as the Alberta Participant is granted Direct Access, the Alberta Participant agrees

- to and submits to the jurisdiction of the Commission with respect to activities conducted pursuant to this order;
- (ii) file with the Applicant a valid and binding appointment of an agent for service of process in Alberta pursuant to which the agent is authorized to accept delivery and service of communications issued by or on behalf of the Commission; and
 - (iii) maintain with the Applicant a written undertaking, executed by persons with the authority to bind the Alberta Participant, that the Alberta Participant will provide promptly to the Commission such information as the Commission may reasonably request, and access to all premises in or from which the Alberta Participant operates;
- (f) to preserve and to provide promptly and directly to the Commission all information reasonably requested by Commission staff;
- (g) to employ reasonable procedures for monitoring and enforcing compliance with the undertakings herein;
- (h) to cooperate with the Commission with respect to arrangements established to address cross-market oversight issues, including surveillance, emergency actions and the monitoring of trading;
- (i) to file with the Commission within 30 days after the end of each calendar quarter, and at any time promptly upon the request of a Commission representative, a statement setting out:
- (i) total volumes of Derivatives Contracts traded in the quarter through the Exchange Platform worldwide, and the portion thereof traded through Direct Access in Alberta; and
 - (ii) the names and principal addresses of all Clearing Members and Participants that have Direct Access to the Exchange Platform in Alberta and their trading volumes computed by separating buy-sides and sell-sides for each contract available to be traded through the Exchange Platform;
- (j) to promptly notify the Commission in writing of:
- (i) any significant change in the information provided by the Applicant to the Commission in support of its application for recognition, or to any representation herein;
 - (ii) any significant change in the Applicant's or the Clearing Agency's rules or US laws relevant to the Derivative Contracts;

- (iii) any matter that, in the reasonable judgment of the Applicant, may have a material adverse effect on the financial or operational viability of the Applicant, the Exchange Platform or the Clearing Agency, including, but not limited to, any significant system failure or interruption;
 - (iv) any significant changes to US laws and regulatory processes relevant to the Applicant's status or conduct as a DCM or as a DCO or CME's status or conduct as a DCO;
 - (v) any monetary default, insolvency or bankruptcy of any Clearing Member or Participant that, in the reasonable judgment of the Applicant, may have a material adverse effect on the financial or operational viability of the Applicant, the Exchange Platform or the Clearing Agency;
 - (vi) any breach of an undertaking herein;
 - (vii) a description of any disciplinary action by the Applicant or the Clearing Agency against a Clearing Member or Participant involving alleged market manipulation, fraud, deceit or conversion, and of any sanction by the Applicant or the Clearing Agency of a Clearing Member or Participant, where the allegation or the sanctioned conduct relates to a Derivatives Contract made available through Direct Access; and
 - (viii) a description of any disciplinary action against the Applicant, the Clearing Agency or a director or senior officer of either;
- (k) to file with the Commission, within 30 days after the end of each calendar year:
- (i) a written confirmation from the CFTC that the Applicant remains in good standing as a DCM and as a DCO and CME remains in good standing as a DCO;
 - (ii) a certificate, executed by a senior officer of the Applicant, that:
 - (A) the representations herein remain accurate except to the extent of any change previously disclosed to the Commission hereunder;
 - (B) to the Applicant's knowledge:
 - (I) there has been no significant change to US laws and regulatory processes relevant to the Applicant's status or conduct as a DCM or as a DCO or CME's status or conduct as a DCO except as previously reported to the Commission hereunder;
 - (II) US laws, systems and compliance mechanisms continue to require the Applicant to maintain fair and orderly markets;

prohibit fraud, abuse and market manipulation; and provide that such requirements are subject to regulatory oversight;

- (C) CFTC listing standards continue to require that the Derivatives Contracts not be readily susceptible to manipulation;
 - (D) the Applicant continues to be subject to oversight by the CFTC with respect to transactions effected through the Exchange Platform;
 - (E) the Clearing Agency continues to be subject to comprehensive supervision, regulation and oversight by the CFTC as described by the Applicant to the Commission in support of its application for recognition;
 - (F) affiliates of Clearing Members and Participants continue to comply with applicable registration requirements and conditions and the rules of the Applicant and the Clearing Agency, and that the Clearing Members or Participants with which they are affiliated are responsible to the Applicant for ensuring their affiliates' compliance; and
- (iii) the terms and conditions of all Derivatives Contracts that differ substantively from Derivatives Contracts previously offered by the Applicant through Direct Access;
- (l) to file concurrently with the Commission a copy of all material filed annually by the Applicant or the Clearing Agency with the CFTC; and
 - (m) all material filed with the Commission hereunder shall, if required to be executed, be signed by a senior officer of the Applicant who has the authority to bind the Applicant and shall be based on such officer's personal knowledge.

Submission to Jurisdiction and Agent for Service

3. The Applicant submits to the non-exclusive jurisdiction of the courts and administrative tribunals of Alberta in a proceeding arising out of, related to or concerning, or in any other manner connected with, the activities of the Applicant in Alberta.
4. The Applicant will file with the Commission a valid and binding appointment of an agent for service in Alberta upon whom may be served a notice, pleading, subpoena, summons or other process in any action, investigation or administrative, criminal, quasi-criminal, penal or other proceeding arising out of, related to or concerning, or in any other manner connected with, the activities of the Applicant in Alberta.

Decision

Based on the representations and undertakings herein, the Commission, being satisfied that it would not be prejudicial to the public interest to do so:

- (a) under section 62 of the Act, recognizes the Applicant as an exchange; and
- (b) under section 213 of the Act, exempts the Applicant from section 106(b) of the Act, which prohibits trading in exchange contracts unless the form of the exchange contracts has been accepted by the Commission;

for so long as the Applicant satisfies its undertakings herein.

April 30, 2012

For the Commission:

“original signed by”

Glenda A. Campbell, QC
Vice-Chair

“original signed by”

Fred R.N. Snell, FCA
Commission Member