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Chief Executive Officer

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RECORDS SECTION September 29, 2004

Ms. Jean A. Webb
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

COMMENT

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Re: Futures Market Self-Regulation; 69 Federal Register 19166 and 69 Federal Register 22599

Dear Ms. Webb:

The Commodity Futures Trading Commission ("CFTC") recently published a summary of the comment letters that it received with respect to the current structure of the designated self-regulatory organization ("DSRO") system in the futures industry and the proposed amendments to the Joint Audit Committee ("JAC") agreement. Chicago Mercantile Exchange Inc. ("CME") believes the summary contains a substantial amount of misinformation concerning the JAC's self-regulatory role and responsibilities.

As a founding member of the JAC, CME would like to clarify that the proposed amendments to the JAC agreement do not constitute new changes. To the contrary, the process described in the amended agreement is a memorialization of the practices that are currently in place at the JAC, all of which have been voted on and agreed to by JAC representatives over the past two decades. Ironically, many of the existing practices were voted on and agreed to by some of the JAC members who are now objecting to them.

Based upon the comment letters that CME reviewed, there appears to be continued confusion over the authority that the amended JAC agreement would grant to an exchange with DSRO responsibilities. However, the JAC agreement and DSRO concept merely clarify which entity will have the primary audit responsibility for an FCM in an effort to reduce duplication of effort and resources at both the self-regulatory organization ("SRO") and futures commission merchant ("FCM") levels. It does not prevent another SRO from performing its own audits at FCMs or from taking its own disciplinary action against an FCM. It merely provides that the DSRO will have *primary* responsibility for reviewing a firm's policies, processes, controls and financial information and to share that information with other SROs.

In particular, several of the comments raise concerns about the voting rights of the various exchanges. The JAC, however, rarely votes on any issues. Instead, most decisions are made through open discussions at meetings in which CFTC staff is generally present and always welcome. Examples of the decisions reached through discussion include whether the JAC should comment on a particular industry development and the best methods for auditing areas to ensure consistency among all of the DSROs. All JAC representatives are encouraged to participate in those discussions. While CME values the knowledge and expertise of the non-auditing SROs during such discussions, we strongly believe that it would be unfair and inappropriate to allow such entities to dictate the allocation of our audit resources.

Another purported concern regards the right of first refusal to be DSRO for an exchange member. However, the agreement does not preclude another exchange from assuming DSRO responsibilities. At CME (and the other auditing exchanges) our focus is to protect the financial integrity of, and assess the risks presented to, our clearing house and the industry. Ultimately, this ensures that customers are well-protected. Audits of clearing member firms tend to be extremely complex, especially as the marketplace evolves. As a result, the information obtained and relationships nurtured during our examinations are an integral part of our risk management process. CME does not object to sharing that responsibility with another entity focused on the same priorities. In fact, we would welcome additional auditing exchanges to reduce our own SRO costs. However, we understand that these responsibilities are a cost of entry and, as a result, some newer exchanges may want to contract those responsibilities to another entity. In the end, it is a question of comfort in having the proper risk controls in place. It is our understanding that all of the clearing members of the new exchanges are currently audited by a DSRO under the existing JAC agreement, so this is, in effect, more of a conceptual issue than a practical one. As noted above, nothing in the agreement precludes an SRO from conducting its own examinations. To the extent that the new exchanges do not desire to conduct audits themselves, we are unclear as to what benefits the "DSRO" title would confer upon them.

Several of the comments noted that the new JAC agreement should not be approved until independent clearing organizations are also free to participate in JAC meetings. The proposed JAC agreement, as well as the current agreement, acknowledges that information about the financial health of a clearing member firm is critical to all parties. Therefore, the agreement specifically allows SROs to share any information received via the JAC with their clearing organization. Such critical information is shared on an *ad hoc* basis, not during JAC meetings. Accordingly, any DCO which is not receiving such information should discuss this matter with their member exchanges. In addition, all U.S. clearing organizations are members of the Unified Clearing Group, which also facilitates the sharing of information among the entities.

The Futures Industry Association ("FIA") also raised an issue regarding the appearance of conflicts of interest between an exchange's SRO responsibilities and its business functions. At CME, we are very conscious of our responsibilities to avoid conflicts and have adopted a compliance policy, distributed to all staff, that stresses the importance of protecting the confidential information received from our member firms as part of our routine oversight responsibilities. In addition, CME is the only designated contract market in the U.S. to create a Board-level Market Regulation Oversight Committee ("MROC"), comprised entirely of non-industry directors, to oversee CME's SRO functions. MROC is charged with reporting to the full Board of Directors on an annual basis concerning the independence of CME's regulatory functions from CME's business operations, the independence of CME management and regulatory personnel from improper influence by industry directors regarding regulatory matters, and CME's compliance with its statutory self-regulatory responsibilities. In taking these steps, we believe CME has created a best practices model for exchange self-regulation that should be followed by the entire futures industry. We also believe that our model renders FIA concerns moot, because oversight of the self-regulatory function rests with the non-industry directors on the MROC--not with the employees or officers of CME. More importantly, however, MROC helps assure a critically important regulatory goal not mentioned by FIA and its FCM registrant members--ensuring that we protect market users from being harmed by potential conflicts of interest by clearing members, individual exchange members and other market participants involved in exchange regulatory and disciplinary processes. Indeed, the credibility of the futures

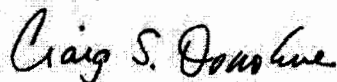
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markets depends upon the avoidance of even the appearance of such conflicts, and the MROC takes an unprecedented step in that direction.

Given the heightened level of concern regarding potential conflicts of interest between regulated member firms and exchange representatives in the securities industry, we are disappointed that FIA would hail the benefits of the appearance of fairness and the avoidance of bias, but then recommend that FCM registrants have the ability to choose their own regulator. In a mutualized, potential loss-sharing environment, as currently exists at the clearing organizations, such an ability to choose a regulator can only be to the detriment of the other clearing members. This practice could create the potential for regulatory arbitrage where FCMs would select the regulator they felt would scrutinize their activities the least thoroughly.

CME feels strongly that the current DSRO structure is sound, free of conflict and, for CME, properly belongs in an exchange environment. CME takes pride in the steps that we have taken and invites the CFTC to review and scrutinize any of our decisions. We would be happy to meet with the CFTC to answer any questions regarding any of the issues raised in the comment letters.

Sincerely,



Craig S. Donohue