February 22, 2011

Mr. David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Via Online Submission

SUBJECT: RIN 3038-AD09

Dear Mr. Secretary:

The Minneapolis Grain Exchange, Inc. ("MGEX" or "Exchange") would like to thank the Commodity Futures Trading Commission ("CFTC" or "Commission") for this opportunity to respond to the Commission's request for comment on the above referenced matter published in the December 22, 2010 Federal Register Vol. 75, No. 245.

MGEX is both a Designated Contract Market ("DCM") and Derivatives Clearing Organization ("DCO"). MGEX appreciates the continued efforts the Commission has put forth to address the requirements placed upon it by Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act").

General Comment

MGEX supports the Commission adhering to the requirements set forth by Section 735 of the Dodd-Frank Act to amend Section 5 of the Commodity Exchange Act ("CEA"). Therefore, it is logical to amend those core principles that need to be addressed so they are coordinated with the CEA. However, it appears the CFTC has liberally exercised the discretion it has been given under the Dodd-Frank Act to undertake "a comprehensive evaluation of its existing regulations, guidance and acceptable practices associated with each of the core principles in order to update those provisions and to determine which core principles would benefit from new or revised regulations and new or revised guidance or accepted practices."[1] Considering the depth and breadth of the workload presented by the Dodd-Frank Act, the Commission's proposed rulemaking and decision to undertake such a comprehensive review seems to go beyond just complying with Congressional mandates. The core principles are becoming less a principles-based regime than a compilation of very prescriptive rules which perhaps was

[1] 75 Fed. Reg. 80572, 80574 (Dec. 22, 2010).

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not fully intended under the Dodd-Frank Act. In a time where budget constraints run across the board – from the public sector such as the CFTC to the private sector, additional burdens and costs such as many of the provisions of this proposed rulemaking may cause are premature at best. Therefore, MGEX respectfully provides the below comments:

Proposed Amendments to General Regulations under Part 38

§38.3 – Procedures for Designation

Under proposed rule 38.3(g), the CFTC is requiring all existing DCMs to certify they are in compliance with the each of the 23 core principles and the CFTC's regulations under part 38 within 60 days of the publication of the related final rules.[2] Should an existing DCM fail to certify, that DCM will be subject to revocation of the DCM's designation status. The Commission requests comment as to whether 60 days is enough time to certify compliance with the 23 core principles. MGEX questions the need for any currently active DCM to recertify after already meeting current requirements. As rules and regulations are constantly evolving, DCMs spend countless hours and dollars demonstrating and proving they are in compliance with core principles through many Rule Enforcement Reviews ("RERs") and through working with and responding to CFTC inquiries. Undoubtedly DCMs will be required to continue to put resources into these same inquiries and RERs going forward regardless of whether DCMs must recertify to the Commission that they are in compliance with the core principles. In addition, with the CFTC proposing such numerous and detailed amendments to the core principles the Exchange questions how it, or any DCM, can be confident to the point of certainty that it is in compliance so as to allow it to provide this type of certification. Therefore, the purpose for requiring such a "catch all" certification seems of limited value other than to point to as part of any subsequent inquiry or RER. Therefore, MGEX respectfully recommends the requirement be stricken. However, if such recertification is deemed necessary, MGEX believes that the process should be limited to providing a signed letter attesting to compliance, and that all the application forms and documentation that goes with a formal application be waived for existing DCMs. Further, considering the significant amendments proposed to the core principles and the uncertainty of whether compliance with all the detailed requirements can be timely met, DCMs should be given sufficient time to recertify. Each DCM will need to assess the proposed rulemaking. Each DCM will arrive at different conclusions and have different requirements. Furthermore, if the CFTC implements such proposals as §38.152 and §38.156, then the deadline should be extended, perhaps no sooner than one year from the effective date of the final rule.

§38.5 – Information Relating to Contract Market Compliance

Under proposed §38.5(c)(3), a DCM would have to notify and recertify to the CFTC upon a ten percent change in ownership. This requirement triggers upon "entering into any agreement(s) that could result in an equity interest transfer."[3] MGEX is a mutual association with a membership based ownership structure. Therefore, changes in membership (and thereby ownership) routinely occur. MGEX assumes the Commission

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[2] 75 Fed. Reg. 80572, 80575 (Dec. 22, 2010).
[3] *Id*. at 80610

is focused on single event situations where a new party obtains a 10% or more interest at one time. In that case, notice to the Commission seems reasonable. However, the Exchange respectfully disagrees with the rationale for the requirement to recertify again as part of such an event. Rather, should there be a concern over such an event, the CFTC reserves the right to inquire of the DCM surrounding changes to DCM rules, practices or procedures.

§38.7 – Prohibited Use of Data Collected for Regulatory Purposes

The CFTC proposes to eliminate all use of data collected via regulatory processes for business or marketing purposes. While MGEX agrees with the underlying purpose of the proposed rule, MGEX also believes that the rule should not be stated as an absolute. Alternatively, MGEX suggests allowing market participants to opt out of having their information being used for business or marketing purposes or, perhaps affirmatively permitting their name to be used if they so choose.

New Regulations and Revised Guidance for Compliance with the Core Principles

Subpart C – Compliance with Rules

i. §38.151 – Access Requirements

Proposed §38.151(b) requires each DCM to provide its members, market participants and independent software vendors impartial access to the DCM's markets and services. It is generally in the best interest of the DCM to have an open and available market and service. As such, codifying this is unnecessary and only services to infringe on the business judgment of the DCM. Should the DCM have legitimate reasons for excluding access, it should not have to worry about CFTC interference. Perhaps, if there is some specific concern regarding such a business decision, the CFTC can again reserve the right to specifically inquire as to the decision made by the DCM.

ii. §38.152 – Abusive Trading Practices Prohibited

The CFTC requires under proposed §38.152 that each DCM prohibit abusive trading practices, including those specifically mentioned in Section 747 of the Dodd-Frank Act. However, the definitions of the listed prohibited activity have yet to be clarified. Therefore, until clarity is provided, Section 747 cannot be adequately enforced due to vagueness.

iii. §38.154 – Regulatory Services Provided to a Third Party

The CFTC issued proposed §38.154 to provide clarity regarding the extent to which DCMs need to be overseeing and involved with the regulatory services that the DCM has delegated to a third party. However, if a service has been delegated to another registered entity or designated self-regulatory organization ("DSRO") pursuant to provisions of the current CFTC-approved Joint Audit Committee ("JAC") Agreement, then MGEX assumes this should be sufficient and no other formal agreement is necessary.

iv. §38.156 - Automated Trade Surveillance Systems

MGEX agrees a DCM's automated surveillance system must maintain all trade and order data on a T+1 basis. However, the requirement to compute, retain and compare trading statistics is not a trade data item. Furthermore, FCMs already compute profit and loss and, therefore, should not be a duplicate requirement for DCMs as they do not, and should not, maintain individual customer account records. Currently, if there is a concern, the DCM may request such information from their clearing member. This methodology along with relying on DSRO information has proven to be effective for decades. Thus, computing, retaining and comparing trading statistics seem out of place as a DCM requirement and MGEX respectfully suggests that this requirement should be removed from the final rule.

v. §38.158 – Investigations and Investigation Reports

The Commission's requirement that no more than one nonpublic warning letter be issued over a 12 month period appears arbitrary, counterproductive and unnecessary. The Commission will effectively prohibit a DCM from using such letters as an educational or reminder tool. Further, routine, non-material matters will soak up unnecessary compliance staff and disciplinary committee time. In short, the Commission's proposal forces DCMs to adopt summary fines or not pursue minor infractions which may lead to additional unintended consequences outside of the purpose of the Dodd-Frank Act. As such, MGEX respectfully recommends this requirement should be removed or written to provide the DCM more flexibility in determining the proper methodology for enforcement of rules, regulations and procedures.

Subpart E – Prevention of Market Disruption

i. §38.251 – General Requirements

Under proposed §38.251, the CFTC is requiring DCMs to implement automated trading alerts to detect potential violations of Exchange or CFTC rules. The CFTC provides that a DCM can avoid the automated trading alerts requirement if the DCM can reasonably show that its manual process is effective. Specifically, the Commission seeks comment on whether the extent of high frequency trading and high frequency trading anomalies should be included as part of a DCM's required monitoring. Alerts are only indicators of potential concerns; they are not conclusive evidence of violations. Further, high frequency trading is not prohibited and has yet to be adequately defined. When an alert is generated, it must be assessed by human eyes. Therefore, the value of such alerts seems limited. A DCM should be permitted to establish whatever surveillance means, including alerts, it determines are necessary. Simply requiring there be alerts to detect anomalies is another requirement that seems to add more burden and cost than potentially providing any real value.

ii. §38.252 – Additional Requirements for Physical Delivery Contracts

Proposed §38.252 requires that DCMs must monitor each contract's terms and conditions to determine whether there is convergence of the futures price to the cash

price of the underlying commodity. It is in each DCMs best interest to ensure a properly functioning market when it comes to convergence. DCMs already constantly monitor and make adjustments when necessary to ensure convergence. By and large, the DCMs have done an outstanding job with convergence and addressing changes as needed under the current set of rules and regulations; therefore, it does not seem additional prescriptive requirements are needed to address the situation.

Aside from the above, perhaps most disconcerting is the requirement that meaningful corrective action be taken when convergence doesn't occur. What are the measuring sticks the CFTC is proposing for each physically delivered contract? Historical statistics may not be relevant for current events and the fundamentals of supply and demand are constantly changing. Delivery locations or pricing points are not always consistent. There are seasonal factors, logistic factors, even political factors. Just because convergence does not occur exactly the same each time or as someone thinks it should, does not mean the contract terms must be altered. DCMs know their markets and they have committees specifically designed for monitoring their contracts. Therefore, DCMs should not be forced to act prematurely and must be given the broadest latitude possible.

iii. §38.254 – Ability to Obtain Information

The CFTC proposes to have each DCM require that traders in their market keep trading records and make the records available to the DCM upon request. MGEX, as a membership based organization, is concerned about the burden that is proposed to be placed upon its traders. It is not clear what records a DCM must tell a trader to keep regarding non-DCM contracts. Assuming a DCM has valid jurisdiction over the trader, how does a DCM monitor and enforce compliance? MGEX does not believe it is appropriate for the Exchange to be required to enforce the record retention rules being imposed by the CFTC. Should the CFTC require the data retention, the CFTC should have oversight for these records and address the specificity as to which records are required to be maintained.

iv. §38.255 – Risk Controls for Trading

Proposed §38.255 requires DCMs to have in place "effective risk controls." These risk controls include but are not limited to trading halts and/or pauses in the event there are exceptionally large price movements. MGEX believes that price halts and pauses could be an effective method to control extraordinary price movements in the market in certain circumstances. However, they should not be mandatory. Each DCM should be permitted broad latitude to establish such controls it believes are most useful for its markets. The CFTC further proposes that where a contract market can be considered a proxy for a similar market, such as indexes, then the risk controls should be coordinated. MGEX proposes that forcing market coordination is unnecessary. If market instability moves from one contract market to another, the next market should be able to pause or halt trading as it determines necessary. Therefore, MGEX suggests that this provision be removed from the final rule.

In addition, should the proposed rule become the final rule, MGEX believes that not all contracts or indexes function alike. MGEX's index contracts participants use cash price

points from across the country to determine the underlying value. Therefore, MGEX indexes cannot drive the price of an underlying commodity either up or down and, thus, there is no market benefit by MGEX sharing data or coordinating risk controls. As such, as it relates to MGEX, MGEX interprets the rule to mean that its index products are not required to share data or coordinate risk controls.

Subpart J – Execution of Transactions

i. §38.502 – Minimum Centralized Market Trading Requirement

The CFTC proposes to require a minimum threshold percentage that 85% of contracts must be traded on a centralized market for that contract to meet the requirements of Core Principle 9. If a contract does not meet the 85% threshold over a twelve month period, the proposed rule requires mandatory delisting. This seems counterintuitive to the Dodd-Frank Act requiring products trade on a regulated exchange. Delisting contracts do not encourage price discovery and transparency. Additionally, the CFTC cites energy, Forex and weather to be areas of major off-exchange issues. However, instead of regulating the areas where it is of concern, the CFTC appears to be using a broad brush to and include all commodities. MGEX suggests that the Commission regulate where the need is and not burden other areas where the market place has been operating efficiently and without incident for decades.

The 85% requirement also seems to function as a high barrier for launching new products. Requiring over 85% of a new product to be traded on a centralized market over its first twelve months of existence could prove to be difficult. Before products can gain traction and have increased trading volume, even small amounts of off-exchange transactions could prove fatal to the product. Therefore, DCMs may have to prohibit any off-exchange transactions until the product has a high volume. However, without off-exchange trading the product might never gain the traction it needs to get into a high enough volume. Accordingly, MGEX believes the CFTC is creating a chicken and egg scenario which may harm competition, innovation and legitimate risk management strategies for various market participants. Therefore, this specific requirement should be deleted, or otherwise changed or refocused on where the CFTC believes such activity may be truly troublesome.

Further, while the CFTC allows a DCM to request for an exemption for new products, MGEX believes this should be automatic if the proposal is adopted. Also, the CFTC still requires the DCM to demonstrate that the new product has averaged at least 50% trading volume on a centralized market. This 50% requirement may still be prohibitively high for new products trying to build trading momentum. Again, this threshold requirement serves no valuable contribution to the marketplace.

In addition, MGEX believes that Exchange for Related Positions (“EFRP”) transactions, including Exchange for Physical (“EFP”) and Exchange for Risk (“EFR”), should not be limited. MGEX has an active and entirely legitimate EFP market that serves a valuable purpose. Therefore, under the CFTC’s proposed rule, legitimate trading activity would be used against MGEX and potentially could force the hard red spring wheat contract to either be delisted or force MGEX to prohibit a legitimate contingent of its marketplace from trading. Both have severe consequences for the Exchange. Once more, this

proposal should be eliminated or changed as described above.

Lastly, MGEX does not agree with the CFTC allowing for the ability of swaps to be able to transfer contracts that do not meet the 85% threshold to a SEF while providing no such solution to the remaining commodities. If nothing else, the CFTC should allow a grandfather clause for existing contracts or at least reduce the threshold for existing contracts. If the CFTC is concerned primarily with Forex, energy and weather contracts, it could exclude those contracts from the grandfather provision and not just a liquidation provision.

As is evidenced by the above comments, MGEX believes that all of proposed §38.502 should be removed.

ii. §38.505 – Exchange of Derivatives for Related Position

Proposed §38.505(d) requires that EDRP trades must be reported within five minutes of consummation. While there have been advances in electronic trading, there are still practical real world barriers to requiring reporting within five minutes of a trade. EDRPs are often generated in a cash market. Therefore, the CFTC should maintain the standard that an EDRP be reported "promptly" or in a reasonable time. Alternatively, should the Commission need a more definite timetable, the CFTC can require the EDRP trade be reported within the same trading day it was consummated.

Subpart K – Trade Information

i. §38.553 – Enforcement of Audit Trail Requirements

The CFTC is requiring DCMs to develop and enforce audit trail enforcement programs. This is certainly a reasonable general requirement. The proposed rule specifically requires a DCM to review all members and market participants at least annually to verify compliance with the audit trail requirements. MGEX believes the CFTC's requirement that all market participants be reviewed annually is excessive and unreasonable. Rather, MGEX recommends sample testing of market participants because sample testing is more efficient, adequate and less burdensome. Furthermore, MGEX recommends the definition of market participants should be more narrowly defined to mean those with direct market access to the trading platform.

In addition, the DCMs must develop enforcement programs to ensure compliance with the audit trail program requirements for both open-outcry and electronic trading. Further, the DCM must level meaningful sanctions when deficiencies are found, which cannot be more than one warning letter or other non-financial penalty for the same violation within a rolling twelve-month period. As noted earlier, the one letter limit is arbitrary and counterproductive. Instead, the Commission should only require DCMs have adequate audit trail programs, as well as an adequate enforcement and disciplinary process. DCMs currently operate well in this regard and have the expertise to know what works best for their business while meeting intended audit trail requirements. As the Commission has noted, the electronic audit trail process is evolving. This means DCMs must be given adequate time to develop and improve such programs if deemed necessary.

Subpart L – Financial Integrity of Transactions

i. §38.606 - Outsourcing

Proposed §38.606 allows DCMs to satisfy their financial surveillance responsibilities by outsourcing them to a registered futures association or other regulated entity. However, the CFTC then requires the DCM to ensure that the regulatory service provider has the capability to conduct the financial surveillance. Further, the DCM remains liable for compliance with the financial surveillance obligations. These requirements seem reasonable. And the application of these requirements should be able to be accomplished within current delegation and information sharing agreements such as the CFTC-approved JAC Agreement for Services. Requiring additional layers of bureaucracy such as requiring DCMs conduct audits of these providers substantially frustrate the purpose, efficiency and economic value for outsourcing to a third party.

ii. §38.607 - Futures Commission Merchants

Further, proposed §38.607 requires that if customers of futures commission merchants ("FCMs") have direct market access ("DMA"), then the DCM is required to implement direct access controls (an automated risk management system for FCMs to use) so as to provide member FCMs with tools to manage their financial risk. However, these controls are not the normal role of a DCM – rather it belongs to the FCM. By requiring these provisions, it would appear the CFTC is forcing DCMs to go from performing financial and market surveillance to becoming a quasi-FCM. DCMs should not be required to assume an FCM's responsibilities or take on additional burdens directly due to another entity's business decision to offer a certain type of connectivity to its customers. Automated controls provided by a DCM are not the only means to enforce risk limitations. If DCMs, DCOs, clearing members and member FCMs wish to implement such controls, they may certainly choose to do so. However, it should not be mandated that a DCM supply such technology as a prescriptive rule. If anything, it should be left as a business decision on each DCM to offer such technology or not when an FCM elects to provide a risk solution to market participants.

Subpart N – Disciplinary Procedures

i. §38.701 – Enforcement Staff

Proposed §38.701 requires a DCM to establish and maintain sufficient enforcement staff in order for the DCM to effectively investigate and prosecute possible rule violations under the DCM's proposed expanded jurisdiction. MGEX, as a combined DCM/DCO interprets the rule to allow the staff to serve as enforcement and review staff for both the DCM and DCO divisions of MGEX and any other entities that become a combined DCM/DCO.

ii. §38.702– Disciplinary Panels

Further, proposed §38.702 requires a DCM to establish at least one review panel and at least one hearing panel to enforce the proposed disciplinary procedures. The CFTC

requires separate panels because they fear conflicts of interest between the ability to determine whether a reasonable basis for finding a violation exists and the ability to adjudicate the matter. However, there is no reasonable basis for this distinction. In order to maximize resources and streamline the process for all involved, MGEX believes one panel should suffice from start to finish. Should the CFTC have a question surrounding disciplinary panels or process, they should have the right to inquire about the process, but not move to such a prescriptive rule.

Subpart S – Recordkeeping

MGEX believes the CFTC needs to provide some further clarity as to how long records need to be kept. Uncertainty arises from changing the requirement from 5 years to "at least 5 years." DCMs should not be forced to become a de facto permanent repository of information because the CFTC may request information indefinitely. At some point, the DCM should be free to dispose of information. However, that requires a finite statement provided by the CFTC.

Further, the detail of the proposal to require all records and data be indexed, and even the index be duplicated, is an example of being too prescriptive. The Exchange is also left wondering why only Commission-required data must apparently be segregated from other forms of records. DCMs should not become a substitute storage facility for CFTC data nor should they be required to relocate and resubmit data that has already been submitted to the Commission.

Subpart W – Diversity of Board of Directors

While this topic will be given further review later in a subsequent comment letter, MGEX believes the CFTC may be overstepping its reach. MGEX strives for diversity in all aspects of its business. However, the business operation and elected board should not be forced by the CFTC to have culturally diverse participants. While the goal is laudable, it simply is not the place of the CFTC to go beyond the expressed language of the Dodd-Frank Act. While the CFTC finds itself in a budget crunch, it is attempting to engage in oversight of matters outside of its jurisdiction. The CFTC should leave this to the states and other federal departments who have oversight of such matters. The CFTC imposing on this area of the law exemplifies the radical extent to which the CFTC is using the Dodd-Frank Act to expand its reach to areas which were not intended or required by Congress.

Burden

The CFTC estimates the average response time for each respondent to be 300 hours for the proposed collection of information for designation and compliance purposes pursuant to part 38. The CFTC further estimates that respondents could expend up to an additional $3,640 annually based on an hourly wage rate of $52 (30 hours + 40 hours × $52) to comply with the proposed rules. MGEX believes these estimates – both in hours and cost – are extremely low.

MGEX again states that due to the vast number of additional requirements the total burden is becoming unwieldy and excessive. While taking each item individually may

not appear overly burdensome or costly, when all the new requirements are aggregated, the additional costs to DCMs, DCOs, FCMs and market participants may far outweigh any potential benefits. MGEX further cautions against the CFTC, due to its funding shortfall or otherwise, from relying on unfunded mandates. The CFTC appears to be more and more choosing this unfunded mandate path. Instead, the Exchange respectfully requests the CFTC to re-evaluate and prioritize what rulemakings are truly necessary in order to oversee regulated markets that have functioned well for many decades.

Conclusion

The Exchange thanks the Commission for the opportunity to comment on the notice of proposed rulemaking. If there are any questions regarding these comments, please contact me at (612) 321-7169 or lcarlson@mgex.com. Thank you for your attention to this matter.

Regards,

Layne G. Carlson
Corporate Secretary

cc: Mark G. Bagan, CEO, MGEX
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