

February 14, 2013

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581
secretary@cftc.gov

RE: RIN 3038-AD88
Enhancing Protections Afforded Customers and Customer Funds Held by Futures
Commission Merchants and Derivatives Clearing Organizations

Dear Ms. Jurgens:

The Joint Audit Committee ("JAC"), a representative committee of the Audit and Financial Surveillance departments of U.S. futures exchanges and regulatory organizations, appreciates the opportunity to comment on the proposed new and amended regulations regarding enhanced customer protections, risk management programs, internal monitoring and controls, capital and liquidity standards, customer disclosures, and auditing and examination programs for futures commission merchants ("FCMs"). Customer protection is the cornerstone of the futures industry and it is critical to ensure the protections afforded under the segregation, secured 30.7. and cleared swaps (collectively "customer") regimes are as strong as they can be for market participants. Market conditions and events of the past couple of years have highlighted the necessity to further enhance customer protections and we applaud the Commodity Futures Trading Commission's ("Commission" or "CFTC") efforts to ensure such goals are achieved.

At the same time, as the Commission proposes a stronger customer protection regime we need to ensure a balance is maintained between increased financial, reporting, notification, monitoring, operational, disclosure and examination requirements and the industry's ability to operate in an effective manner to provide end users with safe and efficient markets for their hedging needs. We encourage the CFTC to be mindful that the regulations do not become overly burdensome so that the futures industry continues to have a diversified FCM community to service end users in an effective manner.

The JAC offers the following comments on certain aspects of the proposed new and amended regulations regarding the enhancement of customer protections.

The JAC welcomes the review of its Joint Audit Programs ("JAC Programs") as utilized in the performance of risk based examinations of FCMs for further enhancements. On an annual basis, the JAC reviews all programs in place for additions and changes to the program steps and questionnaires. Additionally, throughout the year, program steps are added to incorporate new rules and requirements (for example, changes to permitted investments under CFTC Regulation 1.25) and to respond to industry events (for example, adoption of electronic confirmations). The CFTC is invited to propose changes to the JAC Programs and is part of the meeting wherein all program changes are reviewed and discussed. Further, once finalized the JAC Programs are submitted to the CFTC.

In line with the proposed amendments to §1.52, the JAC Programs already incorporate a risk based approach to determine the timing and specific programs to be completed on each FCM risk based examination. Prior to the commencement of a risk based examination of an FCM, a risk profile of the FCM is already under way through the review of correspondence files (including all financial notifications as well as correspondence related to the general affairs of the FCM), financial statements (including trends and deviations), previous risk based examinations (including the report and, if applicable, response, summary of significant findings, points for next examinations, and listing of program steps performed), clearing house risk reviews, and any other relevant correspondence related to the FCM. In addition, all JAC members in which the FCM maintains membership are contacted for input as well as for dually registered FCM-Broker/Dealers, the Designated Examining Authority ("DEA") is contacted for concerns and the scope and results of their most recent examination. Then at the beginning of fieldwork a firm profile is completed of the FCM with an emphasis on changes in business activities, procedures/policies and personnel since the prior examination. Additionally a General Questionnaire is completed of the firm's procedures and controls which covers all areas of the firm's futures activities and includes a thorough risk management analysis. All of this information is then consolidated and analyzed to develop the scope of the risk based examination with a focus on both compliance and financial customer protection and the ability of the FCM to meet capital requirements.

The risk based examinations performed by Designated Self-Regulatory Organizations ("DSROs") are compliance reviews focused on the particular and distinctive regulatory requirements and associated risks of the futures industry. Our risk based examinations involve a comprehensive review of the Statement of Segregation Requirements and Funds in Segregation, Statement of Secured Amounts and Funds Held in Separate Accounts, Statement of Cleared Swaps Customer Requirements and Funds in Cleared Swaps Customer Accounts, and Statement of the Computation of the Minimum Net Capital Requirements. For each particular computation, we base levels of testing on the excess funds held in that particular calculation to ensure balances are properly accounted for and stated. We review the internal controls to determine they are effective through substantive testing of customer and capital balances and compliance programs. Our risk based examinations are not audits and an opinion on the financial statements is not rendered. Thus the explicit adoption of Generally Accepted Auditing Standards ("GAAS") developed by the Auditing Standards Board of the American

Institute of Certified Public Accountants and auditing standards as prescribed by the Public Company Accounting Oversight Board ("PCAOB") is not appropriate for our regulatory work.

On the other hand, public accounting and auditing firms perform audits of the FCMs assessing the internal controls utilized in the preparation of the financial statements and base their materiality levels to the firm overall. They perform their audits utilizing GAAS and the standards prescribed by the PCAOB, as applicable, and issue an opinion on the financial statements as a whole. Further in the proposed rulemaking, public accounting and auditing firms of FCMs are required to fully consider the auditing standards adopted by the PCAOB which pertain to the testing of internal controls over financial reporting. This structure in place today allows the regulatory examiners to concentrate on the specific requirements of the futures industry, their area of expertise, and the public accounting auditors to focus on the internal controls of the firm and the financial statements as a whole, their area of expertise. Therefore regulatory examinations and public accounting firm audits complement one another and lead to stronger and more comprehensive oversight while avoiding duplication of work. By applying GAAS and the standards of the PCAOB to the regulatory examination process, work is duplicated and costs rise without a corresponding increase in the effectiveness of the review program.

The JAC appreciates the necessity of standards in the development and execution of our JAC Programs. Presently in addition to current CFTC Regulation 1.52, comprehensive standards for our regulatory examinations are specified in CFTC Interpretation 4-1, Addendums A and B to CFTC Interpretation 4-1 and CFTC Interpretation 4-2. Collectively they establish, in detail, minimum standards for DSROs in carrying out risk based examinations of FCMs including financial and related reporting requirements, sales practice and compliance reviews, coordination and reliance on the DEA of dually registered FCM-Broker/Dealers, and the adoption and implementation of risk based auditing. These standards specific to the regulatory requirements and associated risks of the futures industry should set the foundation for our risk based examinations and their execution.

We agree and recognize that changes to the industry and events of the past couple of years require a review of the standards in place to ensure they continue to be current, effective and comprehensive in setting criteria for the regulatory examination process. At the same time, the standards must be clearly delineated. As such, we would be happy to work with the CFTC in evaluating and updating the standards currently in place and establishing a process wherein they are continuously reviewed in conjunction with the annual update of the JAC Programs.

In the proposed new regulations, the engagement of an examination expert to review the JAC Programs and their implementation at least bi-annually is put forth. The examination expert must be a nationally recognized accounting and auditing firm with substantial expertise in audits of FCMs, risk assessment and internal control reviews, and is someone acceptable to the Commission. The review will require the examination expert to assess the sufficiency of the JAC's risk-based approach and the internal controls testing and also whether the supervisory program is being appropriately applied by the DSRO in its examinations of FCMs. It is

important to note that the CFTC already reviews the JAC Programs and has input into their development as noted previously. Further the Commission currently performs reviews of the DSRO's risk based examinations of FCMs on a continuous basis. As such, we feel the engagement of an examination expert is redundant to what the Commission already does today. Further the Commission holds the expertise relative to the futures industry and would be better able to review the programs and their implementation versus a public accounting and auditing firm who is not exclusively focused on the futures industry and its unique regulations and customer protection regimes. There does not appear to be added benefit to be gained in relation to the significant cost of engaging an examination expert.

At the same time, we agree with the Commission's view that our JAC Programs and examinations of FCMs should be as strong and effective as possible. Today we currently work with our counterparts on the securities side including the Financial Industry Regulatory Authority and other DEAs through the Intermarket Financial Surveillance Group¹ to share examination procedures and priorities on an annual basis. Likewise, gaining the input of accounting and auditing firms who audit our firms would be valuable in understanding industry trends in auditing practices utilized. To that end, rather than engage an examination expert after the fact to perform a function already being performed by the CFTC, we would like to proactively invite representatives from nationally recognized accounting and auditing firms to attend our JAC meetings wherein our programs are reviewed and discussed. At such time, the accounting and auditing firm representatives can present new and best practices as detailed in the proposed rulemaking so they may be timely included in the amended JAC Programs for the upcoming year. This will also benefit the accounting and auditing firms as they will gain a better understanding of our examination process and the risks we focus on during reviews of FCMs. In this way an interactive and continuous discussion between the regulatory examiners and the public auditors can be achieved to better understand the risks at our FCMs and how they may best be identified and examined for.

The risk based examinations are performed to review and ensure compliance with customer protections and capital requirements. With the complexities of the regulations and their application to an FCM's business, direct and continuous communication and involvement of the FCM's management is essential. During the course of a risk based examination, all problems noted are discussed with the responsible individuals of the respective areas of the FCM and escalated to senior management as warranted. Upon the completion of a risk based examination, a summary of significant findings is discussed with senior management at a formal closing meeting to ensure the significant problems are agreed to and corrective action has been taken or is in the process of being taken. The FCM's senior management is responsible for compliance with industry rules and regulations and its communication with its Board of Directors ("BOD") and other governing committees. Nonetheless, nothing prohibits a DSRO or SRO from

¹ A representative committee of the regulatory organizations of the securities and futures markets established for the coordination of financial surveillance among mutual member firms.

going directly to the BOD or other governing committee of an FCM if it has concerns. The JAC is unclear as to the purpose or benefits of having the DSRO routinely communicate directly with the audit committee of the BOD or other similar governing body during risk based examinations.

The new risk management requirements as proposed under §1.11 are extensive and require an FCM to file a copy of its written risk management policies and procedures to the Commission and its DSRO. In part, the risk management policies and procedures must include (1) identification of account market, credit, liquidity, foreign currency, legal, operational, settlement, segregation, technological, capital, and any other applicable risks; (2) risks posed by affiliates, all lines of business of the FCM and all other trading activity engaged in by the FCM; (3) detection of breaches of risk tolerance limits set by the FCM and alerts to supervisors; (4) periodic risk exposure reports; (5) segregation risk including a process for evaluating and monitoring on a continuous basis depositories, establishing and maintaining a targeted residual interest in customer funds, withdrawing funds from customer accounts, assessing the appropriateness of customer investments, maintaining appropriate separation of duties, timely recording all transactions, annual training, and assessing the liquidity, marketability and mark-to-market valuation of all securities and other non-cash investments held in segregation; (6) operational risks, and (7) capital risks. In addition a supervisory program should be in place to ensure the policies and procedures are being followed.

While we acknowledge that it is essential that policies and procedures over customer funds and their protection be part of risk based examinations of FCMs as they are today, proposed §1.52(d)(2)(ii)(A) requires the incorporation of the full and extensive risk management requirements of §1.11 to be reviewed during examinations of FCMs. Further, §1.52(d)(2)(ii)(E) in part requires the JAC Program to "address all areas of risk to which registered futures commission merchants can reasonably be foreseen to be subject". Such an overly broad requirement is impractical and virtually impossible to meet. The additional expertise, time and resources needed to perform such a review would be extensive and add significant costs to the regulatory review programs. For instance, an examination of the controls and risk management policies and procedures over an FCM's technology systems would require particular expertise very different from the knowledge and expertise of regulatory staff; thus necessitating the hiring of a specialized team of examiners. The regulatory examination process is designed to ensure FCMs are in compliance with customer regulations and net capital requirements to protect customers and the functioning of the futures industry; not to be a guarantee of an FCM's entire operation. Further, as the risk management policies and procedures must already be submitted to the Commission who are experts in the risk management programs to be adopted, the review of the programs would be duplicative in nature. To timely enhance the customer protections afforded by the adoption of the risk management requirements, the JAC proposes that the Commission review the submitted procedures of the FCMs and provide to the DSRO any significant findings and issues related to customer protections to be factored into the risk profile developed of FCMs at the start of risk based examinations. Thus, the risk management profile of the firm can be factored into the review and testing to be performed of the FCM without posing duplicative work and significant unnecessary costs.

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In addition, as noted in the proposed rulemaking, the "Commission does not have adequate information to estimate the ongoing costs for biennial reviews by an examinations expert, or the incremental costs of additional controls testing or ongoing compliance with standards that the FCMs develop pursuant to §1.52(c)(2)(iii)." A thorough analysis of the costs of the proposed requirements and additional work, which in many cases are duplicative, is required to ensure a balance is maintained between the added costs to the industry, which ultimately will flow to the end users of our markets, and the benefits to be derived.

The industry, including FCMs and DSROs, want to comply with CFTC rules and regulations and are eager to work towards a stronger customer protection regime. However the rules, as proposed, are overly broad and are subject to interpretation. Such vagueness persists throughout the proposed rulemaking and will require extensive CFTC written interpretations and guidance to be provided. To ensure full compliance and strong customer protections, specificity is critical.

As the proposed rules are extensive and comprehensive, we request that the CFTC carefully consider adopting the new regulations in a staggered approach over an extended period of time. This will further provide an assessment of the effectiveness of the new rules and allow the industry including customers time to adapt to the enhanced reporting and transparency. In addition, unintended negative consequences may be identified before full implementation allowing for revisions in the proposed rules to better protect customers.

In summary, given the events of recent years, we recognize the need to enhance customer protections to provide strong and safe markets. In fact, several of the proposed enhancements have already been implemented by Self-Regulatory Organizations. Further, the JAC has already instituted several enhancements to its review programs and is committed to adopting a strong and effective oversight program.

We thank the Commission for the opportunity to comment on these significant proposed rule changes and are fully committed to working with the CFTC and industry to enhance customer protections. At the same time, we are cognizant of the significant impacts the proposals would have on the futures industry if adopted as proposed and ask that the Commission carefully consider all comments received.

If you have any questions or comments, feel free to contact me at (312) 930-3235 or debbie.kokal@cmegroup.com.

On Behalf of the Joint Audit Committee,



Debra K. Kokal
Chairman

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cc: Honorable Gary Gensler, Chairman
Honorable Jill E. Sommers, Commissioner
Honorable Bart Chilton, Commissioner
Honorable Scott O'Malia, Commissioner
Honorable Mark Wetjen, Commissioner

Mr. Gary Barnett, Director, Division of Swap Dealer and Intermediary Oversight
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