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Via electronic submission

Ms. Sauntia Warfield
Assistant Secretary
Commodity Futures Trading Commission
1155 21st Street NW
Washington, DC 20581

Dear Ms. Warfield,

Frontier Futures, Inc. respectfully submits this comment to the Commodity Futures Trading Commission in response to proposed rule changes under the title: Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations. Frontier Futures, Inc. is a small Iowa based FCM that primarily does business with hedgers in the agricultural markets. We believe the intent of these proposed rules is correct and a number of these rules will in fact enhance the safety of customer funds in the markets regulated by the CFTC, but are concerned that some of the rules will adversely affect small to mid-sized FCMs and limit or deny access to the futures markets for many of the customers that we serve.

The purpose of these Customer Protection Rule changes is to protect customer segregated funds from loss due to undersegregation. There have been a number of highly publicized failures by Futures Commission Merchants in the past several years, resulting in loss of funds by customers of those FCMs that should have been protected under segregation rules. All of these cases involved fraud or malfeasance on the part of the FCM and a failure to follow the rules and regulations regarding keeping the proper amount of funds in segregation. However, many of the proposed rules are aimed at increasing the amount required by FCMs to hold in segregation rather than preventing improper withdrawals from segregation. The focus for rule changes should be on enforcement and confirmation of current rules and requirements. If this were done, none of these failures could have occurred to the extent that they occurred. All FCMs would benefit from greater enforcement of current segregation regulation. Integrity is key to vibrant and liquid markets. Small FCMs like mine are very interested in the focus of Commissioner Scott O'Malia's task force and would like to associate ourselves with his comments below:

"I would also like to highlight one of today's proposals that will require additional development in order to fulfill the goal of customer protection. Today's proposal calls for the creation of an electronic balance confirmation process that would allow the Commission and Self-Regulatory Organizations ("SROs") to independently check the balance of each segregated account held on behalf of customers. While this can be used to aid in the surveillance of account balances, the Commission proposal only works on an individual basis and requires significant human involvement to log in and monitor individual accounts. What the industry needs is a fully automated system that allows the Commission and SROs to download the account balances for each segregated account held for a customer and compare that balance to the figures on record at each FCM. In response to the Peregrine and MF Global failures, industry participants discussed the implementation of such a system in July of this year during the Commission's

Technology Advisory Committee (TAC) meeting. During the meeting, the TAC members present were virtually unanimous in their belief that an automated customer fund verification system was needed. Certain TAC members also made presentations discussing the technological hurdles that must be overcome in order to put such a system in place.”

There are really only two ways for funds in segregation to become insufficient to meet the obligations of the FCM to its customers. The first is when an FCM withdraws funds from segregation in excess of its ownership of these funds to meet other obligations. This can occur when the FCM incurs losses in proprietary trading accounts and uses customer funds to meet their obligations regarding these losses. It can also occur through simple fraud by the employees or management of an FCM. All of the recent failures by FCMs have been of this nature. Were these FCMs following current rules and regulations regarding the proper treatment of funds in segregation, no customer funds would have been jeopardized by the failure of these FCMs. What is needed to prevent these problems from recurring are better enforcement mechanisms for current rules. The proposed changes that enhance the ability of the CFTC and DSROs to monitor funds in segregation will address this to a certain extent, but only hard firewalls that monitor and control transactions between customer funds accounts and firm accounts and greater restrictions on proprietary trading by FCMs will firmly safeguard customer funds from this type of malfeasance.

The second way customer funds in segregation can be jeopardized is the result of large losses by customers of an FCM. Customers of an FCM that generate debits reduce the amount in segregation by the amount of the debit that an FCM is required to make up out of its own capital until that debit is collected. This is the justification for FCMs maintaining a residual interest in the funds in segregation. If the debit amounts are larger than the net capital of the FCM this will create a shortfall in segregation that results in losses by other customers who have funds commingled. Most of the proposed rule changes address this issue. Requiring FCMs to increase risk management standards, increasing the requirements for excess funds in segregation, and the reduction in days to collect margin calls before they become capital charges are all aimed at protecting an FCM's customer from losses incurred by other customers of the FCM. This is an area that FCMs have done a very good job of policing on their own, and these rules will have significant effects on the cost of doing business for FCMs, and in some cases, especially for smaller FCMs, possibly make it too expensive or impossible for some firms to continue doing business as an FCM. None of the recent failures by FCMs had anything to do with losses incurred in customer accounts by customer trading. In fact, I am not aware of any FCM failures caused by this factor. FCMs are already greatly incentivized to avoid this risk. Commission and interest income is simply too small of a percentage of the risk incurred if customer accounts aren't properly monitored and debit accounts avoided. Higher margin requirements have also limited FCM risk in this area.

The requirement for FCMs to maintain residual interest in segregated funds in excess of the total of customer margin calls will effectively require FCMs to maintain residual interest in segregated funds in excess of any possible margin calls. The risk to customer funds is NOT caused by other customer on margin calls. Customers' funds are only affected by debits incurred by other customers with whom their funds have been pooled. The purpose of margin requirements is to provide a performance bond for the customer holding futures or option contracts to ensure that they do not incur a debit in their account. When the market moves against that position, the customer is then required to deposit additional funds to get their account

off margin call. The best way to alleviate the risk to customers that they will incur a debit is to have adequate margin requirements and ensure that those requirements are met in a timely manner. There is no provision in this regulation that gives FCMs any time to collect margin calls if the market moves against a customer's position. Some FCMs would have to greatly increase their capital or margins would have to be current at all times. This will force many FCMs to require significantly higher funds in customer accounts or to liquidate positions of customers unable to meet their margin calls on a moment's notice. For smaller customers, or those who don't necessarily follow the markets on a minute to minute basis, such as most farmers, meeting margin calls on a moment's notice is often a difficult thing to do. This is especially true of small hedge customers, who would then be faced with liquidation of hedges.

The broader consequence of the regulation requiring FCMs to maintain residual interest in segregation greater than the sum of margin calls may be to force a number of small to mid sized FCMs out of the market. This will have numerous negative impacts on the futures markets, especially smaller participants. Most of the FCMs who clear small hedgers and speculators as well as guarantee Introducing Brokers are small to mid sized FCMs. If these market participants are forced out of business, at a minimum access to the futures markets will become much more expensive for IBs and small traders. It may even become difficult for them to find anyone willing to clear their business. The loss of these FCMs would also take significant capital from the futures industry, reducing the stability of the markets as a whole.

I believe that several of these regulations do not address the real risks to customer funds. Recent events have shown that customer funds are put at risk by fraud and proprietary trading by FCMs, not by their risk management practices as they pertain to customers of the firm. The futures industry and FCMs in general have demonstrated their ability to manage customer risk. The incentives for ignoring customer risk simply do not exist when compared to the potential earnings from commissions and interest that FCMs receive for clearing customer business. The only risk/reward scenario that FCMs have shown an inability to manage is their own proprietary trading. These regulations do not address this issue. A more effective means to protect customer funds would be to put firm firewalls in place between customer funds and an FCM's own funds. This can be accomplished by engaging technology and the holders of customer funds such as banks and other FCMs to only allow transfers out of customer funds to the customers themselves or to the FCM's own accounts when approved by an independent agency. The provisions in the regulations that enhance the ability of regulators to verify funds in segregation are the one area in these proposed regulations that would be useful for this purpose. The proprietary trading risk could also be mitigated by requiring FCMs to do their proprietary trading through another FCM, thereby engaging a third party to do risk management on that trading.

Respectfully Submitted,



Theodore L. Johnson
President and CEO