Kim Taylor
President, CME Clearing

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

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

Dear Ms. Jurgens:

I. Background

CME Group Inc. ("CME") 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") (the "NPR"). CME Group is the parent of Chicago Mercantile Exchange Inc. ("CME"). CME is registered with the CFTC as a DCO, and is one of the largest central counterparty clearing services for regulated derivatives contracts. CME's clearing house division ("CME Clearing") offers clearing and settlement services for exchange-traded futures contracts and for over-the-counter ("OTC") derivatives transactions, including interest rate swaps, credit default swaps, agricultural swaps and other OTC contracts.

Customer protection is the cornerstone of the futures industry. Thus, we strongly support the Commodity Futures Trading Commission's ("Commission" or "CFTC") efforts to codify the enhancements to the customer protection regime implemented by the industry in the wake of the MF Global and Peregrine failures. We further welcome continued industry dialogue on the issues sparked by the Commission's proposal. Although the Commission graciously extended the comment period for the NPR, CME believes that the industry is still in the very early stages of digesting the hundreds of pages of proposed regulations, which seek to fundamentally change the way the entire futures marketplace operates. While customer protections are of the utmost importance to the industry, we must ensure that the full scope of any regulatory changes are understood, including the costs associated with such an overhaul and potential unintended adverse consequences. We also note that customer protection is best served when customers are afforded intermediation services by a diverse, engaged universe of FCMs. Financial services firms choose to provide FCM intermediation services for a variety of business reasons. As we near the onset of the clearing mandate for various OTC products in the US, we would do well to bear in mind that any customer protection regime involves "cost." We urge the CFTC to balance the need for enhanced customer protection standards with a pragmatic perspective that emphasizes cost effective customer protection solutions.

We understand from the CFTC Roundtable on this NPR on February 5, 2013 (the "Roundtable"), and separate discussions with our clearing member FCMs, that the industry is in the midst of analyzing the impacts of the proposals in the NPR and that more time is needed to complete such work. We strongly support the industry's efforts in this regard and would like the opportunity to join their efforts to ensure that further enhancement to the customer protection regime for futures are indeed improvements. Significantly, as a central counterparty, we want to ensure that any changes do not increase risk to clearinghouses or to the financial system as a whole. Thus, we believe it would be premature for the Commission to move forward with finalizing any of the proposed regulations following the close of the comment period and urge the Commission to give the industry time to complete its work.

Because the comment period closes on February 15, 2013, CME offers the following comments on the Commission's proposal. We note, however, that we expect to supplement our comments once the industry has completed its analyses and we have had an opportunity to reconvene and discuss the best path forward.

In this comment letter, CME also offers comment on proposed changes to CFTC Regulation 1.52. CME supports the Commission's goal of evaluating whether any changes should be made to the risk-based examinations currently performed on FCMs. Indeed, CME, in conjunction with the Joint Audit Committee ("JAC") and the CFTC, regularly reviews its procedures and makes changes to those procedures so that they are continually evolving and improving. We are concerned, however, that instead of proposing changes narrowly designed to address perceived weaknesses in the current regulations, the Commission proposes to fundamentally overhaul the nature of the reviews performed by self-regulatory organizations ("SROs") and designated self-regulatory organizations ("DSROs") and, in so doing, threaten the viability of the current regulatory structure. This is a drastic measure that is not supported by an adequate cost benefit analysis. Our specific concerns regarding the proposed changes to Regulation 1.52 are detailed below in Section V.

II. <u>Enhancements to Customer Protection Following MF Global and Peregrine Financial</u>

The Commodity Exchange Act ("CEA") protects the property of customers by means of a segregation regime that requires that customers' property be kept separate from the property of their FCM and from the property of the clearing house. Specifically, under Section 4d(a) of the CEA customer collateral may, "[u]nder no circumstances" be used "except to purchase, margin, guarantee, secure, transfer, adjust or settle trades, contracts or commodity option transactions of commodity or option customers." As the Commission knows, this segregation model had protected customers without failure from 1936 until the recent bankruptcies of MF Global and Peregrine Financial. While we are no longer able to say that no futures customer has ever suffered a loss as a result of an FCM default or bankruptcy, we must keep in mind that the losses that futures customers experienced in those two events were the result of an FCM taking customer property for its own use and **<u>not</u>** as result of fellow customer risk.

Working with a special committee comprised of representatives from the futures industry's SROs, including CME and the National Futures Association ("NFA") (the "SRO Committee"), CME has implemented several important safeguards to detect and deter the misbehavior the industry witnessed in MF Global and Peregrine Financial. These enhancements, which are described in more detail below, fall into three major areas: (i) mitigating the risk of and earlier detection of any improper transfer of customer funds due to errors or theft, (ii) mitigating the risk of and earlier detection of improper reporting of asset balances due to errors or fraud, and (iii) ensuring compliance with CFTC requirements for investments in customer funds. Also discussed in more detail below are the benefits realized to date from our initiatives.

A. *Mitigating the Risk of and Earlier Detection of Any Improper Transfer of Customer Funds Due to Errors or Theft*

With respect to mitigating the risk of and earlier detection of any improper transfer of customer funds due to errors or theft, CME and NFA have implemented various measures – including: 1) requirements regarding an FCM's residual financial interest in customer accounts, 2) restrictions on an FCM's disbursements from customer accounts, and 3) procedures that will facilitate monitoring of customer funds. The following subsections elaborate further on these measures.

1. <u>Requirements regarding an FCM's residual financial interest in customer accounts</u>

Under new CME and NFA rules, all FCMs must have written policies and procedures regarding the maintenance of the FCM's residual financial interest in its customer segregated funds accounts, secured funds accounts (for foreign futures and foreign options customers), and cleared OTC customer accounts. Such policies and procedures must target an amount (either by percentage or by dollars) that the FCM seeks to maintain as its residual interest and be designed to ensure compliance with the applicable segregation requirements. Requirements over such targeted residual interests are reviewed as part of an FCM’s risk-based examination. For its part, CME has adopted new rules to provide clarification regarding an FCM's maintenance of residual financial interest in customer accounts, including that such maintenance requirement applies on an intra-day basis.

2. <u>Restrictions on an FCM's disbursements from customer accounts</u>

CME has adopted new rules that would restrict an FCM's ability to disburse customer funds from customer segregated funds accounts, secured funds accounts, and cleared OTC customer accounts. Pursuant to the CME rules, an FCM would not be allowed to withdraw, transfer, or otherwise disburse customer funds exceeding 25 percent of the FCM's residual financial interest in the relevant customer account, *unless* the FCM's CEO, CFO, or other qualified individual with knowledge of the firm's financial requirements and financial position pre-approved the transaction in writing. The 25 percent threshold would <u>not</u> apply to disbursements that are made to or for the benefit of customers. Further, if an FCM makes a pre-approved disbursement that exceeds the 25% threshold, the FCM would have to immediately file a written notice with CME that is signed by the FCM's CEO, CFO, or other qualified individual and includes a notification of the disbursement; the date(s) of the disbursement, the amount and amount(s) and recipient(s) of the disbursement; a description of the reasons(s) for the disbursements ‘the current estimate of the remaining total FCM residual interest in the customer segregated funds accounts; confirmations of authority; and a representation of continued compliance with CFTC segregation requirements. NFA has adopted similar rules restricting an FCM’s disbursements from customer accounts.

3. <u>Procedures that will facilitate monitoring of customer funds</u>

There are a variety of CME and/or NFA safeguards that will assist those DSROs in monitoring customer funds and an FCM's use (or misuse) thereof. For one, additional testing is required on all risk-based examinations of an FCM's disbursements of customer funds. Additionally, CME rules require that all FCM clearing members report to CME, on a daily basis, the FCM's computations for segregated funds, secured amount funds, and OTC cleared funds. With this information, CME is able to check for variances between such daily computations and month-end computations and will generally be better poised to monitor customer funds for potential unapproved disbursements. Moreover, an FCM's financial statements are analyzed on a monthly basis. This analysis includes trend analysis and an analysis of more than one standard deviation of certain balances. If an FCM violates segregation requirements for segregated customer funds, secured amount funds, or OTC cleared funds, the FCM will face enhanced exchange disciplinary penalties.

B. Mitigating the Risk of and Earlier Detection of Improper Reporting of Asset Balances Due to Errors or Fraud

With respect to mitigating the risk of and earlier detection of improper reporting of asset balances due to errors or fraud, CME and NFA have implemented a number of measures, most of which relate to: 1) confirmation of balances and 2) review of bank statements and certain FCM information.
CME's confirmation process with third-party depositories has been enhanced through use of an electronic confirmation service. This service allows CME to review balances held at bank depositories more efficiently and effectively than under the prior confirmation system. Among the specific types of balances that CME confirms through the new electronic confirmation service are: i) material customer cash balances for purposes of limited daily reviews; and ii) material balances in audit areas where full testing is performed for risk-based examinations.

Since December 2012, CME and NFA have taken e-confirmations to the next level by requiring third party depositories to provide view-only, online access to CME for account information for each of their segregated, secured 30.7 and cleared customer swap accounts on a daily basis. Both the NFA and CME have passed rules that will require FCMs to provide online access to their customer asset accounts at bank depositories in order to be considered a good segregated/secured 30.7/cleared customer swap account, as applicable. CME has signed an agreement with a service provider that aggregates all cash and custodian bank balances on a daily basis.

CME's FCM clearing members are required to authorize their banks to send this daily account information to the service provider, who, in turn, aggregates the information by FCM and sends it to CME on a daily basis. Once received, the Audit Department’s back-end system will process the data and run analytics to compare the data to the daily segregation statements submitted by each FCM. Audit staff will address any material differences between the aggregated third party cash and securities balances with the reports submitted by clearing member firms with FCM personnel.
By the end of 2013, CME will work with other DCOs and carrying brokers to provide daily account access in a similar manner. Similar analytics will be performed on these balances once CME receives them on a daily basis.

C. Ensuring Compliance with CFTC Requirements for Investments in Customer Funds

With respect to ensuring compliance with CFTC requirements for investments in customer funds, CME has implemented several measures. For one, CME requires the submission of semi-monthly SIDRs, which are reports detailing the type(s) of customer investments and depositories used for customer invested funds. CME performs limited reviews of the customer investments reported on the SIDRs to ensure compliance with the requirements of CFTC Rule 1.25. CME also performs detailed audit work on risk-based examinations, including a review of qualified depositories, third-party statements, reconciliations, mark-to-market schedules, valuation (readily marketable and highly liquid), obtaining confirmations, etc. Additionally, in April 2012, CME started performing limited reviews of customer segregated, secured and sequestered statements on a surprise basis outside of the regular risk-based examination.

These initiatives have resulted in tangible benefits to customers. As of February 7, 2013, CME has received 18,881 daily statements of customer funds balances[1] , 86 25% distribution notifications, 1323 segregated investment detail reporting[2], 1691 accounts reporting to online an vendor, and has conducted 57 limited daily reviews. This additional information allows us to better direct our DSRO resources at risk-based reviews of customer balances at our clearing member FCMs and their activity with respect to those balances.

III. Calculation of residual interest and capital charges to undermargined accounts

CME is fully committed to protecting customers against the full range of FCM conduct that may cause customer harm. But, it is important to weigh the costs and consequences of each protective measure against the benefit to the customers. If a "protective" measure is so expensive or if its impact on market structure is so severe that customers cannot effectively use futures markets to mitigate risk or discover prices, the reason to implement that measure needs to be reexamined.

Two elements of the Commission's proposals are likely to fail this test: the proposed rules that would: (i) require ***at all times*** an FCM's residual interest in its customer segregated accounts (firm excess) to exceed the margin deficiencies of its customers and (ii) assess capital charges to FCMs one day after a call for customer margin is not satisfied. These rules, if adopted, will have unintended negative consequences for our customers, especially those who use our agricultural markets, and for many of our clearing members and non-clearing FCMs that provide market access to those customers. It is also likely that these proposed rules will raise the overall level of risk to all participants in our markets.

First, it does not appear that any system currently exists or could be constructed in the near future that will permit FCMs to accurately calculate customer margin deficiencies, continuously, in real time.[3] Without access to such information, an FCM must either maintain a substantial residual interest in the various segregated fund pools or require customers to significantly over-collateralize their accounts. Assuming that a customer's required initial margin covers a one day move with a 99% level of confidence based on recent historical precedents and that one could disregard the fact that this level of confidence suggests that the loss will exceed the initial margin requirement once every 200 trading days, an FCM would be well advised to require each customer to deposit excess collateral at least equal to the required collateral. We believe that this will be a significant and unnecessary drain on liquidity that will make trading significantly more expensive for customers to hedge financial or commercial risks. The liquidity drain will be exacerbated to the extent that the demand for excess margin will increase the

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[1] This includes 8,859 segregated, 7222 secured, 2800 OTC accounts.
[2] This includes 621 segregated, 506 secured and 196 OTC accounts.

[3] For example, as an operational matter, today, FCMs are not able to calculate margin deficits at all times during the day and not even at the intra-day settlement cycles. The daily intra-day call made by the CME Clearing is an estimate of the day's market movements. Clearing members do not capture those intra-day estimates in their internal systems or systems interfacing with the CME Clearing. The firms would not be able to reconcile the clearinghouses intraday calculation to their individual customers' margin obligations, or predict how much of a potential margin obligation a particular customer may need to prefund.

costs and limit the activities of market makers. Ultimately, this increased cost to risk manage will get passed on to consumers in the form of higher commodity prices.

If FCMs respond to the proposed rule by increasing demands for the deposit of excess collateral, the proposal will have the ill effect of forcing customers, who are actively trying to avoid fellow customer risk and potential misuse of their funds at FCMs, to put more money and collateral in the hands of FCMs. This means that there would be more customer money at risk if another FCM were to disregard the CEA and CFTC's regulations precluding FCMs from using customer funds for their own purposes. For this reason alone, we believe that this proposal does not meet the necessary cost benefit test. Customers will be required to place substantial additional funds at risk for the exact type of misuse of funds that severely injured them in the MF Global and Peregrine Financial matters. The goal is to save them from fellow customer risk that might arise if customers defaulted on margin calls to an extent greater than could be covered by their mutual clearing member's capital—a circumstance that has never occurred. We hope that customer confidence in the system in this regard will improve as market participants become more fully aware of the effectiveness of the SRO rules enhancing transparency and oversight of funds held at the FCM level discussed previously, and will, on their own volition, be willing to hold more excess margin with their FCMs.

To the extent that the larger FCMs are able to use their own funds to fulfill the residual interest obligations under the proposed rules, we would expect this to result in significant competitive consolidation in the FCM community. Generally, the mid-size and smaller FCMs will not have the capital to cover the residual interest requirement, and will have no choice but to require their customers to pre-fund potential margin obligations. For the segment of customers attractive to the larger FCMs, those customers would likely transfer their accounts from the smaller FCMs to the larger ones because the cost of trading will be reduced. This may make it even more difficult for the mid-size and smaller firms to compete having a smaller and less diversified customer base.

We believe such consolidation could have a profound impact in the agricultural markets. Specifically, agricultural customers—farmers, ranchers and other commercial users —likely will not be able to transfer to the larger FCMs because they do not fit their customer profile. In our view, the cost of doing business in futures markets will increase measurably for this important segment of market participants because they will have no choice but to stay with FCMs that will require pre-funding of margin accounts, assuming that at least some of those FCMs stay in business.

Significantly, consolidation among FCMs, in our view, actually **<u>increases</u>** systemic risk in the system by concentrating risk among fewer market participants. **<u>Increased systemic</u>** risk should never be a consequence of regulation. We note that we already have seen a dramatic decline in the FCM community in the last 5 years as a result of the changing regulatory landscape and macro-economic conditions.[4]

Another unintended adverse consequence of the Commission's proposal is that the increase in cost to risk manage through trading futures may drive commercial end users into the uncleared OTC space. As the Commission knows, commercial end users transacting in swaps may exercise an exemption from any clearing (and trading) requirements. We are concerned that if it is too costly for these market participants to transact in the listed futures space, those who qualify as eligible contract participants can

[4] Based on our estimates, the industry has lost between 40-50 FCMs since December 2007.

move to an uncleared and less regulated swaps space and decline to use centralized clearing, even if they've been using it for years. They may also move to other markets or instruments for risk management and move completely out of the Commission's oversight. Increasing counterparty credit risk by declining to use centralized clearing where appropriate or increasing use of unregulated markets is contrary to Congress's objectives of reducing systemic risk.

We believe that the proposed change regarding when an FCM must take a capital charge for an undermargined segregation account has the potential to cause the same unintended adverse consequences that the proposed regulations on residual interest calculation would have. While we agree most customers do business with their FCMs by way of wire transfer, the change from three days to one day does not account for important operational issues such as differences in time zones, ACH settlements or the requirement to convert certain non-USD currencies. More importantly, a substantial number of less well capitalized customers – particularly in the agricultural community – continue to meet margin calls by check. Frequent wire transfers or pre-funding accounts may prohibitively raise the cost of doing business for these clients. We do not believe the Commission intends to push small farmers and ranchers, among others, out of the futures markets, and perhaps business entirely if they cannot find another cost effective means for managing their risk. Finally, if the residual interest calculation rules are adopted as proposed, the imposition of the charge seems redundant since the segregation account would need to be fully satisfied by the FCM before the time to take the capital charge hit.

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.

IV. Template Acknowledgment Letters

CME continues to support the Commission's efforts to strengthen and standardize the form of acknowledgement letters ("Template") that DCOs and FCMs must obtain from depositories holding customer funds pursuant to amendments to Regulations 1.20, 1.26 and 30.7, as may be applicable. We encourage the Commission to consider the written comments filed by depository and settlement banks with respect to the Template as highlighted at the Roundtable and relating to: standard of liability; permitted liens and offsets; immediate release of funds; and real-time access to information.

We also encourage the Commission to continue to further clarify the "exceptional circumstances" in which it may instruct a DCO or FCM depository bank to immediately release customer funds, and the resulting impact of such an instruction on the timely payment of obligations to the DCO.
In this regard, we are also concerned that such an instruction may be subject to challenge pursuant to Section 6c of the CEA. We assume that any action by the Commission to require the transfer of customer funds would be based on the Commission's determination that the DCO or FCM is violating or is about to violate the provisions of the CEA or the Commission's rules intended to protect customer funds. However, the CEA does not authorize the Commission to act in this matter *sua sponte*.

Rather, Section 6c of the CEA instructs the Commission "[w]henever it shall appear to the Commission that any registered entity or other person has engaged, is engaging, or is about to engage in any act or practice constituting a violation of any provision of this Act or any rule, regulation, or order thereunder," to "bring an action in the proper district court of the United States … to enjoin such act or practice, or to enforce compliance with this Act, or any rule, regulation or order thereunder." Section 6c further provides that an order "which prohibits any person from withdrawing, transferring, removing, dissipating, or disposing of any funds, assets, or other property" may be issued *ex parte*.

We believe that section 6c sets out the procedures that the Commission must follow before seeking to transfer customer funds held by a DCO or FCM. These procedures provide for prompt resolution of the issues, while vesting a court, not the Commission, with the authority to determine whether a DCO or FCM should be entitled to be heard before an order is issued. We urge the Commission to consider carefully its statutory authority to adopt this provision.

V. Proposed Changes to Regulation 1.52: Self-regulatory organization adoption and surveillance of minimum financial requirements

CME supports the CFTC's goal of evaluating whether any changes should be made to the risk-based evaluations currently performed on FCMs. CME, in conjunction with the JAC and the CFTC, regularly reviews its procedures and makes changes to those procedures so that they are continually evolving and improving. In the last year alone, substantial enhancements have been implemented to the JAC protocols, including a number of changes included in the current proposal. To the extent additional changes are necessary, CME will continue to work with the CFTC, JAC, and interested parties to evaluate and implement appropriate changes to the procedures.

Rather than seeking focused changes to the current regulatory structure, the CFTC proposes fundamental changes to Regulation 1.52. While these changes may have been intended to address perceived weaknesses in the current regulations, in actuality they serve little regulatory purpose while imposing significant costs. Indeed, the proposed changes fundamentally change the nature of the reviews performed by SROs and DSROs and, in so doing, threaten the viability of the current regulatory structure. CME's particular concerns regarding the proposed changes to Regulation 1.52 are detailed below.

A. The proposed changes to Regulation 1.52 improperly conflate the roles played by an FCM's outside auditor and its regulatory examiners

One of the primary strengths of the current regulatory scheme is that SROs and DSROs play a role distinct from, yet complimentary to, that played by an outside auditor. Rather than simply replicating the work performed by outside auditors, the SROs and DSROs perform limited reviews that focus on particular areas of regulatory concern, including the segregation of customer funds and net capital requirements. The current proposal greatly expands the scope of the regulatory reviews by requiring the examination of the entirety of an FCM's financial statements. This requirement is not only extremely costly, but it imposes such costs without any demonstrated regulatory need. Some of CME's particular concerns in this regard are as follows:

- The proposal defines material weakness to cover potential misstatements not just in an FCM's regulatory computations, but also in its "financial statements." The limited regulatory exams are not designed, nor should they be, to examine and assess all aspects of an FCM's financial statements. Rather, the focus should be solely on material weaknesses in an FCM's regulatory computations. Material weaknesses as they relate to an FCM's financial statements currently are, and should remain, the responsibility of an FCM's external auditor.

- The proposed rule provides: "The supervisory program must be based on controls testing as well as substantive testing and must address all areas of risk to which futures commission merchants can reasonably be foreseen to be subject." This language is hopelessly vague, and would leave an SRO or DSRO in the difficult position of guessing as to what areas of risk it should focus its efforts. In addition, it would cause regulatory exams to expand into areas outside the direct purview of the exams. Not only would it require duplicating the work of an external auditor, but the language is so broad that it actually conflicts with the requirement to follow the standards of GAAS and the PCAOB (neither of which contemplates such a far reaching review). In short, this requirement increases cost with no demonstrated regulatory benefit.

- In discussing the role of the examinations expert, the proposal would require an opinion that the supervisory program is reasonably likely to identify a material weakness in internal controls over "financial and/or regulatory reporting and in any of the other items that are the subject of the examination." This language is too broad. As noted above, the limited regulatory exams are not designed, nor should they be, to identify material weaknesses in internal controls over financial reporting. That is the role of the external auditor. To the extent the Commission wants to add requirements regarding the monitoring of external controls, those requirements must be limited to the regulatory role of the SROs and DSROs.

Any concerns regarding the efficacy of the work performed by an FCM's external auditor should be addressed by tightening the requirements for external auditors, not by expanding the role of the SRO or DSRO.

B. The supervisory programs should not be required to conform to GAAS or auditing standards prescribed by the PCAOB

The proposed changes would require that the supervisory programs comply with GAAS "after giving full consideration to those auditing standards as prescribed by the [PCAOB]." This requirement is problematic in a number of ways, and CME believes the requirement should be stricken from the final rule.

By simply referencing GAAS and the PCAOB, the regulation is vague and provides insufficient detail on exactly what standards should be utilized by an SRO or DSRO. This problem is compounded because it is unclear what is meant by "full consideration" of PCAOB standards. As the Commission is aware, Generally Accepted Auditing Standards include the three General Standards, the three Standards of Field Work, and the four Standards of Reporting. These 10 basic standards provide little actual guidance and, therefore, auditors must turn to the more detailed standards provided by the AICPA or the PCAOB. The AICPA standards are established by its Auditing Standards Board (ASB) and codified in its Statement of Auditing Standards (SASs). The AICPA Code of Professional Conduct requires AICPA members who perform audits to comply with all standards promulgated by the ASB. Similarly, the PCAOB has adopted its own auditing standards – AS No. 1 through AS No. 16 – which have been approved by the SEC. In addition, the PCAOB adopted certain of the AICPA standards as its own interim standards. Both the AICPA and PCAOB also require auditors to consider interpretive publications. Under SAS No. 95, interpretive publications are not auditing standards, but rather are recommendations on the application of SASs in particular circumstances. Nonetheless, auditors may be required to be familiar with relevant interpretive publications and at least consider them in performing certain audits. Finally, SAS No. 95 also references other auditing publications, such as professional journals and auditing publications from state CPA societies. While these publications have no authoritative status, they are utilized by auditors as appropriate to understand and apply the SASs. Given this framework, to simply invoke GAAS and PCAOB standards opens up a complex and detailed regulatory structure which was not designed to address the regulatory function played by an SRO or DSRO.

The proposed regulations would leave SROs and DSROs in the impossible position of guessing what portions of GAAS or PCAOB standards must be applied. Indeed, the proposal would appear to impose standards that are inappropriate, and at times nonsensical, for the limited reviews performed by SROs and DSROs. While a detailed review of SASs and the PCAOB Auditing Standards would reveal scores of problems with the approach proposed by the CFTC, here are a few illustrative examples:

- AS No. 16 addresses communications with an audit committee. This presumably would apply since the proposed regulation specifically requires communications with an audit committee. AS No. 16, however, includes a number of specific requirements which make no sense in the context of the reviews performed by SROs and DSROs. For example, AS No. 16 requires specific information to be communicated to an audit committee that is not the appropriate role for an SRO or DSRO. This includes reports related to significant accounting practices and policies, accounting estimates, unusual transactions, financial statement presentation, new accounting pronouncements, alternative accounting treatments, and a going concern opinion. Each of these requirements makes sense for an external auditor, but has no applicability to the limited role played by an SRO or DSRO.

- AS No. 7 requires an engagement quality review and concurring approval of issuance for each audit engagement conducted pursuant to the standards of the PCAOB. AS No. 7 further requires that the engagement quality reviewer must be an associated person of a registered public accounting firm, and then provides very detailed requirements for such a review. This requirement has no applicability to the reviews conducted under regulation 1.52, and it is not even clear that the CFTC believes such a requirement should apply. But the current proposal could certainly be read to require an engagement quality review for each regulatory exam.

- The proposed regulations have a specific independence requirement. However, it is unclear whether the CFTC believes that the independence requirements prescribed by the AICPA and the PCAOB would apply to SRO and DSRO reviews. Independence, as that term is used in SAS No. 1, far exceeds what is necessary or workable for an SRO. In particular, Section 100 of AICPA's Code of Professional Conduct provides detailed rules for external auditors to follow. Many of these requirements make no sense in the context of an SRO or DSRO, and in fact it may be difficult if not impossible for an SRO or DSRO to be "independent" as that term is used by the AICPA and PCAOB.

Should the CFTC push forward with this proposal, the costs on SROs and DSROs would be substantial. By both expanding the scope of the regulatory exams and imposing the requirements of GAAS and the

20 South Wacker Drive Chicago, Illinois 60606 T 312 930 3156 F 312 634 1553 kim.taylor@cmegroup.com cmegroup.com

PCAOB, the proposal would in essence require SROs and DSROs to replicate the role of an external auditor. SROs and DSROs are not staffed to play such a role, nor should they be. CME notes that, according to the 2012 Audit Fee Survey, the average man-hours for audits was 17,457 for public companies and 1,951 for private companies. If the duties of an SRO are expanded to cover the financial statements as a whole, and the SRO must follow GAAS and PCAOB standards, it goes to reason that the level of effort required will be somewhere in that range. In addition, CFTC estimates the cost of developing the new policies and procedures as between $20,700 and $31,000 per SRO, based on 160 to 240 hours from both a compliance attorney and a senior accountant. This estimate grossly underestimates the costs, and seems completely disconnected from the actual changes being proposed. In actuality, SROs and DSROs would be required to develop expertise in both GAAS and PCAOB auditing standards and develop the processes and systems to implement the requirements. Public accounting firms spend millions of dollars annually to establish and maintain their attested practices and to be able to provide services in accordance with GAAS and PCAOB requirements. Establishing such a program from scratch will be even more difficult and expensive. Simply put, the costs of the rule as proposed – both in terms of developing the necessary systems and procedures and in terms of expanding the size and expertise of the audit departments – is prohibitively expensive. In the end, if the CFTC believes that particular provisions of SASs or the PCAOB Auditing Standards, or the various interpretations of those standards, should be carried into the JAC protocols, they can be addressed through the current regulatory structure. But the approach should be focused on the particular needs of the industry, with the goal of only pulling in very specific aspects of GAAS or PCAOB standards.

C. The proposed changes potentially expand who may use and rely on the regulatory exams

Under Regulation 1.52 as it currently stands, regulatory exams play an important, *but limited*, role. That role is limited to the particular regulatory needs under the CEA. Unlike the role played by an external auditor, the regulatory review is not intended to be relied on by the FCM, its investors, or third parties. CME believes that this structure is appropriate, and opposes any changes to regulation 1.52 which could be read to expand the role and use of the regulatory exams. In particular:

- In describing the benefits of the proposed changes to regulation 1.52, CFTC states that changes "would provide significant additional protection to FCM's counterparties, investors, and customers by ensuring that SRO audits of member FCMs are thorough and effective." This language illustrates CME's concerns with the changes – the regulatory reviews are not designed to protect investors in FCMs, nor should they be.

- The proposal requires the supervisory program to have standards addressing "[c]ommunications between an examiner and a futures commission merchant's audit committee of the board of directors or other similar governing body." CME does not believe it is appropriate to have an SRO or DSRO report to an FCM's audit committee or other similar governing body. SROs and DSROs play a regulatory role, and it is no more appropriate to have them report to an audit committee of a company than it would be to have the CFTC itself report to an audit committee. This requirement is particularly troubling in light of the other comments above regarding the proposed expansion in the areas addressed by the regulatory exams.

- As mentioned above, the proposed incorporation of GAAS and/or PCAOB standards could be read to impose certain reporting obligations on an SRO or DSRO. In addition, the proposal specifically requires the development of standards addressing "required items for inclusion in the examination report." CME does not believe that any formal reporting standards, under GAAS or otherwise, are appropriate in the context of a regulatory exam by an SRO or DSRO. CME suggests that that any such requirement should be removed from the final language of the rule. To the extent that the CFTC continues to believe that a formal report is necessary, that report should be limited in its distribution to just the FCM and the CFTC. In addition, the regulations should clarify that the report is a restricted-use report and is intended solely for the use of the CFTC (but not for the FCM itself to rely on).

D. The examination expert does not add sufficient value to the SRO or JAC program to justify the costs of such evaluations

CME supports the concept behind this proposal, and believes that it is a good idea to bring as much expertise as possible to the development of JAC protocols. This should be done, however, through the current JAC process so that any identified examinations experts can assist the JAC in reviewing and refining its protocols. Such a process will achieve the benefits the CFTC is looking for without the substantial costs and problems the current proposal creates. In particular, CME has the following concerns regarding the current proposal for an examination expert:

- It may be very difficult to find a qualified examinations expert, as this is not a traditional area of expertise for an accounting firm. But even if someone with the relevant experience is identified, that person may not be willing to issue a report in the form required by the regulations. In particular, CME suspects that there will be difficulty getting an opinion that "the supervisory program is reasonably likely to identify a material weakness in internal controls over financial and/or regulatory reporting and in any of the other items that are the subject of an examination conducted in accordance with the supervisory program." Indeed, it is not even clear that an audit firm could issue such an opinion under the existing audit, attestation and consulting standards.

- Obtaining such a review would likely be extremely expensive. CME notes that the CFTC has failed to provide any estimate of the cost of this proposal. This failure is particularly problematic given that the benefits could be obtained in a much cheaper and more efficient manner – *i.e.*, simply by including such an expert in the current process used to develop JAC protocols. CME supports including such experts into the JAC process, and believes that inviting them to JAC meetings would provide the benefits without unnecessary costs. In addition, it is much more likely that CPA firms would be willing to participate in the JAC process as opposed to providing a formal opinion.

- The costs of obtaining such a review are also unnecessary because the CFTC already plays that role and should continue to play that role. CFTC staff currently participate in all JAC meetings, and also reviews regulatory exams on a quarterly basis. The proposed rule fails to explain why, given the oversight already provided by the CFTC staff, this additional layer of review is necessary or appropriate.

- The proposal requires the submission of the supervisory program and the examination expert's report within 120 days of the effective date. This timeframe is not realistic given the drastic changes suggested by the Commission. Should the CFTC press forward with the rule as proposed, 18 months is the minimum that will be required for the new programs to be developed and reviewed by an examination expert. SROs would also need the ability to seek exemptions from this requirement should it prove impossible to find a CPA firm willing to provide the requested opinion.

- The proposal requires SROs to obtain an examinations expert report at least every two years. This is too often. CME suggests that, if the CFTC requires such a review, once every 3 ½ years is sufficient. This is a similar time frame used by the AICPA in its Peer Review program.

E. The supervisory program should not be expanded beyond its current scope

The proposal appears to expand the scope of the supervisory program into areas including risk management, financial reporting and sales practices. It is unclear what the CFTC means by this requirement, what would be required to address these areas, and how any program overseeing such areas would, in practice, be implemented. This is particularly true given that the proposal also requires the supervisory program to cover "other compliance requirements." It is not clear what this is a reference to, why the CFTC feels it is necessary, or how it could possibly be implemented. The supervisory program should remain focused on the areas on which it is currently focused otherwise the current proposal will only force SROs and DSROs to divert limited resources which are best focused elsewhere.

F. CME should not be required to adopt rules prescribing minimum financial and related reporting requirements for registered introducing brokers

Introducing brokers are not clearing members of CME. They are currently subject to the financial requirements of their primary regulator, NFA. CME believes this structure is appropriate, and should not be changed. Nor should CME be required to expand its supervisory program to cover introducing brokers. Again, the oversight of such entities should be left to NFA.

VI. Regulation 1.11 Risk Management Program for Futures Commission Merchants

CME notes that proposed Regulation 1.11.e.1, Identification of risks and risk tolerance limits, requires the FCM to identify a variety of market, credit, liquidity, and other risks, and to capture and formulate these risks in formal risk tolerance limits in its written policies and procedures. FCMs typically negotiate service standards with clients in customer agreements. In formulating customer agreement standards with clients, CME understands that different client relationships represent different risk profiles to the FCM, and the FCM is best positioned to assess reasonable risk management standards with individual client relationships. Nonetheless, CME recommends that the regulation specify that risk management standards negotiated between the FCM and individual clients must be reasonable and not overly restrictive, and should not otherwise impede the ability of the FCM to reasonably and adequately manage its risk to individual clients.

VII. Conclusion

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.

CME Group thanks the CFTC for the opportunity to comment on this matter. We would be happy to discuss any of these issues with CFTC staff. If you have any comments or questions, please feel free to contact me at (312) 930-3156 or Kim.Taylor@cmegroup.com, Anne Bagan, Managing Director, Audits at (312) 930-3140 or Anne.Bagan@cmegroup.com or Christal Lint, Executive Director and Associate General Counsel, at (312) 930-4527 or Christal.Lint@cmegroup.com.

Sincerely,

Kim Taylor

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
Mr. Kevin Piccoli, Deputy Director, Division of Swap Dealer and Intermediary Oversight
Mr. Ananda Radhakrishnan, Director, Division of Clearing and Risk
Mr. Thomas Smith, Deputy Director, Division of Swap Dealer and Intermediary Oversight
Mr. Robert Wasserman, Chief Counsel, Division of Clearing and Risk

20 South Wacker Drive Chicago, Illinois 60606 T 312 930 3156 F 312 634 1553 kim.taylor@cmegroup.com cmegroup.com