February 18, 2013

Ms. Melissa Jurgens
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Via Online Submission

SUBJECT: RIN 3038-AD388

Re: Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations

Dear Ms. 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 November 14, 2012 Federal Register Vol. 77, No. 220.

MGEX is both a Designated Contract Market ("DCM") and Derivatives Clearing Organization ("DCO") and 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 Overview

MGEX supports the Commission's attempts to create regulations which help promote efficient markets that will encourage unflinching market participant confidence and consumer protection; especially following the futures commission merchant ("FCM") insolvencies and failures of risk management.[1] However, the Exchange contends that some of the regulations in the proposed rulemaking may miss the mark and have negative unintended consequences which may actually lead to less consumer protection and, therefore, less confidence in the U.S. futures industry. Therefore, MGEX respectfully submits the following comments.

[1] 77 FR 67866, 67868 (Nov. 14, 2012).

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FCM and IB Reporting

The proposed rulemaking provides requirements for Futures Commission Merchants ("FCM") and/or Introducing Brokers ("IB") within sections 1.10; 1.11; 1.12; 1.15; 1.16; 1.17; 1.20; 1.23; 1.26; 1.32; 22.2; 22.17; and 30.7 with respect to filing reporting and notices whereby the Commission appears to only contemplate a single designated self-regulatory organization ("DSRO") by only requiring the FCM to file such reports and notices to the Commission and the DSRO. Only requiring FCMs to file with the DSRO may implies that self-regulatory organizations ("SRO") must have a relationship with the named DSRO. Under the current Joint Audit Program of the Joint Audit Committee ("JAC"), SROs willingly agree to have a named DSRO. However, current regulations do not make that a per se requirement. SROs are not, and should not, be required to join a joint audit committee or its related joint audit program. Therefore, while there may be efficiencies gained by participating in such arrangement, it should not be required in case the efficiencies might not be realized. While MGEX substantially supports the concept of the JAC and DSROs, the Exchange cautions the Commission against creating a regulatory monopoly and instead should offer the flexibility for SROs to choose whether to enter into a joint audit committee and DSRO relationship. Should the Commission want to create a regulatory monopoly, then the CFTC should also create some limitations and controls, including but not limited to the costs allowed to be assessed by the DSRO – which should be minimal. MGEX proposes that since all reports and notices mentioned above are required to be sent to the CFTC, that the Commission, as the collector and repository, should share such information with all SROs – perhaps through a portal regime such as those already employed by the Commission or CME's Winjammer. Utilizing this system and technology would ease the burden on the reporting entities, provide less opportunity for scriveners errors, and provide all interested parties with equal and current information. In the alternative, the Exchange proposes the Commission consider more flexible regulatory language to account for SROs who do not have a relationship with the DSRO.

1.20 – Futures Customer Funds to be Segregated and Separately Accounted For

Proposed regulation 1.20(i)(4) requires an FCM "at all times maintain residual interest in segregated funds sufficient to exceed the sum of all margin deficits that the futures customers of the futures commission merchant have in their accounts."[2] The requirement is echoed in proposed regulation 1.22(a). Requiring such treatment of residual interest incorrectly puts futures regulations substantially the same as it is in Part 22 regarding swaps. This requirement for futures incorrectly blurs the line between the regulatory regimes. Furthermore, requiring FCMs to maintain residual interest "at all times" to exceed the sum of all margin deficits may be impracticable as it is a constantly moving target.

In addition, proposed 1.20(g)(4) requires DCOs to "obtain a written acknowledgement from each depository prior to or contemporaneously with the opening of a futures customer funds account."[3] The Commission proposes using a standard form and places access and timing information requirements on the banks. The proposed requirements are a dramatic shift from the bank or trust company having to

[2] 77 FR 67866, 67941 (Nov. 14, 2012).
[3] *Id*. at 67940.

acknowledge that the funds are customer funds. The Exchange is uncertain as to which banks and trust companies, if any, would be willing to sign such an acknowledgement letter. Those which might be willing to sign such would likely only do so at a significant cost to offset the operational requirements and liabilities created. The Exchange respectfully suggests that the form be permitted to have flexibility in order to allow for greater likelihood for a larger number of banks and trust companies to agree to the terms.

The Commission estimates the costs associated with moving bank or trust company accounts (between $50,000 and $102,000); the cost of obtaining from an existing relationship (between $1,300 and $4,300 per account), ongoing monitoring costs (between $1,100 and $2,800 per year) as well as the access costs (between $270 and $550 per account).[4] These costs are significant and outweigh the proposed benefit. Further, the estimates appear low compared to the ongoing costs associated with providing such access. Further, the costs will likely be heightened due to the potentially considerable narrowing of options of banks and trust companies willing to sign such restrictive acknowledgment letters.

1.30 – Loans by FCMs: Treatment of Proceeds

Proposed regulation 1.30 prohibits an FCM from loaning funds to finance a customer's trading account on an unsecured bases or from accepting a customer's trading account as collateral for the loan. Together, proposed 1.20 and 1.22 above along with proposed 1.30 will force FCMs to require well over 100% collateral from their customers in order to ensure that margin calls will be met. This model is a drastic shift in the FCM business. In an era where protecting customer funds from malfeasance is at an all time high, requiring customers to deposit more money at FCMs is a step in the wrong direction. None of the recent FCM failures have risen from customers defaulting on obligations to their FCM. Therefore, it seems to be adding regulations where there is not a problem. However, the costs associated with proposed 1.30, 1.20 and 1.22 may force many market participants who have legitimate hedge needs out of the futures market. This outcome would be a tragic unintended consequence of regulations intended to reduce market participants risk.

1.52 – SRO Surveillance

As stated above, the various goals of these regulations are laudable and MGEX wholly supports taking measures to prevent malfeasance in the futures industry. However, MGEX believes the Commission is creating substantial additional expense without providing a comparable benefit. First, it remains unclear whether there is a need for an SRO or audit program of a joint audit committee to be reviewed by an "examinations expert" as called for under proposed regulation 1.52(c)(2). The Commission wants the "examinations expert," as defined by proposed 1.52(a), be limited to a "nationally recognized accounting and auditing form with substantial expertise in audits of FCMs, risk assessment and internal control reviews, and is someone acceptable to the Commission."[5] However, as is the case today, all audit programs must also be submitted to the CFTC for review under proposed 1.52(d)(2)(ii)(H). Therefore, unless

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[4] *Id*. at 67914-15.
[5] *Id*. at 67891.

the Commission is acknowledging that it does not have the capabilities to adequately determine whether an audit program is sufficient, having an “examinations expert” also review the program is redundant and an extremely inefficient use of capital. Further, there is the outstanding question of who would be funding the examination. The JAC has worked with the Commission with regards to its joint audit program and has the intention on continuing to do so. The collaborative effort of the CFTC and the JAC should offer much better insight and experience pertaining to risk reviews without requiring bi-annual audits of the audit program by external examination experts. The Exchange proposes that the most efficient use of time and resources would a renewed commitment from both JAC members and the CFTC to continue to look for and together toward best practices pertaining to the audit program. Furthermore, in the case of a joint audit program, the “examinations expert” is unnecessary because each member of the joint audit program has a vested interest in the program’s success and accuracy and, therefore, there is an effective and intrinsic internal quality control taking place. This is evidenced by the continual review done by the JAC of its audit program, which is still required to be done on at least an annual basis pursuant to proposed regulation 1.52(d)(2)(iii). Therefore, while MGEX understands the need for periodic review of the program to ensure its continued sufficiency, the Exchange does not believe a third party is needed to perform such review and that the CFTC does and should continue to be an active party in performing such reviews. In summary, the proposed requirement of bi-annual reviews by an “examinations expert” would lead to needless and extensively costly burdens without providing a benefit that is otherwise already accomplished more effectively.

However, if an “examinations expert” is required, MGEX does not believe that the term “nationally recognized” is a viable expression of who would qualify. There are many highly qualified accounting and auditing firms that are regional. It is unclear whether they would qualify as “nationally recognized.” Further, MGEX believes that the proposed requirements should not be limited to only accounting and auditing firms. The more competition the Commission allows into this space, the more likely the costs will be manageable – although, as expressed above even with this change the cost/benefit ratio is suspect at best.

As the Commission notes, it “does not have adequate information to determine the ongoing cost of the proposed requirements for SROs and DSROs” in relation to the proposed 1.52[6]. The Commission also notes that “Section 15(a) of the [Commodity Exchange] Act requires the Commission to consider the costs and benefits of its actions before promulgating a regulation under the Act or issuing certain orders.[7]” By the Commission’s own words, this analysis has not been done regarding the proposed changes to regulation 1.52. Therefore, at least until such analysis can be done, MGEX urges the Commission to withdraw proposed regulation 1.52.

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) 321-7128 or edelain@mgex.com. Thank you for your attention to

[6] *Id.* at 67902.
[7] *Id.* at 67899.

this matter.

Regards,

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