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CHICAGO MERCANTILE EXCHANGE INC.

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COMMENT

April 10, 2001

Ms. Jean A. Webb
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

Re: Opting Out of Segregation

Dear Ms. Webb:

Chicago Mercantile Exchange Inc. ("CME") is pleased to offer comments on the Commission's new rule regarding "opting out" of segregation. The rule allows futures commission merchants ("FCM") the ability to offer certain customers trading on or through a registered derivatives transaction execution facility ("DTEF") the right to elect not to have their margin or performance bond funds that are being carried by the FCM separately accounted for and segregated. While CME supports the rulemaking, we believe that the proposal fails to provide an opportunity for eligible contract participants trading on a designated contract market ("DCM") to also opt out of segregation so long as all of the same conditions required by new Rule 1.68 are satisfied. In addition, CME does not agree with the Commission's characterization of parties deciding to opt out of segregation.

New Rule 1.68 provides that an FCM shall not segregate a customer's funds where: (i) the customer is an eligible contract participant; (ii) the funds are deposited with the FCM for purposes of trading on a registered DTEF; (iii) the DTEF has authorized the FCM to permit eligible contract participants to elect not to have funds segregated; and (iv) there is a written agreement signed by the customer in which the customer elects to opt out of segregation and acknowledges that it is aware of the consequences of not having its funds segregated.

An eligible contract participant is defined at Section 1a(12) of the newly-amended Act and includes, among other individuals and entities, floor brokers and floor traders. In its justification for allowing eligible contract participants to opt out of segregation, the Commission states that it recognizes that eligible contract participants (including, floor brokers and floor

traders) "are sophisticated customers and as such may not require the same level of protection as retail customers."

Floor brokers and floor traders (i.e., eligible contract participants) trading on a DCM are as equally "sophisticated" as floor brokers or traders trading on a DTEF. In fact, many floor brokers and floor traders trading on a DTEF will, in all likelihood, be the same individuals trading on a DCM. Accordingly, from a participant's perspective, floor brokers and floor traders trading on a DTEF and floor brokers and floor traders trading on a DCM are indistinguishable. In addition, the other requirements of new Rule 1.68 could also be easily satisfied by eligible contract participants trading on or through a DCM. For example, a DCM could authorize FCMs to permit eligible contract participants to elect not to have their margin or performance bond funds segregated and the DCM could also require that a written agreement signed by the customer opting out of segregation be obtained by an FCM.

Although the types of individuals and entities eligible to trade on a DTEF is more limited than those eligible to trade on a DCM, the type of customer that is the subject of new Rule 1.68 is very narrow. For that reason, the applicability of new Rule 1.68 should not be limited to eligible contract participants trading on a DTEF. In fact, under the Commodity Futures Modernization Act of 2000, a DCM is actually subject to greater regulatory scrutiny than a DTEF. A DTEF is subject to, and must remain in compliance with, nine core regulatory principles established by the Commission. However, a DCM is subject to, and must remain in compliance with, eighteen core regulatory principles established by the Commission. Accordingly, the Commission should have at least an equal, if not a greater degree of comfort in allowing eligible contract participants trading on a recognized contract market to decide to opt out of segregation.

The Commission's proposal also states that, to the extent that a customer has a claim against the estate of an insolvent FCM in connection with trades for which it has opted out of segregation, the customer would not be entitled to the normal customer priority in bankruptcy and would be treated as a general creditor of the FCM. Such an approach is not consistent with the way "customers" have received preferential treatment in the past with respect to FCM insolvencies.

Section 190.08(a) of the CFTC's bankruptcy regulations describe in detail the scope of the customer property which is eligible for distribution to "customers." The effect of section 190.08(a) is to subordinate the claims of non-public customers to those of public customers in a commodity broker insolvency. Since insiders such as general partners, officers, directors and 10% shareholders may only hold proprietary or non-public customer accounts with respect to the entities to which they control, the accounts of such individuals are not subject to segregation under the Commodity Exchange Act and the regulations promulgated thereunder because segregation is only required for or on behalf of a public customer, which by definition cannot be

a proprietary customer. In addition, section 190.08(b) of the CFTC's bankruptcy regulations provides that no portion of the customer estate be allocated to pay non-public customer claims until all public customers have been satisfied in full.

The Commission's bankruptcy regime has historically provided a preference for claims of customers, public or non-public, over claims of general creditors of an insolvent FCM. Within the class of "customer," however, public customers receive preferential treatment over non-public customers. In its most basic form, a "public customer" is a person who opens up a trading account at an FCM to trade futures contracts for his or her own account. A "non-public customer" is defined at section 1.3(y) of the regulations and includes general partners, officers, directors and 10% or greater shareholders of an FCM.

An individual or entity that opts out of segregation should neither be treated as a public customer nor as a general creditor in the event of an FCM insolvency. By voluntarily opting out of segregation, such an individual or entity makes an affirmative choice not to receive the benefits of segregation. Accordingly, as a matter of public policy, the benefits of segregation should not be available to a party opting out of segregation. However, the Exchange also believes that opting out of segregation should not subject such a party to less favorable treatment than the proprietary accounts of the FCM.

The Exchange believes that an individual or entity that is a "customer" on one day and then opts out of segregation on the next day more closely resembles a non-public customer than a general creditor in the event of an insolvency at an FCM. General creditors of an insolvent FCM could include the gas and electric companies, food vendors, newspaper and magazine companies and bookkeeping services. The most equitable and consistent treatment for parties opting out of segregation is to treat them as non-public customers for purposes of an FCM insolvency.

CME appreciates the opportunity to offer its comments to the Commission regarding its proposal designed to allow certain parties to opt out of segregation.

If you have any questions regarding this comment letter, please call me at (312) 930-3100.

Sincerely,