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COMMENT

Chicago Board of Trade

OFC. OF THE SECRETARIAT

December 4, 2001

Ms. Jean A. Webb	Mr. Jonathan G. Katz
Office of the Secretariat	Secretary
Commodity Futures Trading Commission	Securities Exchange Commission
1155 21st Street, N.W.	450 Fifth Street, N.W.
Washington, D.C. 20581	Washington, D.C. 20549-0609

RE: File No. S7-17-01 (66 Fed. Reg. 50786, dated October 4, 2001)
Applicability of CFTC and SEC Customer Protection, Recordkeeping, Reporting, and Bankruptcy Rules and SIPA to Accounts Holding Security Futures Products

Dear Ms. Webb and Mr. Katz:

Chicago Mercantile Exchange Inc. and the Board of Trade of the City of Chicago, Inc. ("CME" and "CBOT®" respectively, or together, the "Exchanges") are pleased to offer comments on a proposal published by the Commodity Futures Trading Commission and Securities and Exchange Commission ("CFTC" and "SEC" respectively, or together, the "Commissions") regarding certain customer protection, recordkeeping, reporting, and bankruptcy rules relating to accounts holding security futures products ("SFPs").

CME and the CBOT applaud the efforts of the Commissions, as directed by the Commodity Futures Modernization Act of 2000 ("CFMA"), to avoid duplicative or conflicting regulations that may apply to an entity that is a Full Futures Commission Merchant ("FCM")/ Full Broker-Dealer ("BD") as a result of overlapping regulations applicable to SFPs. Since the Commodity Exchange Act ("CEA") requires customer funds be segregated and separately accounted for by FCMs and the Securities Exchange Act of 1934 ("Exchange Act") requires that securities accounts be subject to special reserve requirements and the Securities Investor Protection Act of 1970 ("SIPA"), overlapping and costly regulation is a potential for SFPs.

The Commissions' willingness to allow industry representatives to develop a model disclosure document for SFPs that discusses segregation and SIPC protections, instead of using a prescribed disclosure, is admirable. Also, the Commissions' desire to maintain consistent reporting and recordkeeping procedures that follow the type of account in which the SFPs are held is a benefit to industry participants. However, the Exchanges believe that other aspects of the proposed rulemaking should be modified. Areas where the proposed rules should be modified are discussed below.

Futures Account or Securities Account - The Commissions' effort to adopt new rules that would allow a Full FCM/Full BD to choose (or let its customers choose) whether an account in which SFPs are held will be treated as a futures account subject to the segregation requirements of the CEA or as a securities account subject to special reserve requirements and SIPC is commendable. Unfortunately, the perception of flexibility is, in reality, unlikely to be available to Full FCMs/Full BDs or their customers. Full FCMs/Full BDs carrying SFPs for customers will be compelled to carry SFPs in a securities account to the detriment of the futures industry.

In a Federal Register release dated October 4, 2001, the Commissions published for comment "Customer Margin Rules Relating to Security Futures." In that release, the proposed regulations suggest that the Commissions' approach to account administration practices "which is reflected in the proposed rules, would require that Regulation T apply to financial relations including margin arrangements, between a creditor and a customer with respect to security futures contracts that are used to offset positions in security futures." Regulation T establishes and defines the various types of accounts where securities subject to Regulation T may be carried and held. These accounts include the Margin Account, SMA, the Good Faith Account, the Broker-Dealer Credit Account and the Cash Account.

The Exchanges are concerned to the extent that the customer margin proposal represents a wholesale application of Regulation T account administration practices without regard to prevailing futures account administration practices which are fundamentally different than those applied to a securities account. These differences are based upon the fact that futures systems are debt free mechanisms while the stock margin system provides for extensions of credit.[1]

Unfortunately, through the margin proposal, the Commissions are attempting to force-fit a futures product into a securities system, thus creating a product that, in all likelihood, may be unrecognizable as a futures contract. It will be operationally difficult or impossible to carry SFPs in a standard futures account without costly and time-consuming reprogramming. In reality, any perceived flexibility provided by the Commissions in allowing a Full FCM/Full BD to carry security futures products in a futures account or a securities account is illusory.

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[1] A futures margin is fundamentally unlike a security margin. A stock margin represents a down payment on an equity interest in a corporation. But an equity interest in the instrument underlying a futures contract is not conveyed when one enters a long or short futures position. Rather, one has simply entered into a commitment to buy or sell in the future. Thus, the term "performance bond" is a more apt term than "margin" to describe the monies used to secure a futures position.

Further, the Commissions' margin proposal leave numerous unanswered questions regarding the extent to which security account administration practices must be applied in the context of a futures account carrying SFPs. For example, the Commissions are silent with respect to the application of the truth in lending rules; or, with respect to day trading rules applicable to maintenance margins as prescribed by New York Stock Exchange and Nasdaq rules. This magnifies the risk of potentially costly errors or oversights on the part of back office operations specifically within the futures community.

Not only do the proposed regulations appear to force-fit security futures into a securities framework but they would require "any related securities or futures contracts that are used to offset positions in such security futures" to be carried in the same securities style account. Thus, futures and options on futures based on non-narrow based equity indexes could likewise become subject to the same security style account framework., or if held in a standard futures account, become unavailable for the purposes of availing the Commissions' strategy-based margin breaks.

Customer Acknowledgement - The Commissions are proposing that a Full FCM/Full BD obtain a signed acknowledgment from a customer trading SFPs so the customer understands which protections (segregation or SIPC) apply to its account. The acknowledgment is designed to specify which regulatory regime applies to the customer's account and to ensure that the customer understands that the account will not be protected under the alternative regulatory scheme.

Requiring a signed acknowledgment from a customer trading SFPs through a Full FCM/Full BD is not necessary and imposes inequitable burdens on a Full FCM/Full BD. Requiring a customer to read a disclosure document and also sign and return an acknowledgment is reminiscent of a less flexible "belt and suspenders" approach to regulation. The Commissions have in recent years, particularly through the Commodity Futures Modernization Act of 2000, moved away from excessive regulation that has the effect of compromising business with little or no benefit.

Entities that are currently registered as a Full FCM/Full BD are not required to provide disclosures identifying the protections afforded by different regulatory regimes. Similarly, and more importantly, they are not required to obtain signed acknowledgments from their customers. In addition, according to the proposed rulemaking, notice registrants are not required to obtain a signed acknowledgment from their customers. This has the effect of penalizing Full FCMs/Full BDs vis á vis notice registrants because the cost and staff time required to administer and enforce the acknowledgment policy would be overly burdensome.

The implication of requiring a signed acknowledgement is that the process of a customer of a Full FCM/Full BD that mechanically signs an acknowledgment and sends it back to the firm is more important than the customer actually reading and understanding the disclosure document. If sending an acknowledgment back to a Full FCM/Full BD implies that the customer understands the regulatory regime that applies to his account, then notice registrants should also be required to obtain a signed acknowledgment from their customers to ensure they are knowledgeable of how the regulatory regime applies to their account. However, the Commissions have indicated that notice registrants are not required to obtain a signed acknowledgment. The Exchanges believe that it is appropriate that notice registrants not be required to obtain a signed acknowledgement for the disclosure documents discussed above and the same standard should apply to Full FCMs/Full BDs.

Change in Account Type - The proposed rulemaking provides that if a firm changes a customer's account type, the firm would be required to create a detailed record concerning the change, obtain a signed acknowledgment from the customer indicating that the customer understood which regulatory regime governs the account and that the account would not be protected under the alternative regulatory regime, and then notify the customer in writing of the date that the change became effective.

Many of the issues discussed above relating to obtaining a signed acknowledgment from a customer are equally applicable to this issue. The requirement that a firm obtain a signed acknowledgment from every customer every time the firm changes a customer's account type is overly burdensome and unnecessary. The administrative costs from a financial and staffing perspective in sending out, tracking and booking signed customer acknowledgments would be prohibitive.

A customer that effects SFP transactions through a Full FCM/Full BD will be provided with a disclosure document explaining the concepts of segregation and SIPC protection. In addition, a Full FCM/Full BD that changes a customer account from a securities account to a futures account or vice versa will be required to provide notice to such customer. Requiring the customer to send in a written acknowledgment of the change is again a belt and suspenders approach to regulation and unnecessary. A customer that is troubled by having his account changed can simply close his account and do business elsewhere.

The requirement that a customer be notified in writing of the date the change became effective is also overly burdensome for a Full FCM/Full BD. The proposed procedure would require the firm to create a detailed record of the change, obtain a signed acknowledgment from the customer regarding the change and notify the customer in writing when the change occurred. The firm's creation of a detailed record concerning the change and notifying the customer in the normal course, such as on a subsequent account statement, is sufficient notice. Requiring a firm to provide a customer with a separate notice as to when the change became effective imposes unnecessary additional administrative costs and staffing burdens on such firms.

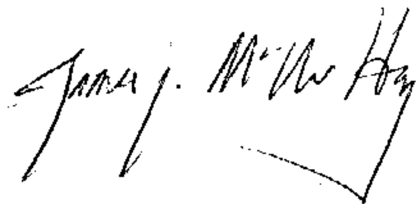
Rule 15c3-3 Calculations - On a weekly basis, SEC Rule 15c3-3 requires broker/dealer firms to calculate reserve requirements which determine its obligations to its customers. Any funds held for purposes of meeting these obligations must be held in accounts titled "Special Reserve Account for the Exclusive Benefit of Customers" and must be covered by a written acknowledgement from the depository that the funds held in the account will not be used for the firm's own benefits/needs. As a result, these calculations are much like the daily segregation calculations required by CFTC regulations.

Currently, any margin requirements held by OCC are included in the "debits" portion of the reserve calculation. In the near future, both CME and the Board of Trade Clearing Corporation intend to clear these products. As both organizations have vast experience with holding segregated deposits for their clearing member firms and in order to provide flexibility in clearing the products, we believe both organizations should also be recognized as good debits for Rule 15c3-3 calculations, provided they maintain the deposits in accordance with the regulation.

Please contact either of us if you would like to discuss any of these issues in further detail.

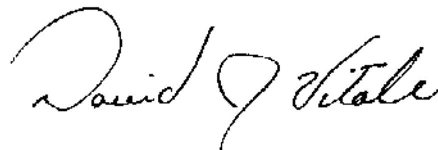
Respectfully submitted,

Chicago Mercantile Exchange Inc.



James J. McNulty

Board of Trade of the City of Chicago, Inc.



David J. Vitale

cc: The Honorable Harvey L. Pitt
The Honorable Laura S. Unger
The Honorable Issac C. Hunt, Jr.
The Honorable James E. Newsome
The Honorable Barbara Pedersen Holum
The Honorable David D. Spears
The Honorable Thomas J. Erickson