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VIA ELECTRONIC DELIVERY

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

COMMENT

Re: SRO Governance, 69 *Fed. Reg.* 32326 (June 9, 2004); 69 *Fed. Reg.* 42971 (July 19, 2004)

Dear Ms. Webb:

The Chicago Mercantile Exchange Inc. ("CME") welcomes the opportunity to comment upon the Commodity Futures Trading Commission's ("CFTC" or "Commission") ongoing review of self-regulatory organizations ("SROs"). CME invented financial futures contracts more than 30 years ago and is currently the largest futures exchange in the United States and the largest derivatives clearing organization in the world. CME is the only demutualized and publicly-traded futures exchange in the United States.[1]

CME has a long history and strong track record in self-regulation. As one of the major exchanges in the world, we believe that our market surveillance and financial supervision regulatory capabilities are part of the brand identity that we have created. In serving the marketplace, CME has stressed the quality and strength of its regulatory capabilities as an attraction to our products, markets and services. Market participants use our markets, in part, because they know we operate with high standards for market integrity and for supervision of trading activity, sales activity and financial activity on the part of our member intermediaries.

As the Commission has requested, we have addressed each enumerated question individually, in the order that they appear in the release.

A. Board Composition

1. What is the appropriate composition of SRO boards to best protect the public interest and serve SROs' needs? If you believe that SRO boards

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[1] All of CME's outstanding shares are held by Chicago Mercantile Exchange Holdings Inc. ("CME Holdings"), a Delaware for-profit corporation. CME Holdings completed its initial public offering in December 2002 and its Class A common stock is listed on the New York Stock Exchange (the "NYSE"). The Board of Directors of CME Holdings and CME are comprised of the same individuals.

should consist of market participants, what participant communities should be represented and how should representation be allocated among those communities (*e.g.*, quotas, volume-based)? Should the composition of SRO boards be different for the various types of SROs (*e.g.*, DCM or DCO)?

CME Response: CME believes that the interests of its shareholders, customers and the public are best served if SRO board composition is based upon the type and structure of the particular SRO. The organization of SROs varies substantially from not-for-profit mutualized enterprises to for-profit public companies like CME. No one composition criteria can address the individualized needs of these diverse entities.

For example, the Commodity Exchange Act (the "Act") requires mutualized designated contract markets ("DCMs") to provide for meaningful representation of a diversity of industry business interests on its board of directors. Although CME is no longer a mutualized DCM, CME continues to believe that it is important for its Board of Directors (the "Board") to include floor brokers, floor traders, employees or officers of futures commission merchants ("FCMs"), representatives of CME clearing member firms and other persons who intermediate transactions in or otherwise use CME products and services. We refer to these individuals as our "industry" directors.

Currently, the Board is comprised of 12 "industry" directors, seven "non-industry" directors and our Chief Executive Officer. We believe that this balance of industry and non-industry directors best serves our organization and ensures that we satisfy our self-regulatory responsibilities. Our industry directors bring an invaluable understanding of our company and its business, while our non-industry directors add other important perspectives, such as public company and financial expertise. Moreover, our self-regulatory functions are overseen by a committee comprised solely of non-industry directors, as described in more detail in response to Questions 3 and 5. In addition, eighteen of our twenty directors are classified as "independent" under the listing standards of the New York Stock Exchange (the "NYSE") and our own categorical standards of independence set forth below in response to Question 3.

Finally, we note that the Commission's mission is "to protect market users and the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options, and to foster open, competitive, and financially sound futures and option markets." (The mission statement is set forth at www.cftc.gov/cftc/cftcabout.htm.) In this regard, we do not believe that it is the responsibility of the Commission to interfere with, much less micro-manage, the overall corporate governance of SROs at the board level by setting arbitrary composition requirements. We believe that state corporation law adequately establishes the requirements as to how directors must conduct themselves so that a fixed composition of an SRO board is not necessary to best protect the public interest and serve the SRO's needs. Under state corporation law, it is the duty of the board of directors, regardless of composition, to exercise its business judgment to act in what it reasonably believes to be in the best interests of the company and its shareholders. Directors must fulfill their responsibilities in a manner that is consistent with their fiduciary duty to their shareholders, in compliance with all applicable laws and regulations.

2. **How and by whom should SRO boards be nominated and elected? If directors should represent particular communities, should each community nominate and/or elect its representatives to the board? If the board consists of independent directors, what nomination and election procedures are necessary to ensure independence?**

CME Response: CME believes that the process for the nomination and election of SRO boards should differ based upon the type and structure of the SRO. We do not believe that there is a "one-size-fits-all" model that can be applied to best protect the varying interests involved with respect to all SROs. For example, a for-profit, public SRO must create a board composition that is palatable to its investors. An SRO that is a corporation would be required to hold an annual meeting of its shareholders at which the directors would be elected. Further, an SRO that has shares registered with the Securities Exchange Commission (the "SEC") must also comply with the SEC's rule and regulations relating to the election of directors and the solicitation of shareholder proxies. If such SRO also has its shares listed on an exchange, such as the NYSE or the NASDAQ, the SRO would be required to have its directors nominated by an independent nominating committee unless the SRO had a contractual obligation to do otherwise.

We believe that CME Holdings' nomination process, as governed by the SEC, the NYSE, and its certificate of incorporation and by-laws, effectively serves its constituents. The Board is comprised of 20 directors, with each director serving a two-year term. Of these 20 directors, 14 of the directors are nominated by the Nominating Committee of the Board of Directors, which is comprised solely of independent directors. Candidates reviewed by our Nominating Committee may be recommended by this committee, other directors, management, shareholders or a third-party search firm. These 14 directors are elected to the Board by CME's Class A shareholders and Class B shareholders (our members) voting together as a single class at our annual meeting of shareholders. The remaining six directors are nominated by nominating committees elected by our Class B shareholders. Only our Class B shareholders may vote to elect these six directors at our annual meeting. However, because CME is a corporation, no matter what shareholder constituency elects a director, he or she represents all of our shareholders and must act in the best interests of the company and all of its shareholders.

To ensure that the Board maintains its independence and industry composition, the experience and backgrounds of the individuals proposed for nomination are reviewed by the applicable nominating committee. The review process includes an evaluation of written materials, such as resumes, as well as in-person interviews. We believe this process ensures that our Board will maintain its balance of independence and market expertise.

3. **Should SRO boards include independent directors and, if so, what level of representation should they have? What are appropriate definitions of "independent director" and "public director?" Should all independent directors be public directors? Please address whether SRO members can be considered independent. Also, please address whether the New York Stock Exchange's definition of independent—the requirements include**

independence from the exchange's management, members, and member organizations—is an appropriate model for the futures industry.

CME Response: CME believes that the inclusion of independent directors on the boards of SROs is important to mitigate any perceived conflicts of interest. However, there are many ways to structure the self-regulatory function to ensure independence without mandating a specific representation of independent directors or bright-line definitions of "independent" and "public" directors. Further, while we applaud the NYSE for adopting an independence standard that includes the requirement that one must be independent from members and member organizations, we do not believe such a standard should be applied to all SROs. The futures industry is comprised of SROs with diverse characteristics that vary based upon the particular type and structure of the entity. What works well for the NYSE may, therefore, not be ideal for a different form of entity such as a for-profit public company like CME. Moreover, we believe there are other ways to ensure the independence of the SRO functions rather than a bright-line standard of "independence."

As a public company with its common stock listed on the NYSE, CME is required to have at least a majority of independent directors on its Board. As a result of our continued commitment to good corporate governance, CME's Board has more than a majority of independent directors. To assist the Board in making its determination as to who is an independent director, CME's Board has adopted the following categorical independence standards:

> A director who satisfies the independence standards of the New York Stock Exchange and meets all of the following categorical standards shall be presumed to be "independent":
>
> - The director does not (directly or indirectly as a partner, shareholder or officer of another company) provide consulting, legal or financial advisory services to the Company or the Company's present or former auditors.
>
> - The director is not a significant shareholder in the Company's Class A Common Stock or Class B Common Stock. For purposes of this categorical standard, a shareholder shall be considered significant if the ownership of shares of Class A Common Stock is greater than five percent (5%) of the outstanding Class A Common Stock or if the ownership of shares of any series of Class B Common Stock is greater than five percent (5%) of the outstanding Class B Common Stock in such series.
>
> - The director does not serve as an executive officer or director of a civic or charitable organization that receives significant financial contributions from CME or the CME Foundation. For purposes of this categorical standard, the Board of Directors

> shall determine whether a financial contribution is considered significant on a case-by-case basis.
>
> In addition, the CME Board has determined that a director who acts as a floor broker, floor trader, employee or officer of a futures commission merchant, CME clearing member firm or other similarly situated person that intermediates transactions in or otherwise uses CME products and services shall be presumed to be "independent" if he or she otherwise satisfies all of the above categorical standards and the independence standards of the New York Stock Exchange.

CME does, however, recognize the perceived concern that potential conflicts of interest may exist with respect to an SRO. To address this issue and to ensure the independent exercise of our self-regulatory functions, CME has created the Market Regulation Oversight Committee, which is comprised of four non-industry directors. We believe that this structure ensures the effective functioning of our self-regulatory responsibilities and insulates us from potential conflicts of interest. The specific responsibilities of the Committee are discussed in more detail in response to Question 5.

In addition, CME has adopted a Director Independence and Conflict of Interest Policy. As a Delaware corporation, CME directors owe fiduciary duties, including the duty of loyalty to all of its shareholders. The purpose of the policy is to provide guidance with respect to common potential conflicts of interest to ensure that any corporate action that might confer a private benefit on a director is understood in advance by the relevant decision makers and that all decisions of the Board are made in the interests of the shareholders. We believe this policy sufficiently ensures that our directors, including our industry directors, will act in the best interests of CME and its shareholders.

B. Regulatory Structure

4. Are the governance standards applicable to listed companies sufficient for futures exchanges or their listed parent companies? Or, given that futures exchanges are not typical corporations in that they bear self-regulatory responsibilities, should they adopt higher governance standards, particularly with respect to self-regulatory activities? Please explain.

CME Response: In response to recent corporate scandals, including the governance issues raised at Enron and WorldCom, U.S. public companies with stock listed on an exchange are now subject to a plethora of increased governance standards to increase transparency, disclosure and accountability. The Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley") and the corporate governance rules adopted by the NYSE raised the bar for corporate accountability and imposed wide-ranging new requirements. For example, pursuant to Sections 302 and 906 of Sarbanes-Oxley, chief executive officers and chief financial officers are required to provide specific certifications relating to periodic reports filed with the SEC, including that such reports fairly present, in all material respects, the financial condition and results of operations of the company. Section 304 of Sarbanes-Oxley also requires CEOs and CFOs to forfeit bonus and equity compensation if their company is required to restate its financial statements due to

material non-compliance, as a result of misconduct, with financial reporting requirements under the securities laws. Sarbanes-Oxley also increased the monetary penalties and prison terms for violations of the securities laws. In addition, the NYSE requires listed companies to adopt codes of conduct and ethics that address, among other things, conflicts of interest, corporate opportunities, fair dealing and proper use of company assets to encourage ethical conduct within the organization.

We believe that in our case, as a public company with stock listed on the NYSE, the rules and regulations of the SEC and the NYSE provide a sufficient and appropriate governance framework. We believe this increased accountability adequately deters the manipulation of the self-regulatory function to improve profitability and ensures that we have adopted measures to facilitate good corporate governance and the effective functioning of our self-regulatory obligations. Moreover, as a public company we regularly monitor developments in the area of corporate governance and continue to enhance our governance structure based on a review of current requirements and best practices. The recent creation of a Board level committee to oversee market regulation is just one example of the steps that we have taken to ensure the performance of our self-regulatory responsibilities and enhance our governance.

5. **Should an SRO's regulatory functions be overseen by a body that is internal to the SRO, but independent of management, members, and business functions? If so, what specific functions should fall within its purview (*e.g.*, regulatory budget; personnel decisions; compensation of regulatory staff; compliance and disciplinary programs; other aspects of self-regulation)?**

CME Response: On April 30, 2004, CME became the first futures exchange to appoint a Board level committee devoted to self-regulatory oversight. The committee, which is called the Market Regulation Oversight Committee (the "MROC"), is comprised solely of non-industry directors. The MROC is charged with the following responsibilities:

- to review the scope of and make recommendations with respect to the responsibilities, budget and staffing of the Market Regulation Department and the Audit Department so that each department is able to fulfill its self-regulatory responsibilities.

- to oversee the performance of the Market Regulation Department and Audit Department so that each department is able to implement its self-regulatory responsibilities independent of any improper interference or conflict of interest that may arise as a result of a member of CME serving on the Board or participating in the implementation of CME's self-regulatory functions.

- to review the annual performance evaluations and compensation determinations and any termination decisions made by senior management of CME with respect to the Managing Director, Regulatory Affairs, and the Director, Audit Department, so that such determinations or decisions are not designed to influence improperly the independent exercise of their self-regulatory responsibilities.

- to review CME's compliance with its self-regulatory responsibilities as prescribed by statute and the rules and regulations promulgated thereunder.

- to review changes (or proposed changes, as appropriate) to Exchange rules to the extent that such rules are likely to impact significantly the self-regulatory functions of the Exchange.

We believe that the newly empowered MROC represents an aggressive and appropriate step towards independence in self-regulation. Importantly, the formation of the MROC represents a best-practice model for exchange self-regulation, and we encourage the Commission to recognize, and other exchanges to follow, our lead.

6. Please address whether any rule enforcement, disciplinary, or other functions currently performed by exchanges should be performed instead by an independent regulatory services provider.

CME Response: CME does not believe that an "independent regulatory services provider" should perform the regulatory functions that are presently performed by the exchanges. Such a provider not only may lack the expertise to perform the functions, but may be subject to its own conflicts of interest.

In this regard, for example, we note that a majority of the NFA's Board of Directors is comprised of futures industry participants—many of whom are employed by intermediaries that have a significant financial stake in the outcome of regulatory developments and investigations.

Rather than separate such functions, CME believes that an exchange should maintain its market center functions (*i.e.*, the operation and promotion of the marketplace) and regulatory functions (*i.e.*, with respect to CME, the Market Regulation Department and Audit Department) in the same corporate entity. The industry and market participants are well served by such a long-standing and demonstrably effective model.

At CME, we have built extensive and sophisticated regulatory systems and programs to ensure market integrity and financial safeguards for market users. We have assembled some of the most talented regulatory, risk management and financial supervision experts in the world of derivatives trading. These people consist of employees in our market surveillance and compliance areas, our financial audit area, our risk management and clearing house departments, our legal department and our trading floor personnel. The quality of our overall regulatory system depends heavily on the integration of these separate functions and on the manner in which these staff are able to coordinate closely their activities and information sharing. Unbundling any part of this extensive and intertwined system will likely damage the protections afforded to the industry and market participants.

Moreover, in times of a market crisis, these staff members work together as a tightly coordinated team that is responsive to CME's needs to ensure market integrity and financial safeguards. Emergency situations demand the highest level of coordination, and significant

disadvantages can accrue from having to coordinate emergency activities across separate organizations.

Finally, many of the trade practice and other irregularities that we investigate and prosecute come from referrals from members, clearing members and customers. We have developed a "public trust" that ensures a high degree of comfort for persons making such referrals. Moving any of our self-regulatory functions could impair this network of effective regulatory referrals.

We thus believe that the best—and most time-tested—model of self-regulation is the model that permits exchanges to regulate their marketplaces.

C. Forms of Ownership

7. What impact do varying business models have on an SRO's self-regulatory behavior? Consider for-profit/not-for profit, member-owned/shareholder owned, and publicly traded/privately held business models.

8. More specifically, is an SRO subject to new influences in the performance of its self-regulatory functions when it converts from a member-owned, not-for-profit organization to a publicly traded, for-profit company? Might a for-profit, publicly traded SRO attempt to attract volume or increase its profits through lax self-regulation? Or, is it more likely that the SRO will seek to protects its brand and add value through effective self-regulation?

CME Response: As a general matter, we believe that self-regulation works because of the business incentive to operate a fair, financially sound and competitive marketplace. Such an incentive applies equally to for-profit demutualized and mutualized exchanges. Reputation and competition are powerful motivating forces for ensuring proper behavior, especially in today's global environment where market participants have virtually immediate, around-the-clock access to a range of competing markets and products.

As a publicly-traded exchange, CME is subject to the same statutory self-regulatory requirements of any other DCM, including mutualized exchanges. Importantly, the Commodity Exchange Act ("CEA") and Commission regulations impose strict self-regulatory responsibilities on all DCMs, which include the requirement that a DCM enforce all of its rules and maintain a continuing affirmative action program to ensure compliance with the CEA, the Commission's regulations and the DCM's rules. In the event that a DCM fails to satisfy these requirements, the Commission is empowered to compel the DCM to fulfill its responsibilities, and may even suspend or revoke the contract market's designation. In an effort to ensure that CME satisfies its statutory self-regulatory obligations—and that CME exercises independence in the fulfillment of these obligations—CME has created the MROC, a board-level oversight committee that consists solely of non-industry directors. (MROC's specific responsibilities are discussed in response to Question 5 above.)

Moreover, as a publicly-traded, for-profit entity, CME has a substantial incentive to properly discharge its statutory self-regulatory responsibilities. CME operates in a transparent

environment in which research analysts and institutional shareholders scrutinize management's business decisions and monitor the company's stock performance. Any failure to maintain and effectively implement prudential regulatory programs could cause analysts and shareholders to adopt a negative view of performance and stock prices could be adversely impacted. Indeed, the results of any materially adverse CFTC rule enforcement review or other agency action involving CME would require disclosure to shareholders. These motivations have been heightened by the Commodity Futures Modernization Act (the "CFMA"), which has made it extremely easy for new entrants to attack existing markets that fail to respond to the needs of their customers. We also note that, as a publicly-traded exchange, CME is not alone in combining its market center and self-regulatory functions. While CME's model may be unique and the market leader in the U.S., the model is well-established internationally. For example, demutualized exchanges such as Euronext, N.V. (through its various markets), the Singapore Exchange (SGX), OMX (through its Stockholmsborsen market), and the London Stock Exchange (LSE), all employ a model that generally combines the market center function with the self-regulatory function. Such a model is thus not only well accepted internationally, but demonstrates that the model effectively permits demutualized exchanges to satisfy their self-regulatory obligations.

Finally, any notion that an established for-profit entity, like CME, might attempt to attract order flow or increase its profits through lax self-regulation is misplaced. CME, for example, has *increased* the resources that it devotes to self-regulation since going public. At the same time, CME's disciplinary committees have imposed sanctions that are consistent with the level of sanctions imposed prior to CME's public offering. Operating as a for-profit company has thus impelled CME further to strengthen its brand through effective self-regulation.

D. Disciplinary Committees

9. How should SRO disciplinary committees be structured so as to ensure both expertise and impartiality?

CME Response: Ensuring that a disciplinary committee has the requisite level of expertise is best accomplished by encouraging members and users of an exchange's products to participate in the disciplinary process. Such individuals not only understand the nature and jargon of the futures business, but possess first-hand knowledge of the often complex and technical workings of the business. The result of such participation is that case resolutions are commensurate and responsive to the charges brought. At CME, our disciplinary committees include a majority of members with industry expertise. In each non-summary proceeding, CME includes at least one broker, one local and one firm (*e.g.*, FCM) representative, thus ensuring a multitude of market perspectives. Based upon our feedback with the community that we serve, the level of market expertise is appropriate.

We believe that impartiality is best accomplished by requiring SRO disciplinary committee members to abstain from participating in a disciplinary matter if there is a perceived or actual conflict of interest or the member has engaged in an *ex parte* communication concerning the merits of the matter. Importantly, CME Rules 416 (Conflicts of Interest) and 417 (Prohibited Communications), both of which are discussed more fully in the response to Question 14, make it clear that CME will not tolerate violations of these important precepts.

10. Please address whether SRO disciplinary committees should have independent, non-SRO member chairs and/or committee membership. Should the level of representation for independent, non-SRO members vary according to the type of disciplinary case?

CME Response: CME believes that SRO disciplinary committees should have independent, non-SRO committee members. In this respect, CME has pioneered changes to the structure of its disciplinary committees. For example, non-members were added to CME hearing panels in 1990 and the degree of influence of non-members has been consistently expanded—most recently in 2004, when CME increased the proportion of independent panelists on its disciplinary committees.

Presently, CME's Probable Cause Committee (the "PCC"), which is the committee responsible for the issuance of charges involving allegations of trade practice violations, is composed of three non-members and four members, plus a non-voting member chairman. CME's Business Conduct Committee (the "BCC"), which is the committee that is responsible for resolving such charges, is composed of two non-members and three members, plus a non-voting member chairman.

We believe that it is important that the level of representation for independent members is consistent across all types of disciplinary cases. While some exchanges use non-member panelists in the disciplinary process only when a case appears to involve customer harm, CME believes that independent, non-industry panelists are a useful component in *all* types of disciplinary cases before the PCC and BCC.

The Clearing House Risk Oversight Committee, which is a risk-management oversight committee that has ancillary disciplinary authority—an authority that is rarely invoked given the committee's risk-based focus—is comprised of 11 members, which include: 1) five broker-dealer/FCMs (*e.g.*, Morgan Stanley, J.P. Morgan Futures, Goldman Sachs, Bear Stearns, O'Connor); 2) one FCM-only firm; 3) one settlement banker; 4) three floor members; and 5) one CBOT member firm representative (in connection with CME's agreement to provide clearing services to the CBOT). Because clearing firms own a significant amount of the collateral available to the CME Clearing House, we believe that their interests should be principally represented on the committee.

11. How and by whom should SRO disciplinary committees be appointed? Should the terms of committee members be limited? Please explain.

CME Response: At CME, an annual roster of potential committee members is developed by the Market Regulation Department, which checks disciplinary histories, ensures that panels are diverse, and flags potential problems to the Board Chairman. The Board Chairman prepares the final list of appointees, which is approved by the Board. The Market Regulation Department has authority for selecting pit committees and has significant input on the choice of committee members that have regulatory authority. In contributing to the selection process, the Market Regulation Department relies upon the experience that it has acquired in coordinating the disciplinary process to identify individuals that not only possess a high level of

competency and the proper temperament, but individuals who have not been subject to major disciplinary action. We believe that our selection process is time-tested and has worked well, and we are aware of no complaints to the contrary.

CME is opposed to strict term limits for its disciplinary committee members. The pool of the most qualified individuals to serve on disciplinary committees is, by definition, limited. We believe that any governmental mandate to remove qualified and committed disciplinary committee members pursuant to artificial term limits would have a detrimental impact which substantially outweighs any benefits to the process. Instead, the combination of natural attrition in the ranks of committee members and the rotation of new members onto the committees (as noted above) best serves CME's efforts to maintain high-quality committees.

E. Other Issues

12. What additional information, if any, should SROs make available to the public to increase transparency with respect to their governance and regulatory structures (*e.g.*, board member affiliations; regulatory staffing and budget; disciplinary committee membership and affiliations, etc.)?

CME Response: CME is a public company subject to the disclosure and reporting requirements of the Securities Act of 1933, Securities Exchange Act of 1934 and the rules and regulations promulgated thereunder by the SEC. In addition, CME is subject to the disclosure requirements of the NYSE, which require CME to make publicly available on its website numerous corporate governance documents and provide annual certifications regarding its compliance with the listing standards.

In accordance with the foregoing rules and as a matter of best practice, CME makes widespread disclosures to its shareholders and the general public. For example, CME files financial reports on an annual and quarterly basis with the SEC. It also has created a corporate governance section on its website that contains CME's key corporate governance documents, including its Director Independence and Conflict of Interest Policy, Corporate Governance Principles for its Board of Directors, categorical standards of independence, charters and memberships of its Board standing committees, and biographies for each of its directors, including their relationships with the Exchange. This high level of disclosure goes far beyond that of any other SRO, and CME welcomes such transparency.

We do believe that certain information should remain confidential, such as our regulatory budget allocations. While we believe that we devote significantly more resources to self-regulation than other SROs, in our view, such information constitutes a protected trade secret, the disclosure of which would not provide any meaningful benefit to the marketplace.

13. Would additional core principles for SROs help to clarify their responsibilities with respect to governance, or would regulatory guidance be more appropriate?

CME Response: CME does not believe that additional core principles for SROs are necessary. The core principles promulgated under the CFMA with respect to DCMs, coupled

with the Commission's extensive regulations, more than adequately prescribe the governance and self-regulatory responsibilities of DCMs.

Of the 18 core principles enumerated in the Act, ten of the principles relate to an SRO's governance and self-regulatory responsibilities. They are:

- Core Principle 2: Compliance with Rules;
- Core Principle 3: Contracts Not Readily Subject to Manipulation;
- Core Principle 4: Monitoring of Trading;
- Core Principle 5: Position Limitations or Accountability;
- Core Principle 6: Emergency Authority;
- Core Principle 11: Financial Integrity of Contracts;
- Core Principle 12: Protection of Market Participants;
- Core Principle 14: Governance Fitness Standards;
- Core Principle 15: Conflicts of Interest; and
- Core Principle 16: Boards of Mutually Owned Contract Markets.

These ten Core Principles adequately prescribe a DCM's self-regulatory responsibilities, and recognize the Congressional mandate in the CFMA, in which Congress replaced prescriptive, restrictive rules with broad, flexible core principles. In addition to the Core Principles, however, Appendix B to Part 38 of the Commission's rules sets forth acceptable practices relating to the self-regulatory responsibilities of DCMs, and Part 8 of the Commission's rules specifies, among other things, that each exchange shall establish an adequate enforcement staff which shall be authorized by the exchange to initiate and conduct investigations, to prepare reports and to prosecute possible rule violations.

Importantly, the CFTC periodically examines each SRO to ascertain whether it is adequately fulfilling its self-regulatory responsibilities. The CFTC has ample weapons to compel an exchange to fulfill such responsibilities. For example, under Section 8e of the Act, the CFTC has the power to issue a deficiency order against an exchange if the CFTC has reason to believe that the exchange's trade monitoring system does not satisfy one or more of the statutory requirements. Among other penalties, the CFTC may refrain from approving any application for designation as a contract market from an exchange that is the subject of a deficiency order. Even more broadly, Section 5b of the Act authorizes the CFTC to suspend or revoke the contract market designation of any exchange that has failed or refused to comply with any of the provisions of the Act or CFTC regulations.

CME thus believes that the framework established by the CFMA, which provides for flexibility and accountability, adequately prescribes an SRO's responsibilities with respect to governance and self-regulation.

14. What steps should be taken to manage or eliminate conflicts of interest involving SRO board and disciplinary committee members?

CME Response: CME believes that it is imperative to eliminate actual *and* perceived conflicts of interest involving SRO Board and disciplinary committee members.

With respect to potential conflicts involving Board members, CME has adopted a Director Independence and Conflict of Interest Policy (available at www.cme.com) to ensure that any corporate action that might confer a benefit on a director is understood in advance by the relevant decision makers and that all decisions of the Board are made in the interests of the shareholders. Members of the Board as directors of a Delaware corporation owe fiduciary duties to the shareholders, including the duty of loyalty. This policy was adopted to provide guidance with respect to common potential conflicts and to supplement rather than replace any applicable laws or regulations governing conflicts of interest. In accordance with the terms of the policy, among other requirements, directors are required to disclose the existence and nature of any material interest, not previously disclosed, to the General Counsel or the Board in connection with any proposed rule change, transaction, contract or arrangement prior to the consideration of such item. After such disclosure, a determination is made by the Board, after consultation with the General Counsel and outside legal counsel, if necessary, as to whether a conflict of interest exists. In the event any potential or actual conflict of interest exists, the Board determines the appropriate action to be taken. As a general matter, it is appropriate for a director to abstain from voting on a matter in which he or she has a material financial interest.

With respect to potential conflicts involving disciplinary committee members, we believe that the present safeguards are appropriate and adequate. CME seeks to ensure the avoidance of conflicts through CME Rule 416 ("Conflicts of Interest"), which broadly requires that any member of a committee (including the PCC, BCC and Clearing House Risk Committee), Board hearing panel or appellate panel abstain from participating in any matter where such member: 1) is a witness, potential witness, or a party; 2) is an employer, employee, or co-worker of a witness, potential witness, or a party; 3) is associated with a witness, potential witness, or a party through a broker association; 4) has any significant personal or business relationship with a witness potential witness, or a party, subject to limited exceptions; or 5) has a familial relationship to a witness, potential witness, or a party.

Furthermore, Rule 417 ("Prohibited Communications") seeks to avoid conflicts by proscribing *ex parte* communications between any panelist of a charging, adjudicating or appeal committee and any subject or respondent (or their counsel) or representative of the Market Regulation Department. The rule further proscribes a CME member from attempting to influence a pending disciplinary matter. Taken together, Rules 416 and 417 represent an unparalleled standard in seeking to avoid conflicts in futures market SRO disciplinary proceedings.

To the extent that the possibility of conflicts of interest is a problem in theory, it may be less of one in practice—at least in CME's experience. While exchanges may be the subject of general allegations of conflicts, they are rarely implicated with respect to actual, specific conflicts. Moreover, exchanges like CME have extensive experience in recognizing and addressing potential SRO conflicts of interest. Such experience is likely to continue to prove sufficient to overcome any increased conflicts brought about by market changes.

15. Should registered futures associations that are functioning as SROs also be subject to governance standards?

CME Response: CME believes that registered futures associations, such as the NFA, should be subject to the same governance standards as other SROs. To exempt futures associations from comparable regulation not only would encourage regulatory arbitrage, as new contract markets shop for the low cost (and concomitantly low quality) provider, but invite disparate qualities of regulation. Ultimately, such an approach would serve to commoditize the self-regulatory function and thereby damage the credibility of the futures industry.

Conclusion

In recent testimony before Congress, former Chairman James Newsome testified that: "We continue to believe our SRO structure works very well." Chairman Newsome added, with respect to the CFTC's ongoing study, that ". . . so far nothing suggests we have to make broad changes." CME shares Chairman Newsome's view, and believes that the self-regulatory system employed by CME is time-tested, flexible and efficient, and the best system available to the industry.

Thank you for the opportunity to comment upon the Commission's study. If you have any questions or comments, please do not hesitate to contact me or Matthew F. Kluchenek, Director and Associate General Counsel, at (312) 338-2861.

Respectfully submitted,

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