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Via Electronic Mail

Ms. Eileen A. Donovan
Acting Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

**Received CFTC
Records Section**

9/7/06

Re: Comment Letter on Regulatory Governance
Proposed Acceptable Practices, 71 FR 38470 (July 7, 2006)

Dear Ms. Donovan:

CBOE Futures Exchange, LLC ("CFE") appreciates the opportunity to provide its comments to the Commodity Futures Trading Commission ("CFTC") with respect to the acceptable practices ("Proposed Acceptable Practices") proposed in the above-referenced CFTC release ("Release") relating to the governance and decision-making processes of futures exchanges.

CFE's General Views Regarding the Proposed Acceptable Practices

CFE generally supports the Proposed Acceptable Practices, including the proposals that each futures exchange should have a governing board composed of at least fifty percent public directors and that each futures exchange should have a regulatory oversight committee ("ROC") CFE and Chicago Board Options Exchange, Incorporated ("CBOE"), CFE's parent organization and a national securities exchange, have each experienced first hand the benefits of operating with a governing board with significant public representation. CBOE has also experienced first hand the benefits of having a ROC. Based on this very positive experience and consistent with the views that CBOE has expressed in comments to the Securities and Exchange Commission ("SEC") regarding its proposed governance standards for securities exchanges, CFE believes that the implementation of standards under which each exchange is expected to have a governing board and executive committee composed of at least fifty percent public directors and a ROC will enhance exchange governance and serve to protect market participants and the public interest. However, CFE does have some comments with respect to certain aspects of the Proposed Acceptable Practices. These comments are described below along with some factual scenarios involving CFE which illustrate why CFE believes that these aspects of the Proposed Acceptable Practices should be modified or clarified, as applicable.

Additionally, CFE would like to note its view, consistent with the intent of the Commodity Futures Modernization Act, that futures exchanges should generally be subject to core principles rather than to detailed and prescriptive rules or guidelines. Having core principles allows for multiple ways in which to achieve the same objective, which fosters innovation and different market models and which in turn promotes competition. Accordingly, CFE would be concerned if the CFTC were to begin to make a practice of promulgating detailed rules or guidelines with respect to the various core principles that are applicable to futures exchanges

under the Commodity Exchange Act. However, in this instance, CFE believes that the implementation of the Proposed Acceptable Practices is appropriate given that futures exchange governance permeates all aspects of the activities of a futures exchange and given the importance of ensuring the integrity of the self-regulatory process.

CFE's Specific Comments Regarding the Proposed Acceptable Practices

A Futures Exchange Should Be Permitted to Have Its Governing Board Make the Determination Regarding Whether a Director Qualifies as a Public Director

The Proposed Acceptable Practices provide that in order "[t]o qualify as a public director of a contract market, an individual must first be found, by the board of directors on the record, to have no material relationship with the contract market." CFE agrees with the approach of the Proposed Acceptable Practices that a futures exchange should be able to have its board of directors make the determination regarding whether a person has a material relationship with the exchange and thus whether the person is eligible to qualify as a public director of the exchange. Although the Proposed Acceptable Practices do not reference having the nominating committee of a futures exchange make these determinations, the Release appears to state that the nominating committee should be the body to make these determinations. Although CFE does not take issue with allowing either the board of directors or the nominating committee of a futures exchange to make these determinations, CFE requests that the CFTC clarify that the board of directors of a futures exchange may make these determinations on its own without any independent nominating committee involvement. Since CFE is wholly owned by one entity, CFE does not have a nominating committee, and CFE believes that it would be inefficient to be required to establish a nominating committee solely for this purpose. Instead, CFE believes that it is appropriate for the board of directors of a futures exchange, as the highest governing body of the exchange, to be able to make these determinations.

A Public Director of a Futures Exchange Affiliate Should Be Able Qualify as a Public Director of the Futures Exchange

The Proposed Acceptable Practices provide that a person who is a director of an affiliate of a futures exchange would not qualify to serve as a public director of the futures exchange. The Proposed Acceptable Practices define a futures exchange affiliate to include a parent entity of a futures exchange, a futures exchange subsidiary, and an entity with which a futures exchange shares a common parent. CFE believes that the Proposed Acceptable Practices should not preclude a person who satisfies all of the criteria for a public director in relation to both the futures exchange and the futures exchange affiliate, with the exception that the person serves as a director of both entities, from qualifying as a public director of the futures exchange.

The following real life example illustrates why the Proposed Acceptable Practices should be modified in this regard. One of CFE's current directors is Susan Phillips. Dr. Phillips is currently Dean of The George Washington University School of Business, and she previously served as CFTC Chairman and as a member of the Board of Governors of the Federal Reserve System. Dr. Phillips also currently serves as a public director of CBOE, and is currently Chairperson of the CBOE ROC. Dr. Phillips would satisfy the proposed criteria for a public director with respect to both CFE and CBOE, with the exception that she serves as a public director of both entities. Yet because Dr. Phillips serves as a public director of CBOE, she would be precluded under the Proposed Acceptable Practices from qualifying to serve as a public director of CFE. CFE cannot envision any potential conflicts of interest that would justify such an outcome. Additionally, CFE believes that such an outcome would actually run counter to the

goal of improving futures exchange governance in that a futures exchange such as CFE would lose the benefit of the wealth of experience and expertise that a person such as Dr. Phillips can bring to its governing board.

A Lessor Member of a Futures Exchange Affiliate Should Be Able to Qualify as a Public Director of the Futures Exchange

CFE reads the Proposed Acceptable Practices to allow a lessor member of a futures exchange affiliate to qualify as a public director of the futures exchange assuming that the individual holds a de minimus equity percentage interest in the futures exchange affiliate and otherwise satisfies the proposed qualification criteria to serve as a public director of the futures exchange. Nevertheless, in order to avoid any future ambiguity in this regard, CFE requests that the CFTC clarify this to be the case.

The following actual scenario illustrates why CFE believes this clarification is warranted. Lawrence Blum is one of CFE's current directors. Mr. Blum is not a CFE Trading Privilege Holder ("TPH") or affiliated with any CFE TPH and is not a CFE lessor in that CFE trading permits are issued by CFE itself and are not owned by any other parties. Mr. Blum is a CBOE lessor member without trading privileges on CBOE, and by virtue of his status as a CBOE lessor, has a de minimus equity percentage interest in CBOE. Because a CBOE lessor member like Mr. Blum has no direct relationship with CFE, including the fact that he is not a CFE TPH or a CFE lessor, and since he has only a de minimus equity percentage interest in CFE's parent organization, CFE does not believe a CBOE lessor like Mr. Blum has a material relationship with CFE that could affect his independent judgment or decision making or that should otherwise disqualify him from acting as a CFE public director.

As an additional point of reference in this regard, the SEC recently approved an International Securities Exchange, Inc. ("ISE") rule filing which we read to permit a non-member owner lessor of ISE to act as an ISE non-industry director. See ISE Rule Filing Number SR-ISE-2006-04, approved by the SEC in Release Number 34-53705, 71 FR 25260 (April 28, 2006). Pursuant to that rule filing, ISE's Board of Directors is composed of the ISE chief executive, six individuals affiliated with ISE trading members, and eight non-industry representatives, two of whom are public representatives. As we read the definitions of industry representative, non-industry representative, and non-member owner in Sections 13.1(t) and 13.1(w) of ISE's Limited Liability Company Agreement and ISE Rule 300, an ISE non-member owner lessor may qualify as an ISE non-industry director. CFE notes that acting as a lessor member of an exchange affiliate in the manner CFE discusses above is an even more attenuated association with an exchange than acting as a lessor member of the exchange itself (as we believe was approved by the SEC under this rule filing).

A Futures Exchange Should Be Able to Include Public Representatives Who Are Not Public Directors of the Futures Exchange on its ROC

The Proposed Acceptable Practices require that the board of directors of each futures exchange establish a ROC consisting of only public directors of the exchange. Although CFE agrees that it is appropriate to require that a futures exchange ROC be composed solely of individuals who are eligible to serve as a public director of the exchange, CFE does not believe that a futures exchange should be precluded from having public representatives on its ROC who are not public directors of the exchange.

The following factual scenario relating to CFE illustrates why CFE believes this to be the

case. As noted above, CBOE, CFE's parent organization, currently has a ROC. The CBOE ROC is composed of five CBOE public directors. One of the members of that Committee, Dr. Phillips, is a CBOE director and a CFE director. The other four members of that Committee are Robert Birnbaum (former President of the New York Stock Exchange and the American Stock Exchange), Duane Kullberg (former Chief Executive Officer of Arthur Andersen), R. Eden Martin (President of The Commercial Club of Chicago), Roderick Palmore (General Counsel of Sara Lee), and Samuel Skinner (former Chief of Staff to President George H.W. Bush). These four other members of the CBOE ROC are CBOE public directors, but they are not CFE directors. In order to promote efficiency and avoid duplication of effort, CFE may wish to designate the CBOE ROC to also act as the CFE ROC. Yet because four of the five members of the CBOE ROC are not CFE directors, CFE would be precluded from doing so under the Proposed Acceptable Practices. CFE does not believe this result would serve the interest of enhancing futures exchange governance in that it would preclude CFE from having the benefit on its ROC of the expertise of these four other individuals both in terms of their individual experience and in terms of their experience from having served on the CBOE ROC.

A Futures Exchange ROC Should Perform an Oversight Role and Not a Managerial Role

The Release states that a futures exchange ROC is not expected to assume managerial roles. CFE strongly agrees with this principle. However, CFE does not believe that the specific responsibilities of a ROC that are enumerated in the Release and in the Proposed Acceptable Practices are consistent with this important concept. For example, the Release states that a ROC may delegate its day-to-day authority over self-regulatory functions and personnel to the Chief Regulatory Officer ("CRO"). Even though this day-to-day authority may be delegated, CFE does not believe it is appropriate for a ROC to have day-to-day authority in the first place. Additionally, the Proposed Acceptable Practices provide that a ROC shall supervise the CRO, who will report directly to the ROC. These and other of the proposed enumerated functions of a ROC are inconsistent with the traditional role of directors and would effectively make the members of a ROC managers of a futures exchange's regulatory program and of the CRO.

Directors should evaluate, oversee, and monitor management performance and establish broad policy objectives for management to implement, not function as managers of an exchange. As noted in the Business Roundtable Report on corporate governance:

"The board of directors has the important role of overseeing management performance on behalf of stockholders. Its primary duties are to select and oversee a well qualified and ethical CEO who, with senior management, runs the corporation on a daily basis, and to monitor management's performance and adherence to corporate standards. Effective corporate directors are diligent monitors, but not managers of corporate operations."

See The Business Roundtable, Principles of Corporate Governance (May 2002), at 1. See also, Report of the American Bar Association Task Force on Corporate Responsibility (2003), at 26 ("It is not desirable for directors to try to manage the corporation directly and comprehensively, and there are inherent limitations on the abilities of outside directors to assure corporate responsibility.").

Based upon the first hand experience of CBOE in operating with a ROC for the last four years, CFE believes that the functions of a futures exchange ROC should be similar in scope to the responsibilities of the CBOE ROC rather than to the more managerial functions proposed in the Release and Proposed Acceptable Practices.

The CBOE ROC charter provides that the scope of responsibilities of the CBOE ROC is to oversee the independence and integrity of the regulatory functions of the exchange and to seek to ensure that the regulatory functions of the exchange remain free from inappropriate influence. The charter then goes on to provide for the CBOE ROC to perform the following specific functions: (i) meet regularly with the CRO and possibly other senior staff in the Regulatory Services Division to learn of new developments and issues confronting the Division, and to hear their reports and concerns; (ii) review and make recommendations to the Board of Directors regarding the staffing and budget for regulatory operations, including the budget for needed technology or technology support; (iii) meet regularly with the Internal Regulatory Auditor; (iv) review decisions by CBOE's Business Conduct Committee not to authorize the issuance of statements of charges that were recommended by Exchange staff, and refer the matters to the Board of Directors for further review in accordance with CBOE Rules; and (v) make a full report (oral as well as written), no less frequently than once per year to the Board of Directors regarding the Regulatory Services Division and the manner in which CBOE is performing its regulatory functions.

The CBOE CRO has direct access to CBOE ROC and can contact ROC members as the CRO deems appropriate and necessary. The ROC also meets privately with the CRO on a regular basis to discuss regulatory issues. Additionally, the ROC has sent a memo to all members of CBOE's regulatory staff inviting them to directly contact the ROC with regard to any issues relating to CBOE's regulatory program and compliance.

CFE believes that the foregoing approach assures the independence and integrity of an exchange's regulatory programs and provides for the CRO to meet regularly with the ROC without the inefficiency and impracticality of having a committee that only meets periodically undertake the managerial responsibility of supervising the exchange's regulatory program and CRO.

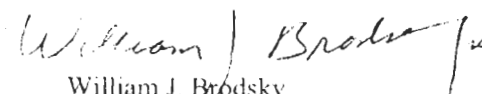
Futures Exchanges Should Be Provided with a Sufficient Period of Time to Implement the Proposed Acceptable Practices

The Proposed Acceptable Practices do not set forth a time frame for their implementation. Because it will take some time for a futures exchange to implement the Proposed Acceptable Practices, including the time needed to restructure its governing board and to identify and appoint additional public directors if necessary, CFE believes that the CFTC should, at a minimum, allow futures exchanges six months from their date of approval to implement the Proposed Acceptable Practices.

Conclusion

CFE welcomes the opportunity to work further with the CFTC on these important issues of futures exchange governance and self-regulation. Please feel free to contact Arthur Reinstein in our Legal Division at (312) 786-7570 if you have any questions regarding our comments.

Very truly yours,


William J. Brodsky
Chairman of the Board
CBOE Futures Exchange, LLC