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April 25, 2007

COMMENT

Via Electronic Delivery

Ms. Eileen Donovan
Acting Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

**Re: Conflicts of Interest in Self-Regulatory Organizations; 72 Fed. Reg. 14,051
(March 26, 2007)**

Dear Ms. Donovan:

I. Introduction

The Chicago Mercantile Exchange Inc. ("CME") has twice commented on the Commodity Futures Trading Commission's ("Commission" or "CFTC") rules respecting Core Principle 15. On September 7, 2006, CME provided extensive comments: (1) challenging the Commission's authority under the Act to adopt the proposed prescriptive rule in the form of an acceptable practice, and (2) demonstrating that the acceptable practice was not related to compliance with Core Principle 15 of the Commodity Exchange Act ("CEA" or "Act"). The issues raised by CME's comments were not fairly addressed by the Commission's final rule published in the Federal Register on February 14, 2007. In fact, the problems with the proposed rule were exacerbated by material alterations adopted subsequent to the close of the comment period.

On March 13, 2007, CME, with other exchanges, petitioned the Commission to repeal the definition of "public director" in the final rule. The exchanges urged the Commission to retract the public director definition because compliance would be infeasible and because the definition materially deviated from the definition in the proposed rule published for public comment. The exchanges argued that the final public director definition was not a logical outgrowth of the proposed rule and therefore did not comply with the notice and comment requirements of the Administrative Procedure Act. The exchanges reserved all of their prior arguments that the rule exceeded the Commission's authority.

On March 26, 2007, the Commission's proposed technical amendments to the acceptable practices for Core Principle 15 were published in the Federal Register. The proposed revisions were a commendable effort to cure the over-breadth of the final rule. Unfortunately, the corrections to the technical drafting errors contained in the February 14, 2007 version of the rule do not cure the fundamental problems described in CME's prior comments. We believe that the drafting problems are symptomatic of the rule's lack of foundation in the language or intent of the CEA.

II. Summary of Prior Arguments

The Commission's final rule, mistitled as an acceptable practice, imposes a board composition requirement on publicly-owned designated contract markets ("DCMs"), requires an arbitrary percentage of "public" directors, imposes a test that can not practically be performed or satisfied, and imposes prescriptive rules for regulatory oversight committees ("ROC") and disciplinary panels. The CEA does not grant the Commission authority to require an arbitrary minimum percentage of "public" directors on publicly-traded DCM boards. The relevant Core Principle, 14, which is not cited by the Commission as authority, provides:

(14) Governance fitness standards

The board of trade shall establish and enforce appropriate fitness standards for directors, members of any disciplinary committee, members of the contract market, and any other persons with direct access to the facility (including any parties affiliated with any of the persons described in this paragraph).

The Act directs the exchange, not the Commission, to establish such standards. CME is in full compliance with Core Principle 14 and with Core Principle 15, which provides:

(15) Conflicts of interest

The board of trade shall establish and enforce rules to minimize conflicts of interest in the decisionmaking process of the contract market and establish a process for resolving such conflicts of interest.

CME's fitness and conflict of interest standards, which are publicly available, are consistent with corporate governance best practices. Additionally, the Act does not grant the Commission power to dictate the formation or conduct of a ROC. The proposed safe harbor for Core Principle 15 bears no reasonable relationship to the Core Principle upon which it rests. CME's comment letter of September 7, 2006, demonstrated that:

- The proposed acceptable practices impermissibly impose required means for complying with the Core Principles that contravene the performance standards approach of the Commodity Futures Modernization Act.
- The Commission does not have statutory authority to regulate board composition of demutualized exchanges or to regulate the board's decision-making process and the day-to-day operations of board committees.
- The obligation of CME's directors to serve the needs of all market participants is defined and controlled by CME's obligation to ensure that we fully comply with all of our legal obligations. The Commission's formulation of this responsibility seems to go beyond these parameters and impose an unidentified obligation on our directors to act in a manner that serves the interest of market participants which may be inconsistent with his or her fiduciary duties under Delaware law.

- The Commission failed to consider the costs and benefits of the proposed acceptable practices as required by the Act.
- The Commission relied on uninformed and biased speculation to support its efforts to dictate board structure for demutualized exchanges. Its own orders, investigations and rule compliance reviews demonstrated that demutualized exchanges have properly performed their statutory functions under their previously approved conflict of interest rules and policies.
- There is no basis to conclude that a "public" director will have a greater incentive than any exchange or other industry member would have to make the optimal investment in self-regulation.
- The proposed acceptable practices impose inflexible uniform requirements upon all exchanges without regard to the nature of a particular exchange or the futures products traded on that exchange.
- To the extent this proposal evidences a return to a prescriptive regulatory regime, U.S. exchanges will be unfairly disadvantaged vis-à-vis their European counterparts, which are able to compete more effectively under flexible, principles-based guidelines.

III. Notwithstanding the Proposed Amendments, the Acceptable Practices Remain Flawed

Our March 13, 2007 petition highlighted a number of problematic consequences of the final rule. While the Commission now suggests that those inequities flowed purely from drafting errors, those problems were informally discussed with the Commission before the final rule was published. The proposed corrections slightly mitigate some of those consequences, but they are far from cured. For example, to determine whether the Commission's identified \$100,000-in-payments disqualifying threshold for potential public directors is being reached in a given case requires an inquiry into whether the total payment made by all exchange members, and the affiliates of those members, to any of the entities with which a purported non-industry director is affiliated totaled more than \$100,000 during the previous year or were likely to total \$100,000 at any time during her tenure as a director. As we noted on March 13: "The range of the required inquiry [to determine whether a director is "public"] is astronomical. CME currently has 3,000+ persons who own memberships, 1,500+ persons who lease memberships and 100+ persons who are deemed members for the purpose of participating in certain CME incentive programs." Neither CME, nor any person seeking to qualify as an independent director, can reasonably identify the affiliates of those thousands of "members." Compounding the problem is the requirement to conduct a similarly implausible analysis for each immediate family member of the director.

The proposed revisions do eliminate complexities related to this test, in particular the need to identify and assess relationships between the directors and "affiliates of members." The revisions also limit the definition of "payments" to "professional fees," however, the term "professional fees" is not even defined. It is not clear whether professional fees include those fees charged by doctors, lawyers, accountants, architects, speakers, writers, or other categories. It is not clear why fees in a non-defined "professional" category should be subject to some kind of disfavored status.

The scope of the Commission's definition would automatically preclude a large number of persons from serving as "public" directors. It is fair to ask whether the Commission tested the scope of its definition by applying it to the talent pools from which great institutions try to draw their "public" directors. By way of example, in Chicago, Northwestern Hospital has an extraordinary reputation and treats many in the financial services industry. It certainly receives more than \$100,000 in annual payments from members or officers or directors of members of contract markets. Presumably, the Commission's rule would preclude from service as public directors everyone who is an employee, officer or director of the hospital. Similarly, employees, directors or officers of many large institutions or companies that provide goods and services to the public could also be excluded from the pool of "public" directors.

The changes that were made to correct what the Commission has categorized as "drafting errors" do not provide any significant relief. The definition of "public director" no longer begins with an inquiry into the firms with which a director is affiliated. Instead, the Commission proposes an objective test that examines direct payments to the exchange director or to a firm of which that exchange director is an employee, officer, or director. This is an improvement but the Commission did not adopt a relevance or materiality exception for the employee category. Thus, one is affiliated with a firm or company regardless of the capacity in which one is employed. It does not make sense that the managing partner at a major law firm is on a par with a clerk at that firm. Additionally, it is not clear why the payment of professional fees exceeding the \$100,000 limit to a law firm employing a candidate's immediate family member in any capacity should preclude him from serving as an independent director.

IV. The Commission's Comments Regarding ROCs Should be Tempered

The proposed revisions do not fix the disconnect between the Commission's comments regarding the final rules for ROCs, which impose requirements beyond the plain language of the final rules, and the Commission's rulemaking authority. For example, the Commission states that "ROCs have the absolute right to whatever resources and authority they may require to fulfill their responsibilities, including resources within their DCMs." 72 Fed. Reg. at 6951. The Commission also purports to regulate the ROCs' choice of counsel, stating that "ROCs should not rely on outside professionals or firms that also provide services to the full board, other board committees, or other units or management of their DCMs." Id. at n.78. There is no basis for the Commission to dictate the ROC's choice of professional advisers. Similarly, the Commission's comments state that ROCs must determine regulatory budgets and supervise and manage regulatory personnel. We are concerned that the Commission's comments prescribe a far broader managerial role for ROCs than do the final acceptable practices and that DCMs cannot effectively govern themselves when the day-to-day management of DCMs must be channeled substantially through ROCs.

V. Conclusion

The ongoing inability of the Commission to express adequately the "intent" of the rule does not appear to be a drafting problem—it flows from the lack of legitimate purpose and principle that informed the Commission's decision to control the characterization of a director rather than to control her quality and the independence of her decision-making. The Commission's effort to force exchanges to fill their boards with so-called "public" directors is a solution to an unidentified problem. Three years of careful study demonstrated no need for such a rule. We hereby renew our March 13, 2007 petition and respectfully ask the Commission to repeal the definition of "public director" in the acceptable practices for Core

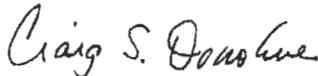
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Principle 15, 17 CFR Part 38, and to delete in its entirety the acceptable practice for Core Principle 15. It is unlikely that an exchange can make the certification required by the final rules. There is a very direct and meaningful way in which to draft an acceptable practice for Core Principle 15 and we would be pleased to participate in that effort. We also renew our petition to the Commission to repeal its comments to the final rule regarding ROCs because those comments differ substantially from the terms of the acceptable practice.

Thank you for the opportunity to comment upon the Commission's proposed rule amendments. If you have any questions or comments, please do not hesitate to contact either of us, Richard Lamm, CME Managing Director and Regulatory Counsel, at (312) 930-2041, or Matthew F. Kluchenek, CME Director and Associate General Counsel, at (312) 338-2861.

Respectfully submitted,

Chicago Mercantile Exchange Inc.
and
Kansas City Board of Trade



Craig S. Donohue
Chicago Mercantile Exchange Inc.



Jeff C. Borchardt
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cc: Chairman Reuben Jeffery
Commissioner Michael Dunn
Commissioner Walter Lukken