

**Response of U.S. Futures Exchange, L.L.C. to CFTC Staff Question  
Concerning Financial Surveillance**

1. *U.S. Futures Exchange, L.L.C. (“USFE”) has entered into a Regulatory Services Agreement (“RSA”) with the National Futures Association (“NFA”), under the terms of which, among other things, NFA will perform certain activities described in the RSA as “Financial Analysis and Risk Analysis” of USFE members (“FARA Activities”). USFE has also entered into a Clearing Services Agreement (“CSA”) with the Clearing Corporation (“C Corp”), under the terms of which, among other things, USFE may “request [C Corp’s] assistance with ... the financial surveillance of [USFE] Members” (“FS Activities”). The Commission has noted previously that, with regard to such arrangements,*

*the [contract market] must assure itself that the ... contracted services will enable it to remain in compliance with the Act’s requirements. Moreover, the [contract market] must have a sufficient degree of control over the persons under contract because it remains the [contract market’s] responsibility to ensure that its obligations under the Act are met.<sup>1</sup>*

*Please describe in detail USFE’s plan for overseeing proper performance of the FARA Activities and FS Activities. Please include in your response discussion of, among other things, specific USFE management responsibilities with respect to the RSA and CSA; USFE authority to direct changes in NFA and C Corp systems, procedures, or practices utilized by the FARA Activities and FS Activities; and USFE internal controls to ensure fulfillment of the RSA and CSA.*

**Response:** USFE places the highest priority on ensuring the financial integrity of its market and the contracts it will be offering. USFE is committed to providing financial surveillance that meets and exceeds industry standards. In our prior submission of December 31, 2003 regarding financial surveillance and in our meeting with the CFTC staff on January 14, 2004, we described in detail the financial and risk analyses and monitoring procedures to be undertaken by USFE and its partners, the NFA and C Corp.

Section 5c(b) of the Act makes clear that a contract market or derivatives transaction execution facility that complies with any applicable core principle through delegation of a relevant function “remain[s] responsible for carrying out the function.” USFE recognizes that it assumes responsibility for ensuring that the regulatory services outsourced to NFA and C Corp are performed in accordance with Core Principles and USFE has committed to take appropriate steps to effectively monitor and supervise these activities. USFE is carrying out that commitment both informally, through coordination efforts and staffing, as well as in its formal agreements with NFA and C Corp.

Specifically, USFE intends to appoint a full time risk manager with direct responsibility for overseeing financial surveillance, including the NFA and C Corp services. This risk manager will report directly to the head of compliance or another senior management officer. We further

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<sup>1</sup> 66 Fed. Reg. 42,256 at 42,266 (August 10, 2001)(“A New Regulatory Framework for Trading Facilities, Intermediaries and Clearing Organizations”).

expect that senior management will report to the USFE Board of Directors at least quarterly on the status of financial surveillance and the performance of the NFA and C Corp contracts.

Furthermore, USFE, NFA and C Corp have already instituted regular meetings, initially at least weekly, to coordinate procedures, processes and systems and to discuss issues of concern relating to financial surveillance. These regular meetings understate the level of coordination and USFE involvement, however. Key staffers of the three companies are, and will continue to be, in frequent telephonic and electronic communication to ensure that there is an open channel of communication available to address any problems that may arise.

In addition to these actions, USFE has taken care in its contractual agreements with both NFA and C Corp to ensure that it has the ability to direct that changes can be made in the specified procedures. Thus, if changing circumstances warrant, new regulatory requirements are promulgated or USFE identifies deficiencies in the current procedures, it has an existing mechanism available for ensuring its continued ability to meet its statutory responsibilities within the existing contractual frameworks.

### **Material Redacted**

Finally, it should be noted that although it is highly unlikely that NFA would decline to perform additional regulatory procedures or examinations requested by USFE related to the services NFA is currently providing, nothing in the RSA limits USFE from itself undertaking a direct examination of its members' trading activities or their financial integrity.

With respect to Clearing Members, C Corp, as an independent entity and designated derivatives clearing organization, has the principal responsibility for ensuring the financial integrity of its members, subject to direct Commission oversight. That is not to say, however, that USFE does not play an important role in ensuring the financial integrity of USFE members who are, or clear through, C Corp members.<sup>2</sup>

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<sup>2</sup> Indeed, as noted above, USFE has undertaken significant efforts to coordinate NFA and C Corp processes and procedures to ensure that financial surveillance performed by both companies would be seamless. C Corp and NFA share information on a daily basis. The daily sharing of certain information is detailed in the agreement between USFE and NFA.

## Material Redacted

Based upon the above, USFE clearly demonstrates its commitment to fulfilling its obligations under the Core Principle on financial integrity. In entering into contractual relationships with C Corp and NFA it has chosen established entities that are already registered with and overseen by the Commission. Moreover, it has been careful to enter into contracts with these two institutions which provide sufficient mechanisms for oversight and that have mechanisms through which new or enhanced procedures can be put into place. Moreover, USFE has already begun the important, but less formal process, of coordination and information-sharing that is crucial to an effective program of financial oversight. Finally, USFE will have the necessary experienced staff in-house<sup>3</sup> to analyze and act promptly on surveillance information it receives and to evaluate and suggest enhancements that may be necessary to the over-all program.

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<sup>3</sup> In this regard, we expect that as a consequence of our merger agreement with BrokerTec Exchange, L.L.C., we will gain staff with particular and deep experience in this area.