UNITED STATES OF AMERICA
COMMODITY FUTURES TRADING COMMISSION

GLOBAL MARKETS ADVISORY COMMITTEE MEETING

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Development of Real-time Risk Systems:

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Risks in Automated Order Routing:

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Citadel Derivatives Group

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ROGER LIDDELL
London Clearing House

BONNIE LITT
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JAMES NEWSOME
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P R O C E E D I N G S

(1:30 p.m.)

COMMISSIONER SOMMERS: We're going to started, if everybody can take their seats. Good afternoon and welcome to this meeting of the Global Markets Advisory Committee. This is my first time to chair a meeting of this committee and I'm very much looking forward to the dialogue regarding issues of importance to global futures markets. We have a number of members here with us today who are continuing as members of GMAC and several new members as well. We really appreciate all of you taking time out of your busy schedules to be with us today because we rely on your input.

Let me take a minute to recognize Acting Chairman Walt Lukken for his outstanding service to GMAC. Walt served as chairman of this committee from October 2003, to early February of this year, a period of nearly 4-1/2 years. Under his leadership the committee worked on an array of issues including MiFID, cross-border clearing, bankruptcy issues related to segregated and secured funds, as well as international regulatory coordination, and I value his guidance on these international market issues.

The GMAC was established by the Commission in 1998 to seek industry input on matters that impact the global derivatives marketplace. Today's discussion certainly falls within that category. After an update on current international initiatives, we will discuss the implications of various legislative proposals that have recently been introduced in Congress concerning foreign boards of trade that provide access to U.S. customers without registering as a U.S. exchange. The issue of U.S. Access to foreign exchanges has been debated by this committee before. In fact, the agenda for the very first meeting of GMAC held on May 14, 1998, included, "Placement of U.S. exchange terminals abroad and foreign exchange terminals in the U.S." At that time, U.S. exchanges were concerned that foreign exchanges with trading terminals in the U.S. might gain a competitive advantage over U.S.

Exchanges due to less-burdensome home regulatory structures and the Commission was grappling with what it meant to be located outside of the United States as that phrase is used in Section 4(a) of the Commodity Exchange Act.

The global landscape has changed tremendously since that time. U.S. exchanges now operate around the world and the Commission has issued no-action letters to 18 foreign exchanges permitting access to U.S. customers. Advances in technology and innovative business plans have opened markets and spurred competition in a way that has benefited economies worldwide providing risk-management tools where they didn't exist before.

While the global landscape has changed, questions surrounding the Commission's no-action process and whether it provides both the regulatory tools necessary for proper oversight of cross-border business and a level regulatory playing field have persisted. In 2006 the Commission reaffirmed the no-action process as providing the most flexible method of ensuring that appropriate conditions are put in place to address the specific factual circumstances of a given market as demonstrated most recently by the enhanced conditions added to the no-action relief for ICE Futures Europe and the Dubai Mercantile Exchange, but as I mentioned, questions still persist. Jackie Mesa, our Director of International Affairs, will summarize the different categories of pending legislation which will lead us into what I hope will be a productive discussion of the implications of these various proposals.

Futures exchanges and the means to access them are evolving in an era that is increasingly dominated by electronic trading. Sophisticated customers often want more control over trade execution, more direct access to the markets, and less intervention by their brokers. There are different terms for this trend, but most widely used is direct market access or DMA, our second topic for discussion today. We will have an update on IOSCO efforts from Robert Rosenfeld who is our Deputy Director of International Affairs. Ananda Radhakrishnan, our Director of Clearing and Intermediary Oversight, will speak to us on the potential risks of DMA. And finally, we'll hear from Peter Reitz from Eurex, R.J. Cummings from the IntercontinentalExchange, Kim Taylor from the CME Clearing House, and Yvonne Downs from Newedge.

There are two main types of DMA. Traditional DMA provides centralized order routing where the customer inputs an order and relies on the futures commission merchant to route this order directly to the exchange of their choice. When this introduced some years ago it was a huge advance compared to the preautomated trading that preceded it. Pure DMA which is newer than traditional DMA allows customers to connect directly to the exchange instead of going through a futures commission merchant's traditional infrastructure. It is increasingly popular particularly with high-volume traders. Going directly to an exchange can reduce latency or time delay on routing orders. DMA has improved trading efficiency and generally offers traders more safeguards via the clear audit trail it provides, but the emphasis on speed is challenging traditional approaches to risk management. Clearing firms traditionally accessed risk and pretrade controls as trades passed through the firm's order routing infrastructure and before they reached the exchange. Some traders whose trading strategies depend on high-speed access to exchanges want to avoid delays caused by such pretrade risk filters. Clearing firms are cautious about this kind of business but competitive pressures make it hard to turn away such traders. This has meant that risk assessment for pure DMA clients is often done after the trade is executed on a posttrade basis.

Today's meeting of the committee gives us an excellent opportunity to discuss the risks and benefits of DMA including the challenges to risk management, how exchanges and the intermediaries have responded to these risks, and whether there is a need for industry-wide guidance.

Before we begin I'd like to go around the room and have everybody introduce themselves and tell us what industry, association, or firm you are with. And for logistical purposes, to let you know the mikes that we are using today are push to talk so after you are doing speaking, if you could push to turn them off as well. And if everybody could put their cell phones or BlackBerrys on vibrate, sometimes they can interfere with our audio feed. And finally, just one other thing, if you'd like to be recognized to participate in the discussion, just turn your placard up. Let me turn things over to my fellow Commissioners for any comments they have and I'll go to our former Chair of GMAC Acting Chair Walk Lukken.

CHAIRMAN LUKKEN: Thank you very much, Jill. It's a pleasure to be here. I think it was last October the last GMAC meeting we held and which I chaired, so there have been a lot of important changes since then, most importantly, Jill has taken over the leadership of this committee. It seems like an eternity ago, October of last year. I've lost some weight and some hair since then, but anyway I commend her for setting an important agenda here today on issues that are very relevant to policymakers here as well as in Congress. These are obviously, and this is an understatement, busy times for us here at the Commission, so the GMAC convenes at an important time here and hopefully can influence the discussion by policymakers.

Certainly with the increase of electronic trading in global markets around the world, we've had to evolve as an agency here and we're trying to evolve at lightning speed. We've been a long-time international leader over our history and we should not shy away from that. For 20 years we were one of the first to develop a mutual recognition system for firms and 10 years ago for exchanges. So that is something that as an agency we've been a leader on around the world.

One area that has developed recently is the increased use of cross-border-linked products. It's something we first tackled in June 2006 when the Commission held a public hearing on this issue and put out comment in the Federal Register what is a foreign border trade located outside the United States. And the Commission in October unanimously issued a policy statement affirming the no- action process and the next month signed with FSA an agreement to share information. But in doing so we recognized that there was a chance for wrongdoing between the markets and we wanted to make sure there were not regulatory gaps and so we were always looking to try to improve the program, and certainly recently we've made improvements to the program with additional information sharing from the FSA as well as the imposition of position limits in this area. Congress is keenly interested in this area, but I'm interested in hearing from this group that works on these issues every day to hear whether the program is working, how it's working, are improvements necessary, and help us to frame as policymakers so we can advise the lawmakers on what they may have to do over the coming weeks and months. So that's very important.

And obviously direct market access is an issue that's around the bend for us. We're trying to deal with it now so we don't have to be dealing with a crisis months from now. It's helpful to understand all the risks that surround this issue and so I'm looking forward to a lot of listening today and learning about this issue and how as regulators we need to be addressing this and whether there are solutions that could be at hand for us. Thank you so much for coming here, and I commend Commissioner Sommers for the agenda that she put forward today.

COMMISSIONER SOMMERS: Mike, do you have an opening statement?

COMMISSIONER DUNN: Thank you, Chairman Sommers, for leading today's meeting. I commend you for your work in this area and I look forward to hearing from the international experts that you've gathered here to speak about direct marketing access and foreign boards of trade.

Since the last GMAC meeting, interest in commodities have continued to grow here in the United States as well as around the world. Whether the discussion is international oil markets or global food supplies, markets in these commodities are at the forefront of everyone's thoughts. As these are worldwide markets, solutions to concerns and problems can be addressed in settings such as these where international experts gather to talk about significant developments from a variety of perspectives. Today we discuss direct access issues. It's important to remember that in the electronic environment ourselves, a board of trade location becomes less and less concrete as exchange models evolve. Managing risks associated with exchange activities become more complex as new trading relationships develop. Additionally, with legislators considering whether to revise the

Commission's current policy for allowing foreign boards of trades direct access to customers here in the United States, it will undoubtedly be helpful to hear from the industry's views on the current process and any possible revisions.

I look forward to hearing from everyone gathered here today and would like to thank all the Advisory Committee members for participating.

COMMISSIONER SOMMERS: Thanks. Bart, do you have a statement?

COMMISSIONER CHILTON: Thank you for doing all this work, Commissioner Sommers, and to your staff for doing it.

Walter Lippman had this quote which I thought was neat and it was, "Where we all think alike, no one thinks much." That's why it's great to have this sort of group here who can think and offer different opinions to what may be the common convention. As Commissioner Dunn said, a lot has changed, and I won't go into all the details, but the technology is obviously a big, huge deal. No longer do you have terminals that are located in one country and directly tied to another exchange, and we ought to get used to that as regulators. That's going to be around for as far as we can see in the future. And figuring out how you deal, how Jackie helps us deal, with international regulators as we move down that road is going to be increasingly important. Likewise, the number of products have changed and they've become interesting, and as Mr. Sprecher knows, challenging for us in dealing particularly with look-alike contracts. And I just can't think ICE and Mr. Sprecher more for providing the information that Acting Chairman Lukken requested that provides transparency. Here you're an innovator in this industry and you must just feel like you can't win for losing when you've got more than one regulator to deal with and you've done it gracefully, and this information I think is important for us to have and important for American consumers, and so thank you for that. And I also want to thank FSA for being helpful in part of this information-gathering request and transmittal process.

But these are extraordinary times and if you look at what's going on on Capitol Hill, there are close to 20 bills now on market manipulation, et cetera, and they all tout themselves as good government bills. Huey Long said Louisiana is some day going to get good government and they ain't going to like it. There's a lot that people don't like about these 20 bills. Mr. Brodsky was in my office earlier and I turned down a James Taylor concert. Do you know his encore song? He plays that Steamroller song? There's a line in there about a demolition derby and I thought that's almost like all these 20 bills that are sort of competing, and we certainly don't want to have the Commodity Exchange Act full of a hefty hunk of steaming junk, and so I think whatever we do or whatever Congress does needs to be targeted, it needs to be surgical as opposed to some big sledgehammer. And I think the Durban- Levin Bill that really codifies this no-action process and the transparency that we're now getting from ICE is really such a process and really such a bill that can help and I hope that whatever other proposals may come down the pike in Congress that they are similarly as surgical and targeted and as thoughtful, because as you all know more than anybody in the world, these are incredibly sensitive markets and they're incredibly important markets for consumers. So I look forward to hearing from all you great thinkers. Thanks.

COMMISSIONER SOMMERS: Thanks, Bart. I'm now going to turn it over to Jackie Mesa who is our Director of the Office of International Affairs for her overview.

MS. MESA: I wanted to go around the table and have everybody introduce themselves. I'll start with Eric.

MR. VINCENT: I'm Chairman of the Managed Funds Association which represents the alternative investment industry. I'm also present of Osprey Management, a New York based investment management firm.

MR. DONOHUE: I'm Craig Donohue, CEO of

CME Group.
MR. DOWNEY: I'm David Downey with OneChicago.
MR. HAHN: I'm Arthur Hahn with the Katten Muchin law firm and I represent Euronext Life.
MR. DAVIS: Kevin Davis with MF Global.
MS. MEDERO: Joanne Medero. I lobby for Barclays wholesale businesses.
MR. CRAPPLE: George Crapple. I'm Co-CEO of Millburn Corporation. We're a CTA and CPO. I'm on the board of the NFA and the FIA.
MR. SPRECHER: I'm Jeff Sprecher. I'm the CEO of IntercontinentalExchange.
MR. REITZ: I'm Peter Reitz. I'm a member of the board of the Eurex Exchanges.
MR. CUMMINGS: R.J. Cummings, Vice President of Product Development and Design at IntercontinentalExchange.
MS. TAYLOR: Kim Taylor, CME Clearing.
MR. LIDDELL: Roger Liddell, London Clearing House.

MR. ANDRESEN: Matt Andresen. I'm the Co-CEO of Citadel Derivatives Group.

MR. ROTH: Dan Roth, National Futures Association.

MR. BRODSKY: Bill Brodsky, Chairman and CEO, Chicago Board Options Exchange.

MS. LITT: Bonnie Litt, Goldman Sachs.

MR. FORD: Ken Ford, I'm currently Chairman of the FIA. In my day job I'm head of listed derivatives at Credit Suisse.

MR. DAWLEY: Mike Dawley, Goldman Sachs.

MS. DOWNS: Yvonne Downs, Newedge.

MR. NEWSOME: Jim Newsome, President and CEO of NYMEX Holdings and I think for this meeting a member of the board of the Dubai Mercantile Exchange.

COMMISSIONER SOMMERS: Now I'm going to turn it over to Jackie.

MS. MESA: Thank you, Commissioner Sommers, for allowing me to present some of the issues that are on the Office of International Affairs plate, and I can't take entire credit, I think the entire Commission is working on a few of these issues that I'm going to talk about today.

I wanted to provide updates in three areas. First, studies that other countries or international organizations have done or are doing regarding rapid increases in prices and commodities in futures markets including some studies in speculation. I'll also briefly discuss the CFTC's recent amendments to two foreign board of trade no-action letters for direct access, although I think most of you probably could recite back to me what I'm going to tell you in a few moments. Then finally, many of the bills proposed in the U.S. Congress deal with foreign boards of trade and so I wanted to broadly summarize those bills into general categories without going into specifics, and I'll do that at the end.

As you know because so many of you around the table have testified, or at least a few or you repeatedly, Congress and others are concerned that the run-up in commodity prices might be caused in part by what is characterized now as excessive speculation. A number of foreign countries are doing work in this area and we try to monitor these developments from my office and cooperate or coordinate with the foreign authorities or international organizations were appropriate. So I'm going to through a few of these organizations and what they're doing.

In June, the G-8 finance ministers released a statement requesting national authorities to examine the functioning of commodity futures markets and take appropriate measures. The G-8 also calls on the IMF to work with national authorities to analyze real and financial factors behind the increase in oil and other commodities. They also require the IMF to deliver a report to the G-8 finance ministers. So consistent with the G-8 calls for national authorities to work with the IMF, we recently met with the Fund to discuss their ongoing work. They typically always put out two reports a year every 6 months, the Global Financial Stability Report, and the World Economic Outlook. Both of these always touch on commodities in some way, but they've told us that the reports will largely focus on the commodity price increases and deal with speculation and their studies regarding if speculation is a factor. These reports will be out for the public in October and we are going to try to work with the IMF as much as possible as they develop these reports.

The European Commission is also preparing a paper which will be out in December. They also are going to publish an interim report in mid-September on recent market developments in oil and food including the possible role of financial speculation in the increases, and we're communicating of course with the European Commission as they start this study. A country that's already one a report which I find really interesting is India, because some of you know they banned trading in four food commodities including wheat a rice. So the parliament commissioned a body to study what was going on with the high increases of these four food prices and whether it was speculation. There was a report on April 30 by the SEN Committee, and they found that futures trading had no impact on these commodities, but the report did not actually recommend a lifting of the ban. In fact, as of today a ban still exists in India on these four food commodities. The Japanese Ministry of Economy and Trade and Industry also issued a paper in 2007. The difference here is that they did look at the price of oil specifically. They looked at it when it was $90 a barrel. They found in their report that $30 was due to speculation or something other than supply and demand. We met with METI, the group that put this out, and asked for the data to back that up. We don't have it, but we'll keep asking them for that.

In June the U.K. Treasury released a report analyzing the trends and drivers in commodity markets that have led to recent price increases. That's a good report. I don't think it specifically addresses speculation but focuses a lot on supply-and-demand factors and why we are where we are today. I thought you'd find it interesting too that the U.S. agencies aren't the only ones being called to testify. Just this morning the UKFSA testified before the House of Commons on regulation of the U.K. Energy markets and I think ICE also participated in that.

MR. SPRECHER: We received the invitation.

MS. MESA: You received the invitation? So we're starting to get reports on what went on this morning.

Now I'd like to turn to recent amendments on our foreign screen no-action process. By way of background, as Acting Chairman Lukken also mentioned and Commissioner Sommers, we've had since 1996 a foreign exchange direct access staff no action in process in place that's worked very well. Eighteen foreign markets have received permission to provide direct access to U.S. customers through this process based on a review of the foreign board of trade and the home regulator and conditioned on certain things like books and records and information sharing. We again examined this policy and process in 2006 when ICE Futures Europe listed the West Texas intermediate crude contract that settled off the NYMEX settlement prices for the WTI, what our surveillance staff calls creating effectively one market. That listing was unique from a regulatory point of view because it was the first listing of a foreign board of trade contract that settled off an existing U.S. exchange contract. After a public hearing and a public comment period, the Commission issued a policy statement reaffirming the foreign board of trade no-action process. But our staff see an issue regarding the one market and it was really that the U.S. regulators were not able to observe the entirety of one trader's position on both markets. Pursuant to that concern, the CFTC entered into an information-sharing arrangement with the UKFSA to receive large trader data, and in late May of this year we announced that we were enhancing that arrangement, and I'll just go through the steps of where we are enhancing that.

We were getting large trader reports but on a weekly basis, and in the settlement -- daily large trader reports. Now we get them daily instead of weekly and expansion of the trader information to all months out instead of the two nearby months. In some cases we weren't getting the end user of each large trader and now we will. Also we're improving the formatting of how that information is coming in. The way it's going to come in now is it will be seamlessly integrated into our surveillance system just like our own large trader data. And we will integrate that data that we're receiving into our commitments of trader report.

A second enhancement and condition of the no action that we made a couple weeks later is in June we amended the no-action letter to include adoption of equivalent U.S. position and accountability levels on the WTI crude oil contract and on other similarly linked contracts. We are allowing the foreign board of trade to adopt similar hedge exemption requirements and they are going to report violations to the Commission when an exemption or a spec limit is violated and ICE Futures has 120 days to comply with those provisions. We put the exact same similar conditions on the Dubai Mercantile Exchange and issued that letter on July 7. The Commission has announced that Commission staff will apply these new conditions to any future request for direct access where the contract listed on the foreign exchange is cash settled against those listed against those listed on the U.S. Exchange.

Finally I want to turn briefly to discussion of various bills that are out there pending in Congress that could impact the CFTC's international program. Commissioner Chilton, you said there are about 20 bills, there are actually more than that, and only 26 deal with international. So there's even more than that that deal with the CFTC. It's just amazing to keep track of, and as of today I should add that

-- increase that number. But instead of boring you and discussing each one, I'm just going to bulk them into general categories. A lot of them generally codify what I just went through on how we conditioned the DME and Ice Future's no-action letter. There are some core differences. Many of the bills or most of the bills say that this should apply to contracts that are physically delivered in the United States. So if a foreign board of trade is trading a contract that physically delivers in the U.S., then these conditions should apply. Some of them further qualify that and say on energy contracts that physically deliver in the U.S., then the CFTC should condition these no actions. Lieberman has I think maybe one of the bills out there that actually deals with linkage by settlement price, but otherwise I think most of them talk about physical delivery.

There are also a number of bills that amend Section 4 of the Commodity Exchange Act to extend the Commission's authority over U.S.

persons trading on a foreign board of trade. They require the U.S. person to limit or reduce or liquidate any position or apply recordkeeping requirements to individuals trading on foreign boards of trade as the CFTC deems necessary. So it really goes less to the foreign board of trade and more to the U.S. persons trading on the foreign board of trade.

Finally, and I'm going to go to the other extreme, some bills require full registration of a foreign board of trade that has an affiliate in the U.S. It's interesting too because there's one bills that goes into a lot of different ors, so if you have an affiliate you have to register, if you trade a commodity physically settled in the U.S. you have to register, or if you trade a significant price discovery contract, it doesn't like it to anything in the U.S., just if there's a significant price discovery contract you have to register. Another bill puts all these together and says if the foreign board of trade has an affiliate or trading infrastructure, an undefined term, or trading infrastructure in the U.S., the foreign board of trade trades energy commodities that perform a price discovery function, then you have to register as a DCM. So that gives the unique bills that are out there in broad categories. We're busy, but so is the rest of the Commission. While the CFTC has no formal position on any of the legislation, we have been working with Congress and relevant staff when asked to provide technical assistance on some of these bills. This concludes the broad update and I'm happy to answer any questions and turn it back over to you.

COMMISSIONER SOMMERS: Thank you. Does anybody have any questions for Jackie on her international initiatives or dialogue in the international areas?

MR. VINCENT: Jackie, one question if you could share with us, in your conversations with the FSA about information sharing. I understand that you reached an agreement, but was there any resistance by the FSA in terms of the level of information sharing and the imposition of position and accountability levels? And do you anticipate those issues in the future if requests are made for further information?

MS. MESA: It's interesting how this is getting spun a little bit in the press. As you know or may not know, the FSA has something called the Balls amendment which allows the UKFSA to veto a rule on one of their exchanges if it imposes a burden on the exchange that is excessive or more than what the FSA would normally impose. So they have said in response to what we have done that they haven't seen the rule that has to be placed on the exchange in order to do the speculative limits and until they see that rule, they reserve the right to apply the Balls amendment and to look at this closer and decide if it's excessive. So that's a fact and that's what they've stated to the press. We of course have been in discussions with them on information sharing and on the speculative limits. There has been a lot of back and forth. In fact, I talk to the FSA almost daily. It's pretty interesting what's been happening. We always talked about weekly, but now it's daily. On the information sharing, absolutely no resistance. I think they recognize the world we're in and why it's necessary to be as transparent as possible.

On the speculative limits, it's not what they do. They have a risk-based management system. If they see something that's bigger for a normal size of a trader then they'll inquire and ask them to get down. We have in our foreign board of trade no-action process found their system comparable so we already earlier judged that what they did at the FSA was comparable. But in this situation they recognize that these linked contracts are unique and in this limited situation they understand that there was concerns that traders may be going to ICE Futures Europe to exceed what we weren't allowing them to do in the U.S. and with ICE Futures Europe and UKFSA all understood that this was going to be a condition of the CFTC's no action. But it wasn't as if this was a negotiated agreement, this was a condition that we put on the no action. I hope that answers your question on where we are with them.

MR. VINCENT: Yes. Thanks.

COMMISSIONER SOMMERS: Are there any other questions? I'll ask everybody if they can identify themselves and the organization that you're with before you ask a question so we can get that on the record.

If there's nothing further, I think that it's clear from Jackie's summary of these legislate proposals that there may be implications to these proposals for you, your business, and certainly for this industry. I know that there are a lot of people around the table who want to engage in this discussion. I'll turn it over to Craig Donohue with the CME Group.

MR. DONOHUE: Thank you, Jill. I would just start by saying that I think the CFTC really should be commended for the no-action process that it has implemented and operated for Jackie I think you said a dozen years now and it certainly has I think everyone would agree promoted tremendous growth in the marketplace. It has helped globalize all of our activity, expanded investor choice, and I think generally worked very, very well. And I think it's worth pointing out as well that when we talk about enhancing our competitive position in the global marketplace and the regime that we have on the futures side of the market in the U.S. that it compares very favorably to what exists on the securities market side, so there's no doubt that this has worked incredibly well for us as an industry. And while I respect the changes that have been made in the no-action process, I think it has gone probably as far as it should. In terms of the legislation, it's difficult to comment on the various bills that you've talked about but I think for the most part they're all lacking in effectiveness in different ways and it's probably not possible to get into the details of why that will likely not be effective from a legislative perspective. But I think it's important to preserve the flexibility of the CFTC to do the kinds of things that were done here which I do think are effective, but don't throw the baby out with the bath water.

As you can imagine, we operate ourselves in more than 85 countries and we think that what's been done, again it's a double-edged sword. It opens up access to this market but at the same time it also provides a level playing field for large enterprises like CME Group to do business on a global basis in a way that we can live with the existing regulatory structure that we have in the United States.

We ourselves have listed foreign contracts with foreign delivery points in the past, in the soybean market for example with delivery points in Brazil, and as we continue to globalize our own business by partnering with other exchanges around the world including most recently again Brazil, we anticipate developing more products with foreign delivery points that do serve a price discovery function. So at least from CME Group's perspective we would hope that what's been done is as far as it will go. I think that it's not helpful to have legislation that encumbers the good decision making of the CFTC and I think that the ability to do what you've done on a collaborative or a cooperative basis versus imposing your will on foreign regulators or foreign boards of trade that are doing business here not only will put us all at a competitive disadvantage and likely limit our growth opportunities, but I think will also result in similar practices being adopted over the course of time that make it much more difficult for us to navigate the global regulatory environment.

COMMISSIONER SOMMERS: Thanks, Craig. Art, I know you have been involved in this process with this Commission probably since we started issuing these no- action letters so I'd like to hear your views.

MR. HAHN: I indeed was. I remember walking on the beach with Andrea Cochran at Boca one year and saying why is a screen different than a telephone call to put in an order and she held fast and said somehow it was different. I think the history probably is relevant a little bit here and what I would commend to everybody when they begin working on this subject matter is go look at the Commission's release in November 2006 after the last round of roundtables on the no-action process. The Commission pulled together a wonderful history of it and why the decisions were taken and how we got to where we are today. It has not been a straight line, it's been a complicated process, and it's worth in the middle of the storm going back and understanding how we got here.

As Craig says and as Walt has said, the hallmark of the Commission has been to solve the problem of globalization and the way you do that is this magic word comparability. You make a judgment that the foreign regulatory regime is comparable, that it fulfills the same goals as the Commission's goals. If you try to be exact, you cannot be global and that will hurt U.S. industry here, it will deny access by U.S. market participants to foreign markets, because simply stated, just as we in the United States and at the Commission and at the SEC would not stand for some foreign regulatory coming in and saying here's what your rules are, foreign regulators are of like mind and know to a certainty that they are watching what is happening now.

Jackie mentioned the Balls clause. That was a blatant statement, we in Europe are worried about in that case it was the export of Sarbanes-Oxley. We don't want our public companies to have to live in the Sarbanes world and NASDAQ might buy the London Stock Exchange, we don't want U.S. exported here and we'll stop it. We'll close it down. Close to my home in the NYSE Euronext world, when that merger was being negotiated, the European regulators were extraordinarily sensitive about the export of U.S. and the impact not only in European exchanges but members of European exchanges.

So what kind of burdens are we going to put on them? Larger trading reporting and other kinds of restrictions. I see Peter nodding his head. He knows how the Germans would react to that. I think if America is to have its institutions access the rest of the world, we cannot get caught up in a herd mentality that puts up a wall. It's going to hurt U.S. companies. It will hurt U.S. consumers who won't have access to these markets. We do live in a global economy and we have to be sensitive to it.

A final comment is that I think the no-action process is an extraordinary one. I don't know if we really conceived of it when it all started, but it has today shown the flexibility to deal with the energy issue as Ben articulated here. I think we're going to come in to challenges in the future. I lived again through the process when the Commission tried to do rule making in this space. It was Chairman Born's regime. There was a strong to push to make rule making and they suspended no action. It didn't work well at that time. Rule making tends to be hard and fast. It lets my crowd the lawyers get at it in a way to go and find a way to get around it. It teases out some hard, inflexible positions. What I would counsel us as we go forward here is do exactly what we have been doing which is pay very good attention to the no-action regime. Turn that screw tighter is good judgment dictates that that be done. Loosen it if you need to. You've got a wonderful, flexible machine that can deal with the challenges of globalization and technology and everything the markets can invent. If you hard wire it you will lose that flexibility and I would caution against that either at a legislative level on the Hill or, candidly, by rule making a Commission level. So those are some thoughts.

COMMISSIONER SOMMERS: Thanks, Art. I know this has certainly been something that has hit close to home for you, Jeff. I was wondering if you'd share some of your thoughts.

MR. SPRECHER: Where do I start? Generally speaking we think that the no-action process is the right process to deal with these issues and I think we might want to consider renaming that process because it isn't no action. Right? It is a flexible action. The reason that we think it's the right process is that none of this can work unless regulators work together and unless all of you have a dialogue and not just information sharing but a policy-making sharing relationship with your global peers and then the industry will not globalize. We actually have a very good working relationship with this Commission and with the staff and we've watched the no-action process change with respect to our business as it's changed and at the end of the day it's the best process that we can think of that's out there.

We are not advocating any of the legislation on the Hill right now because a lot of it is simply just trying to codify what you already have done here as a Commission, and you feel you need that, that's great and we would be supportive of it. I guess our view as being a regulated entity is we haven't seen that you've needed it. You've obviously been able to adapt and take action as our business has changed. But if you did say you need it or if you are advocating for more personnel, more systems and what have you, certainly we would be an advocate for you on the Hill on those because we do think the process works.

Commenting a little bit on Jacqueline's opening statement, we did have a hearing today with the Treasury in the U.K. One of the side comments that was made up there is this a reverse Boston Tea Party where we're having regulation without reputation? So there is a view in the U.K. that this should be a two-way dialogue and they are not necessarily getting that from Capitol Hill. I know they do get it from the Commission. So it increasingly is why we think that this is the right venue for that kind of global discussion and debate.

On the Balls Amendment which Art correctly mentioned was adopted in the U.K. to spread the Sarbanes- Oxley, part of why we think that this no-action process will work is that in order for ICE Futures Europe to put on position limits, accountability limits, information dissemination, we have to adopt exchange rules and in order to adopt an exchange rule we have to have the oversight of the FSA and the FSA technically could theoretically block the adopt of our rules even if we as an exchange wanted to take such a rule because they're held to their own regulatory standard that the markets that they operate must be free and fair and it's incumbent on us how to demonstrate that these actions that you're taking in the no-action process keep the markets free and fair, and we do believe that that is the case. We've messaged that to not just the FSA but many people in government in Europe that we think that on balance these are the right things to do and that it will continue to protect the markets and they'll flourish.

So the balance of you all as a Commission here is as you're promulgating rules, other regulators have to come to believe that what you're doing helps the integrity of markets, and while we at the exchanges can help to be a messenger in that regard, ultimately it's going to be your common dialogue, goodwill, and interoperability globally that will actually allow the no-action process to continue and I'm sure will continue to evolve as the business evolves.

COMMISSIONER SOMMERS: Thanks, Jeff. Ken, I know that the FIA has some views regarding some of the legislative proposals that are out there. If you could share with us --

MR. FORD: We agree with all our exchange partners. I think, and it sounds like we are pretty much in agreement with a lot of what's been said here, we are happy to codify what the relationship has been between the CFTC and the FSA in regards to ICE Europe. We think that works real well. It gives the clarity I think that the market needs. But I think our concern is and I think Commissioner Chilton alluded to this, you got to be really careful how to put the language in the legislation to make sure that there are not unintended consequences because we've looked at a lot of the different bills that are out there and I think Craig said that you don't want to throw the baby out with the bathwater. There are a lot of things in there that could have a lot of untended consequences where you may force of the USFCMs to move their business to their foreign FCMs which obviously is counter to what the CFTC and the U.S. is looking for in terms of clarity. So I think we can support a lot of this, but again it comes down to exactly what the language is that is used. We just have to be real careful, and we're very happy again always to work with the CFTC and everybody to help craft that language so that it is very carefully done. I guess that would be our point.

COMMISSIONER SOMMERS: Thanks, Ken. Does the board member from the Dubai Mercantile Exchange have a thought?

MR. NEWSOME: I do, but first I want to say that I agree 100 percent with the viewpoints of my soon to be new boss Craig Donohue.

A number of us have been working on the Hill for the last month or 5 weeks and I think it's time to get past generalities and for us as a group to really start drilling down and circling around language that we think we can support. I have become convinced over the last 2 weeks that there's a 100-percent possibility that something is going to be passed and we've got an opportunity to try and shape what that becomes. All of you know that there is language out there that we can live with and then there's a lot of language out there that we can't live with. Specifically, with regard to foreign boards of trade, NYMEX supports the no-action process unconditionally. It has been a great process. It's the kind of flexibility that's needed. Obviously there is no one who could have more incentive to throw Jeff under the bus than NYMEX. Hopefully Jeff will agree with me that we have not done that.

MR. SPRECHER: Not for lack of trying.

(Laughter)

MR. NEWSOME: I don't want to have to

throw you in the Greenberger category now. Obviously we have supported the Commission's conditioning of the no-action letter with the two primary components. A lot of members of Congress have wanted to go much further than that. We have opposed that at every step of the way and will continue to oppose that because we don't think going further is good policy, and I think to take the flexibility away from the Commission in dealing with what can be very intricate, complicated situations would be a huge mistake. But I think in drilling down on the process a bit, certainly I don't think anyone around this table is concerned about the CFTC and the decisions that the CFTC will make as we move forward because you guys do understand this marketplace and you do understand the real fear of unintended consequences and damage to markets and moving markets offshore. But again I think as an industry we've got to get more specific. And I'll just throw out there from our standpoint that we love the Durbin language. There have been attempts in the House to use the Durbin language as a core to other pieces of legislation. We think that is the appropriate approach to take. Senator Durbin codifies basically what the CFTC has done. I think everyone around this room would probably recognize that the most beneficial component of most pieces of legislation is to generate more resources for the CFTC. We all recognize that that is sorely needed. But whether it's Durbin or something close to Durbin, I would simply encourage everyone to get engaged on it and to start supporting some specific language because the horse is out of the barn and he's running very quickly and the more that we can all gather around similar language I think the better off we're going to be.

COMMISSIONER SOMMERS: Thank you, Jim. Do any of my fellow Commissioners have questions?

CHAIRMAN LUKKEN: I talked quite a bit with lawmakers about this issue, in particular foreign boards of trade, and there is a lot of, as Jeff said, it's unfortunate that it's called a no-action letter because I think there is misunderstanding about the process in which we engage here at the Commission to allow this type of access. Certainly for many of you involved in writing no- action letters to the agency and us approving them, these are 40- to 50-page documents where we go through analysis of regulatory regimes, improving these, and what the exchanges are doing and making sure that there are comparable objectives. And certainly the Commission sees every no-action letter that comes through this agency and we have the ability as a Commission to object to those no- action letters that are occurring, so there is proper oversight.

I think the other point I would say where there is a lot of misunderstanding is our limitations in law about what we can do with regard to foreign boards of trade. There are prohibitions in our Act that limit how we can recognize these foreign boards of trade and what they can do and we've been subject to those limitations over the last 10 years in trying to craft this no-action process. But often, and I'd be interested in comments from people on this, there seems to be a gut feel among some that these some of these products are U.S. products, that this crude oil product, maybe because it has West Texas in its name, is a U.S. product and they cite how much is traded where in regard to ICE Futures and because it's a U.S. product and even though it's cash settled, and I think actually a majority of the traders are not located here in the United States --

MR. SPRECHER: And it's exacerbated by this phenomena of algorithmic trading and they will be wherever we are in our view wherever the matching engine is.

CHAIRMAN LUKKEN: But there seems to be a desire among congressional members to try to define what is a U.S. Product and that to be a trigger for legislation, and I'd just ask the group whether this a futile exercise given the current market environments. We have NYSC Life with the possibility of listing products from anywhere. We have LIBOR contracts with Eurodollars, we have foreign currency products where anybody's foreign currency can be influenced by what we're doing here in the United States. I think the beauty of the no-action process it it's a nimble process, but it also allows us to get the information we need immediately and instead of worrying about triggers we just go ahead and say we want the information and we want these controls in place and we can do it.

Should we care about what is a U.S. product or not? Is this relevant to the debate? Or should we just try to do what we've been doing I think which is try to develop these no-action letters. Maybe that's a loaded question. Do you have any thoughts on how we might be able to --

MR. DONAHUE: Walt, I'll just make a brief comment which is I think it's a great question. We have right now a concentration of liquidity in certain kinds of instruments where I think in the commodity, and maybe Jim and Jeff would agree, on the energy market. People do tend to think in domestic terms because the delivery point might be located in the U.S., but the reality is that people are using these for global hedging purposes with significant basis risk but they're using it because the liquidity is available say for example in the board of trade's corner soybean contracts and so it's hard for us in the business to think about it as a domestic U.S. contract that we have a particular superior interest in than people who are using that very same product for hedging and risk-transfer purposes even though their production and exportation or their risks might be in Brazil or between Brail and China for example on soybeans. But I think there's a real gap in the political realm how people think about these markets on the commodity and energy sides versus how they're willing to think about it in the financial derivative side where I think they more easily recognize that it's true that these are just sort of global markets and global financial instruments used by global customers for any range of purposes in the market and I think that's a huge education effort that we have, but it isn't useful to think about these things as just domestic products that we have some kind of localized superior interest in.

COMMISSIONER SOMMERS: Does anybody else want to comment on that? Mike, do you have any questions for the group?

COMMISSIONER DUNN: No.

COMMISSIONER SOMMERS: Bart, do you have any questions?

COMMISSIONER CHILTON: No, thank you.

COMMISSIONER SOMMERS: If there are no further comments on this subject matter, we'll take about a 10- minute break and come back and discuss the DMA issues.

(Recess)

COMMISSIONER SOMMERS: I'm going to go ahead and get started with this portion of the meeting dealing with the direct market access issues and we're going to turn now to our Deputy Director of International Affairs Robert Rosenfeld for an overview on the IOSCO efforts.

MR. ROSENFELD: During this segment I'd like to review with you some of the issues that we're studying within a project on direct electronic access that has been initiated by the Technical Committee of the International Organization of Securities Commissions. I think in highlighting these issues we'll help frame some of your discussions this afternoon.

The scope of the project is addressing the two basic models of electronic access, intermediated access which is the automated order routing system, and sponsored access which are arrangements based on the intermediary's access rights, and the nonintermediated access which is simply access by exchange member who is neither an intermediary nor a clearing member. It's known in the United States as direct market access or DMA. We've tried to look at the different access models from a functional basis, there's a great diversity of language internationally, but I think one distinguishing characteristic is the direct market access which is outside the firm's infrastructure.

The actual status of the study is that the information collection stages have been completed and we're currently reviewing the information and writing a report. The work involves two separate technical committee working groups, one on exchanges and the other on intermediaries in which a colleague Warren Gorelick from OIA participates. IOSCO works slowly and it's a consensus organization and the final report probably won't be issued until early next year.

In the rest of my discussion I'd like to highlight some of the issues that we've heard from exchanges and intermediaries during the course of this inquiry. The challenges of direct electronic access really flow primarily from the potential diminution of control by responsible intermediaries when the orders go outside of their order execution system. You have a diverse class of geographically dispersed traders who can electronically access the exchange and who can execute trades timed in milliseconds. Each of those characteristics result in some regulatory challenges. Some of those are any time you have access to the exchange trading system outside of the intermediary's control, that challenge is their traditional risk management approaches. DEA creates incentives for traders to gain execution advantages based on the type and geographic location of their connections raising concerns with regard to equality of response time. It facilitates access to markets beyond the traditional class of regulated users which introduces issues of rule compliance, monitoring and the ability of the exchange to sanction nonexchange members. It facilitates algorithmic trading which raises issues of system capacity and the potential need for rationing bandwidth. And it raises the probability of and magnifies the effect of potential system failure such as an order stuck in the loop. I remember Mr. Sprecher at the Chicago Expo last year warning that it's only a matter of time before something like this blows up.

In the second bullet point I don't want to imply that international regulators believe that there is a major problem with respect to differences in response time based on the type and geographic location of their connectivity arrangements. In fact, in the 1990 IOSCO principles for the oversight of screen based trading systems which was developed by a working group headed by the CFTC, that issue was addressed and it recognized that differences in response time will be inherent in the means to connect to an exchange. I guess that it would be the difference between DSL and dialup internet. What was decided in those principles was that differences in response time was not inherently unfair but was a matter of disclosure and equality of access to those types of connections.

One of the major concerns of direct market access has been on risk management. The speed of execution narrows the timing in which firms can carry out their traditional pretrade risk-management controls and this is particularly a problem with direct market access outside of the intermediary's system architecture or control. Intermediaries have traditionally carried out a gatekeeping risk management function, and during the course of the IOSCO study firms have reported however that they do not always receive system tools or timely data to enable firms to implement real-time pretrade risk-management controls. During the period of the study we've seen the major exchanges and clearinghouses make significant system enhancements providing the risk-management tools that I think respond to a firm's concern such as providing real- time monitoring of trades, building in various alerts and stop functions and pretrade filters. I believe you'll learn about these in the presentations that are planned and I think they illustrate what can fairly be called state-of-the-art risk-management tools.

Other risk-management concerns that have been raised during this study have been concern about the algorithmic traders who are seeking millisecond reduction in execution times have pressured firms and exchanges to trade without preexecution filters. Interestingly, one exchange that appeared before the group said that they were under pressure from some algorithmic traders to disconnect the pretrade filters not only out of a concern for latency, but they were concerned that the carrying broker would back engineer the trader's trading strategies and potentially trade against them. So I guess it's tough being a firm when one of our best clients doesn't trust you. But it was very interesting to hear that this is a very real concern that has been confronted.

When you have regulators look at a problems -- we're going to identify issues and there has certainly been a great deal of discussion on the risk-management implications of DMA and there's been an emphasis on the availability of pretrade system tools. There's always a danger when you focus on the risks that it becomes one- dimensional, but the exchanges and clearinghousing firms that we've been hearing from have all pretty uniformly emphasized that risk management should not be viewed as one-dimensional and that the three legs of risk management, know your customer, pretrade and posttrade controls, can be applied appropriately in varying degrees depending on the characteristics of the client and they've cautioned that IOSCO should not endorse any one-size-fits-all approaches to risk management. Again regulators look at an issue, so we're obviously identifying risk, but it's important not to overlook the fact that direct electronic access has brought some very real benefits across the board. Clients get global market access and best executions, firms can provide better client service, and it facilitates rule compliance from exchanges, it's obviously a larger global base and it increases liquidity, regulators and clearinghouses produce an accurate audit trail, the enhanced liquidity fosters better price transparency, and has resulted in development of better risk-management tools.

In conclusion, the IOSCO project I think will provide transparency in identifying issues and suggesting potential nonprescriptive approaches. Again during the year and a half of this study as it has gone on we have seen rapid advances in technology that appear to address many firm risk-management concerns. I know the CME and Eurex in particular that I'm aware of have gone through several iterations of risk-management enhancement.

There is a continuing concern that has been articulated regarding whether uniform approaches should be mandated, for example, in the use of filters, but in the end IOSCO recognizes that it is up to the local regulatory authorities to craft the specific regulatory response, and in this regard, your discussions today will help in that regard. Thank you.

COMMISSIONER SOMMERS: Does anybody have any questions for Robert on the IOSCO project? If not, we'll move forward to Ananda Radhakrishnan who is our Director of Clearing and Intermediary

Oversight to talk about the risks that may be associated with direct market access.

MR. RADHAKRISHNAN: Thank you, Commissioner Sommers. What I'd like to talk about in the next few minutes is to highlight some of the concerns that I have and the division that I work with has with respect to direct market access. I'm glad that I can do this in this context because we have sitting around this table representatives from market participants, people who are traders, people who are the intermediaries, and the exchanges and the clearinghouses. So I'm suggest to you my view of what's happening out there and I'm wrong, you should tell me that I'm wrong, but if I'm right, I would like to know why it is that I'm right, and I'll explain what I mean by that.

I first got to know about the problems surrounding direct market access 2 years ago. The FIA had a conference call update and there was a panel called Challenges in Direct Market Access. The one issue that seemed to concern me was that it appeared that the intermediaries who were clearing for the traders had no ability to do preexecution risk management. Everybody was alarmed at this, but it seemed to me very strange for any intermediary to accept the fact that you could guarantee a transaction for somebody and not do risk management before the trade is executed. It just doesn't compute to me because nobody is putting a gun to your head to take that customer on, so I didn't understand it then. As I investigated it further, what I found is or what I've been told us that the exchanges are going directly to the traders to say, You know what, we have a better way of trading, I'll give you direct access. And the exchanges and the traders or the traders themselves are going to the firms and saying, I want direct access because this exchange is promising me all these wonderful things. So again I'm given to understand that the firms are saying that they have no choice but to accept this. I don't understand that. You do have a choice because it seems to me unless I'm wrong that before a customer can get direct access, there has to be an agreement among the customer, the exchange, and the trader that somebody will get direct access. So providing an explanation that you have no choice but to grade direct access doesn't make a lot of sense to me, but as I said, I could be wrong.

I think what's happening is as Robert has pointed out, people want to trade very fast, in milliseconds. I didn't know that a human being can process something in milliseconds, but I guess I didn't account for algorithmic trading where human beings are not involved in trading decisions but, rather, some sort of computer program sends trades to matching engine. So it seems to me that there are three groups of people who have responsibilities to do risk management. One is the traders themselves because it appears to me that you need to understand what it is you're doing. I hope you understand what it is you're doing, but if you are not sure, then I'd ask you to look into your organizations to make sure that you know what it is you're doing. And when I look at you I'm not looking at you because I'm blaming you, I'm just looking around.

Number two is the intermediary. Without our permission, my understanding is direct access doesn't happen, so if you cannot do preexecution risk management and you think that is important, why are you letting people get access through your firm?

Number three is the exchanges or clearinghouses. You have a role to play as well because if as I've been told you are marketing direct access to customers then you have a responsibility to make sure that the customers understand what it is they're doing, that your intermediaries understand what is they're doing and are exercising sound risk-management practices, and you yourself do not abdicate your responsibility.

In this respect, I will highlight a white paper that the FIA did in 2007. Right at the end I'll read something to you. It says, Ideally firms would like to have preexecution risk controls on client accounts. When that is not possible, the more real time the information a firm receives from the exchange the better it will be able to monitor and control risk. The question I have is why isn't that ideal possible? I realize the benefits of getting trade execution information as soon as the trade is executed, but the question I have is why isn't that ideal possible. If somebody could explain it to me.

There are two other issues that I want to talk about. So far the conversation has been on direct access by customers. I also think that the intermediaries need to understand what their proprietary traders are doing as well because they also have direct access. The presumption is that since they're trading house money, there are appropriate risk controls in place, but I would urge all intermediaries to make sure that that is so. The third element is electronic give-ups. When I was told about electronic give-ups, I didn't understand. I thought an electronic give-up was an oxymoron, but I guess it is not. And the issue here is the firm that's being given up to doesn't know what it's going to get until after execution. So the question is who is doing the risk management, who is exercising control? Is it the executing firm? I've been told no. So how can the firm that's being given up exercise any sort of risk management if it doesn't know what it's going to get?

Ladies and gentlemen, I don't think it is our job to tell you how to do your jobs. It is not the government's job I don't think to stop you from losing money. However, there will be a point in time, and I mentioned this at another occasion where the amount of money that you lose will have an impact on the market, will have an impact on other firms, it will have an impact on possibly the clearinghouse, there's where our concern is, and I don't know where that line is for each firm and that is the concern that I have. Thank you.

COMMISSIONER SOMMERS: Thank you, Ananda. Does anybody have any questions or comments for Ananda? Kevin?

MR. DAVIS: Kevin Davis from MF Global. Hi, Ananda.

MR. RADHAKRISHNAN: Hi.

MR. DAVIS: Speaking as someone who has issues to deal with when it comes to direct market access, I think the key issue is that if a firm puts on premarket controls and in our case almost every single trade that goes through does have premarket controls, they are definitely at a disadvantage or the client who goes through those controls are definitely at a disadvantage to a company that doesn't have those controls. And because as you say you can't possibly know or be certain what everybody's risk-control systems are, what their structures are, how they're enforcing their policies or not enforcing their policies, in my view the only effective way to absolutely guarantee that the market remains orderly is that it should be mandatory that every direct market access client has some form of pretrade control. That way the playing field is leveled.

Algorithmic traders as we all know trade in the milliseconds and if an algorithmic is trading without controls he has a slight advantage to the guy who has been trading with controls. So the only way to make that problem go away is to mandate that everybody has pretrade risk controls. You could put a time limit on it and say 1 second or that everyone has to have a second of latency in order to achieve that risk control. For me that's the only way to absolutely assure that there aren't problems of the type you just suggested that could bring the whole market into disrepute.

MS. DOWNS: May I just comment? If you're going to say everybody, you mean globally because you could not do this on any one market or any once place. Customers trade on multiple markets at the same time -- the differences between those markets, you'd have to have a defined latency across all markets globally, and if everybody thinks that can happen, that would be one thing, but you would have to make it a latency long enough that somebody can then make the judgment call which is the other half of the equation that that's acceptable.

MR. DAVIS: I would assume that first of all you obviously would do it market by market and it's clearly not possible for the CFTC to mandate that -- for example would have to have such controls on their systems, but they certainly can insist that every U.S. market has some form of control. It's not a human decision that needs to take place. These deals can be done I'm sure at your shop as are ours electronically so you're not talking about the amount of time it takes for somebody to sort of leap through a margin -- you're talking about 1 second or 2 seconds or 1-1/2 seconds or whatever the appropriate amount of time should be, but if everybody is on the same page, you've solved the problem. The problem is that when you have people on different pages some with controls, some without controls, and that's when the pressures build up. I understand what Ananda says, absolutely you can say no, but we're not helped by exchanges going directly to our customers, offering them DMA access or suggesting DMA access to them. That makes our job that much harder. But it doesn't have to be universal. We're only concerned about U.S. markets here.

MS. DOWNS: I disagree. Our customers don't trade -- we're members of 70 markets. We have customers who go across all those 70 and to do that they can't have a dislocation between the pricing on the same commodity economically that's occurring in Dubai as it is in the United States. If there's that difference then those markets don't perform the function of price discovery or anything else so you couldn't do this -- because of the linkages and the nature of the global markets that we're in, you could not do this on any one market or just in the United States and make it work.

MR. DAVIS: We'll agree to disagree.

MS. TAYLOR: Actually, I think there's another alternative to what Kevin is suggesting. The approach that we've taken in building out centralized position-based credit controls which will be coming out later this year or very early next year in our system is to approach the problem with latency as a constraint. So we are approaching it with a no latency -- we challenged our technology guys with a no latency outcome and what they came up with is actually very creative. It does not stop the current trade but it reduces the size of the next trade and it stops the next trade. So if anyone has a customer that they are uncomfortable with one trade that they might make, you probably don't want to give that customer direct electronic access and we probably should all be asking questions if you are, but in the type of customer base that is typically given direct electronic access, we feel that this is a very good means for encouraging firms to be able to use credit controls and basically the latency is -- I suppose it's not fair to say it's no latency because there is a point where every order is checked to see if there's a credit control applying to it. That's the only latency and every order is subjected to that whether or not there actually is a credit limit put on that order or not. So for the CME's markets, that addresses the issue. It does not address the issue that Yvonne is talking about in terms of if other people approach the problem differently, markets could still get out of line.

COMMISSIONER SOMMERS: Bill?

MR. BRODSKY: This is Bill Brodsky. I usually the CFTC as an example of why the SEC should be doing something more quickly or more affirmatively, but it's interesting, for the last 12 months or so the SEC has allowed something like this in our markets and they called it sponsored users or sponsored access. And although I'd say it's still in a pretty embryonic state, the day it's dealt with on the securities side is that there's an instant drop copy to the clearing firm so they have the ability, albeit right after the trade, but immediately after the trade, to run that through their risk system and let the red flags go off which I think probably deals with what Yvonne is talking about, and that is it's very hard to inhibit something that could be technologically dealt with in terms of the speed that the computers are going to allow because the users are demanding it, it's all about latency, and it may be instructive to get some experience or get the benefits of some of the work that's been done on the securities side as to what the experience has been. What it does not allow is for customers who are from outside the U.S. to have that kind of access at this point because, again, even though it's not technically a pilot, it's being kind of rolled out in a slow way and I think it's more the issue that there is more jurisdiction over customers in the U.S. than there is from without. So I think that in your work as you study this that it would be probably useful to find out what's going on on the securities side.

COMMISSIONER SOMMERS: Thank you. With that I think I'll turn to Kim for her presentation from CME Clearinghouse.

MS. TAYLOR: Thank you, Commissioner.

Thanks for giving us the opportunity to talk here today. I want to talk briefly about a business overview of DMA, and that's been talked about a little bit here, so I will be quick there, CME's risk-management philosophy, the risk management that applies to DMAs in our markets, and then the next steps that are coming.

As far as the DMA business profile, I think the one thing that I can say about DMA access is that I definitely think DMA is here to stay. The type of trader that uses this has become a very important type of trader in all of our markets. I think that the use of this access is facilitated for people who would be high-frequency proprietary trading shops, look at them as the new liquidity providers. They also I think engage in arbitrage in ways that they arbitrage markets where there are nonobvious arbitrage opportunities to the rest of us because they have very sophisticated models in order to do that and I think that all of that activity facilitates better price discovery, more efficient markets, and better liquidity for everyone who is participating in the market. So I think it's not only something that I'm not sure we could stop, but I don't see why we would want to stop it as a type of business.

I think that clearing members report increasing demand for this type of activity. There are some differences in risk management and compliance perspective at clearing members that make them vary in their willingness to facilitate this type of business or the breadth of the customer set for which they will facilitate this business and personally I think that that is okay. Risk management of customers is a clear member business decision and always has been. I think it needs to continue to be. I do think there's a role for the central providers to provide some improved risk-management monitoring features or access to data, and I'll talk about that a little bit later.

Our philosophy for account level risk management, I guess I almost stated on the prior slide, the clear member is in the best position to provide the risk management at the account level. They know the customer, they know what the customer is doing, and actually providing too tight a set of preexecution credit controls that apply narrowly to one market could actually increase risk as opposed to decrease risk overall because the Globex, our system, doesn't know what the customer is doing in any other market and the action we might be stopping might be actually a risk-reducing action and that would be unwise for us to stop. So the clearing member really is in the best position to take the global look at the customer's exposure and to manage that. And we do require that clearing members acknowledge when they give a DMA that they're on the hook for the risk management and we do require that they acknowledge that they either have the ability to put pretrade risk controls or cut the customer's access off or that they can ask for a waiver of those requirements by explaining to us what kind of posttrade risk management and customer up-front credit review they have in place. Actually that's one of the things that Ananda talked about that I would I think challenge a little bit, that risk management of electronic access is not a one-legged stool, it's a three-legged stool. You need to know your customer, you need to have appropriate pretrade risk controls to your business and your knowledge of that customer, and then you need to have an appropriate posttrade risk management trading environment. And looking at the clear member's mix of those three aspects of risk management is something that we do when we perform risk reviews with the clearing member and also that the risk management that they're doing is appropriate to the type and size of the customer base that they're doing business with.

In terms of our philosophy on centrally provided risk-management functionality, one of our customers actually gave me I think what is the best line about this that I've heard, to take infinity risk off the table. We cam provide some high-level protections many of which we provide now, many of which many markets provide now, and I think there are refinements that are underway coming from a number of different systems. But to give you some examples, some of the tools that we provide are real-time access to the trade information, the price information, the mark-to-market information, the position level information, so that the clearing members will be able to load that immediately into their posttrade systems and be able to use it right away. We also provide certain types of high-level protections like fat-finger protections, maximum order size, we have all the trade bust and trade adjust policies to correct for very obvious error trades that I think is well received by the marketplace. We have some protections in case of connectivity failure so that you don't get left in the market with orders and you're not able to monitor if they're being executed or not. And then I think it is not inappropriate for a central provider to provide high-level types of execution limits and alerts about abnormal activity and certain monitoring tools.

In terms of the way that electronic trading in general and probably DMA in particular have impacted the clearing-level risk management that we perform, everything has become much more real time, but the beauty of electronic trading is all of the data is also available much more real time, so in many ways electronic trading has improved I think the risk-management culture and the industry very significantly.

Some of the things that we're focused on more now than perhaps we were historically is looking at separate thresholds of activity and behavior for clearing members and actually some large account-level thresholds as well for day trading and P&L activity because with the high-velocity trading there can be a lot of trading activity relative to the level of trading activity that we would have been accustomed to in the past. We also have a very broad interpretation of risk management I think at CME. We have a risk-management unit within the clearinghouse division but our risk-management team across the company includes certainly our market operations folks in our Globex control center. They are the know-your-customer leg of our risk-management stool on an execution basis, they're very familiar with what happens in the markets, and they're very familiar with when activity is abnormal and they can raise concerns and reach out to the customer and reach out to our technology folks. I think that the monitoring that our technology folks do of the activity levels and the order activity that's coming in on our systems and the latencies that the system is experiencing is also a risk-management function because when we find something that seems odd, we escalate it and try and resolve it with the customer. Then our market regulation team as well performs as part of the risk-management function. We also have increased our focus on the way we look at the real-time nature of clearing member risk management particularly with respect to cases of the less global clearing member base, certainly what they do in their overnight risk management.

Our risk-management policy, Ananda alluded to some of this, does require that clearing members have to authorize a DMA connection so no customer gets access directly to the system without the clearing member authorizing that and signing off on the fact that they're responsible for the risk management, that they're responsible for the guarantee, and that they have the proper controls in place either preexecution or they can ask for a waiver in that regard and use postexecution credit controls.

Some of the types of tools that we provide either historically, recently, or in the near term are listed here, are our Firmsoft and Telestat functions, are adjuncts to the Globex system that allow either the clearing member or in the case of Telestat it also allows the customer himself to monitor order execution activity, what his position looks like, and to cancel orders. We have real- time back-office confirms with the ability for the clearing member to choose to drop more than one copy of those to another risk-management location. Some drop their overnight ones to Europe. We also let them drop them directly to the customer if they chose to do that, and that's all at the clearing member's discretion. We've had real-time posting of positions for 15 years, and online access to clearing-level mark-to-market is also available. Recent new functionality I'll talk about a little bit more on the next couple of pages, cancel on disconnect and drop copy, and then also the near-term changes that are coming.

The cancel on disconnect, one of the things that becomes very important when you're doing high-velocity trading or when you're putting a lot of orders out into the book is that you need to know that you will be executed on things without knowledge if you're disconnected and so this feature is an opt-in feature. The clearing members have to sign off on their customers opting into it, and if the connection is lost then all market orders are automatically cancelled so you won't get filled on something while you're having a connectivity problem, the orders that are out there that would tend to be customer-ordered desk orders by clearing members more so than order activity by the velocity trading community that are good until cancelled or good for the day, good until a certain date, those are left open in the system, and that was launched in March 2008.

Drop copy, I guess we stole the name from the securities side, this is our feature that came out in May of this year that allows clearing members or trading participants, a DMA connection can get this directly or a clearing member can get it for any of their activity, let's you get a simultaneous copy of all orders that come into the system. So you don't get just a copy of the trades as they're executed, you get a copy of all the order activity so that you could rebuild the worst-case scenario in your own risk-management systems and it is a simultaneous process so again it doesn't inject any latency into the customer's experience of using the markets, yet it improves the risk-management facility that the firm has in place or the customer has in place. We've actually had a number of trading firms, some have gone live and some are testing, adding this as an independent risk-management reconciliation of their books within their own firms as well as having clearing members use it. The credit controls that I mentioned earlier are under development. It allows real-time active monitoring of the positions without an impact on trading latency. The way that it does that is the current order goes into the system, also a copy goes off to the side and is evaluated against the risk controls. If the customer approaches the risk control that the clearing member has set for the customer, I believe the default level is 80 percent, so if you're at 80 percent of your limit, then your order quantity on our next order that comes in will be limited, it will be reduced. So as you approach your limit, the size of any next order that comes in is reduced by the system so you're less likely to have the next order take you over your limit in some extreme way. And it also provides the ability for the clearing member to get alerts because the most important thing besides not having latency is also not having false positives. You don't want to turn off customer's access to the markets again primarily because they might be trying to execute what is a risk-reducing trade to their overall position and you don't want to disadvantage them in that way, so the system allows for clearing members to get real- time notifications as customers approach their limits so if the clearing member knows that the customer is doing other activity in other markets they can adjust the limit in order to keep the customer trading and keep the risk management intact as well.

One of the things that some people didn't like about this that I actually think is one of the beauties of it is that is fairly crude. It is a single dollar limit for futures and options that is based on kind of a margin basis. So the products are evaluated on the risks that they pose in terms of margin, it's added up to a dollar limit, so it's not a very fine-tuned, precision risk management, but I don't think that's the appropriate job for the central infrastructure providers anyway, that's a job more appropriately done by the clearing members who have all of the information about what is going on with the customer.

The position-based credit controls are coming out in two phases. The clip size or the order size limits will be available the third quarter of this year. The maximum dollar exposure controls are either going to be very late this year, mostly likely early first quarter of 2009. Then we have a third release planned that will allow clearing members the ability to set what we would call nonbinding alerts on any accounts. Our expectation is that clearing members will use probably both drop copy and the position- based credit controls that are centrally provided primarily for accounts that don't go through their infrastructure. But the ability to set nonbinding alerts would also allow them to have something that is a little bit of a backstop to their own infrastructure and then set a limit that they could get notified if the customer is approaching it.

I would agree with some of what has been said here about this being a cooperative effort. Risk management in the industry is a cooperative effort between the trading participants, the intermediaries, and the central infrastructure providers and I think that that is going to continue, and we've worked a lot with particularly the intermediary community on the functionality that was important to them and workable for them in the systems that we're putting out.

COMMISSIONER SOMMERS: Thanks, Kim. Does anybody have any questions about the CME system?

MR. DOWNEY: Kim, the CME Clearinghouse doesn't take any financial responsibility for any of the trading. Right? Still the onus is on the clearing member whose fund protects the community?

MS. TAYLOR: Each individual clearing member is responsible for all the trades that clear through them and the Clearinghouse would only have financial responsibility directly if a clearing member defaulted and then we would have the financial responsibility. So we do guarantee all the trades but that only kicks in if there were a clearing member default.

MR. DOWNEY: So if your controls fail by 1,000 percent, it's unreasonable that it would, but in the unlikely scenario, who is going to pay all that margin for those trades that go back and that firm that goes down? The members, right?

MS. TAYLOR: There are various tiers of the default protections. The first tier is any resources we have from the defaulting firm, the tier is CME capital, and then the third tier includes contributions from other surviving clearing members. That's correct.

MR. DOWNEY: It just seems to me that a small FCM with a little piece of the pie who is going to get called on for a capital charge if somebody goes down would be interested in knowing what Goldman's credit controls they've put on their direct market access or Morgan Stanley's and exactly what types of control they have over their customer. I think it's a reasonable thing. These milliseconds count. These people, if your systems are not set up to provide for this quick access, trust me, the difference between 4 milliseconds and 5 milliseconds are a profit and the people who are at 5 are not going to make the money and the people who are at 4 will and there's a floor, there's zero. Right? It's not going to be reached, but the problem is that everybody is stuck at the clearinghouse level. If the clearing members want to provide their customers with this access and they're going to take the credit, I think it's great. But all the other clearing members have to recognize that if something happens at their one firm, everybody is on the hook at the end of the day, and the rest of the firms don't have control over one member's decisions.

MS. TAYLOR: I think in addition to any kind of electronic preexecution credit controls, the general risk- management monitoring function that a clearinghouse provides has always addressed the types of risks that you're talking about in terms of one clearing member potentially being exposed to the bad actions of another. It's part of a clearing provider's role to help ensure that clearing members have risk-management controls that are appropriate to their business.

COMMISSIONER SOMMERS: Ananda?

MR. RADHAKRISHNAN: Kim, does your drop copy functionality allow a clearing firm to stop access? Because you're getting a simultaneous look at what orders are coming in and if you're not happy can you stop?

MS. TAYLOR: The clearing members already have the ability to stop the access so that it's not coming out with the drop copy that they have.

COMMISSIONER SOMMERS: Does anybody else have any questions for Kim?

CHAIRMAN LUKKEN: Just a real quick question. The opt-in provisions, why opt in versus opt out? It seems inherent in the interests of the Clearinghouse to want people to -- you wouldn't have developed these tools if you didn't think they were inherently helpful.

MS. TAYLOR: That is correct. The issue with the drop copy is for many clearing members, they probably have to do some work in order to be able to use the order messages that would be coming through and so it doesn't make sense to overwhelm their capacity with a bunch of messages that they have no use for. So I think it's very likely that clearing members and trading member firms will embrace drop copy over time for activity that doesn't go through the clearing member's infrastructure and they're unlikely to want to get a drop copy of all the order activity for the messages that do come through their infrastructure and I think capacity is not terribly expensive now, but it's not free either and our assumption is that clearing members will want to focus and target their scrutiny to the places where it matters.

MR. DAVIS: One problem I foresee, Kim, is if some firms opt in to better risk control and others don't, the ones that don't opt in have better latency potentially so more and more business is going to go to the firms with the fewer risk controls or less risk control and in the end it's going to have to become mandatory that everybody has pretrade risk controls. We can talk about -- global issues that you referred to, we are also members of probably the same 70 as you are. In the end the only way to properly control this is to insist that everyone has pretrade risk controls and you'll have to level out the playing field.

MS. TAYLOR: You reminded me of one feature that I forgot to mention and that is the feature for the position-based credit controls we also have the capacity for the Clearinghouse to set a control over a particular account or over a particular clearing member if the clearing member isn't using controls and we feel that it would be warranted, so we have the ability to do that. The other point I would stress is that we built this to be no latency in the first place and every order is subjected to the same check to see if there's a credit control and that's the only latency and I think they figure it's going to be not even measurable. So we have accomplished I think what you're talking about in terms of leveling the playing field that way. We don't really feel it's appropriate for us to mandate, I think we would probably not be in favor of the CFTC mandating either, that everybody had to put a certain type of risk control over their customer base because I really do think that it's more appropriate to be a firm's decision. We're trying to make it an easy decision for the firms to put the credit controls on by making it indifferent in terms of the latency that it creates.

COMMISSIONER SOMMERS: Ananda?

MR. RADHAKRISHNAN: Just for the record, we know what Kim's position is on a mandate. Who would you like, Kevin, the mandate to come from? The exchanges or the CFTC?

MR. DAVIS: I think given that the exchanges, wonderful partners and tremendous friends that they are, they are commercial enterprises, I think in the end it's going to have to come from the CFTC. And one other thing, Ananda, you made a point about giving acceptance. A lot of the rules and regulations that are revolving around accepting give-ins actually emanate from the old days when these were all floor-based markets. There are some exchanges present here today where the convention is that if you have always accepted give-ins from an executing broker for a clearing account of yours, unless you give them 24 hours notice that you won't accept give-ins, you're not allowed to not accept that trade. So there's work that needs to be done to look at that part of it because some of these rules are really rooted in the past.

COMMISSIONER SOMMERS: Mike?

MR. DAWLEY: Just a couple comments.

First of all, I agree with Kim. I think the CME's approach is a good approach. I don't necessarily agree with my good friend Kevin on some regulation being put in place. This is a period of evolution I feel and we need innovation in risk-management techniques and unfortunate incidents like Kevin's makes us all better at risk management. I also commend Ananda for pressuring us to keep thinking about this. This is a really important issue, but pretrade risk controls I think is a real abused term. We have to decide what is a pretrade check. Is it something versus initial margin? Is it a contract limit? There are all kinds of definitions you could put on pretrade risk controls. The bottom line is everybody is focused on latency. So what pretrade risk control is going to affect the speed to market? These are the things we need to talk about. Putting in regulation in or mandating that the entire industry have some sort of pretrade risk control is going to get way too complicated. Yvonne pointed out how it's just really hard to do globally. So I think we should really promote and work with our exchange partners, and I think a lot of exchanges, the CME, Eurex, all the exchanges here, have done a good job at getting us the data we need to be able to innovate and create better risk controls and I think we should just continue down that path.

COMMISSIONER SOMMERS: Ken?

MR. FORD: I would just comment that the FIA has been working on a study with the FOA and all our major exchanges around this issue and other issues as well around risk and it's been a good partnership, and hopefully we'll have something meaningful coming out of that, whether it's best practices or something, or something meaningful come out of that in the next few months or so.

COMMISSIONER SOMMERS: Thanks, Ken. I think Mike's comments on pretrade protection are an excellent segue to Peter Reitz's presentation from Eurex. Thank you.

MR. REITZ: Thank you very much. Maybe

what I'll talk about will sound very similar to what you heard before because we're working on the same issues in the same environment. But maybe Eurex is also in an unique position in some regards because having been an electronic market from day one and having had the concept of clearing members and nonclearing members as trading members from day one, we have had this issue of direct market access from our very first day. Obviously the reason why we are focusing on this now has a lot to do with the changes in trading style that we've seen. A lot of this has been addressed before. We're all aware of the automatic trading systems that are out there and the need for new trading strategies. And obviously just to put this particular aspect of risk management into perspective, I think what we're looking at is not just latency and the requirements that that creates for exchanges in terms of through put and speed of the matching engine, it also creates a lot of additional requirements for broadcasting of information in general and just reducing round-trip times, real-time information on the whole depth of the order book which is now available. Eurex for example will distribute every change to the order book to the whole depth of the book in real time. Obviously that creates a lot of need for additional bandwidth so you have to create new options on how members can get access, how they can connect to the exchange with very broad bandwidth solutions, and to address all of this. So I'm thinking of this as we're building our Formula One car and we're building in the Ferrari engine to address the need of speed that seems to be out there, and at the same time we have to make sure we have the brakes as well and that's the risk-management part. So if you're going at 200 miles an hour on the German Autobahn, you have to make sure that if there's a truck that moves you'll be able to stop in time and that's the risk-management part of what we're developing in our system.

As Kim said before, this can only be

done as a collaborative approach between the clearinghouse and the clearing members. So we have created work groups together with our clearing members to see which are the issues that we should focus on, what are the tools that we can provide to help them do better risk management to protect the clearing members. We have obviously a level of responsibility ourselves to protect the clearinghouse, but that's a whole nother topic that we can talk about here. But I'll focus on the risk of direct market access that occurs on the level of the clearing member.

As I said earlier, the key to all of this is information distribution. So not only do we obviously distribute real-time trade confirmations, we also distribute real-time order confirmations and we have worked on real-time margining and that's something I'll go into more detail about a little bit later. But that's something that we have started in our intra-day margin process many years ago and that's something we're improving.

The second thing that I'll talk about a bit more in detail is how we enable our clearing members to stop any trading activities of a nonclearing member and how we're going to develop that further. The first slide here just gives an overview on where we've come from, where we are today, and what are going to be the future developments, and I'm going to talk about the main points of each of these in a bit more detail.

As I said, we've had intra-day risk management for many, many years and it was based on a batch-driven margin system that calculates all the positions and the margin requirements every 15 minutes and sends out that information to all the clearing members and then triggers intra-day margin calls if any position is not covered by the margin and the collateral that has been provided. With the recent release rolled out in November of last year, we enhanced that by introducing those pretrade limits, and I'll talk about in a minute what level we have and what are the parameters that can be set by each of the clearing members, and also introduced this stop button where a clearing member can basically with the push of one button disconnect a trading member. We also invested in reducing those batch cycles for the risk position limit calculation and the margin calculation to 10 minutes. What we're going to roll out in November of this year will be the next generation of this risk infrastructure and that will allow us to do even a margin calculation real time because it will be based on any change in position or any change in price even of the collateral that is pledged to the clearinghouse to allow a clearing member to see its risk position in real time.

Let me go into a little bit more detail of the pretrade risk measures. What we offer our clearing members is different levels of those, one on a particular order, the size of the order, you can set a maximum order quantity on every single order. Then obviously a risk can not only exist in adding a new order, but adding many new orders into the order book at the same time, so there's a limit on order frequency that can be put in place for every trading member. And of course the aggregate position within the order book of orders that have not been filled is also a way to address the risk and so we have a limit on those working orders in the order book that can be set individually for each trading member.

The second thing is the stop button as I said earlier. That's something that we had in place also for many years. It's a process that was in place where we as an exchange or as a clearinghouse could obviously stop someone from trading and we could also do that on behalf of a clearing member if they decided that they don't want to guarantee any more trades that are coming in from a particular member. That process has just been automated so that the clearing member himself can do that with the push of a button just to address the real-time need for that kind of functionality as well.

With the upcoming release this November, that will be expanded to the level of the trading member itself where they can basically stop activity down to the individual trader level, and remember that trader may not be a person, but a computer, and they will have a stop button to also control for example an algorithmic trading- based computer that just has gone wild for example and then they can stop that immediately not on the clearing level but also on the trading member level.

The second thing that we will introduce as I mentioned the real-time risk calculation. If you want to do this for the absolute level of real time, it's a pretty complex issue. What we have done is we have analyzed all the parameters that go into the risk calculation and have all of these calculated real time and that includes obviously the collateral that is pledged so there's a real-time valuation of the collateral, there's an intra-day posting and release of collateral so that is all calculated in real time, and that information is then pushed out to the clearing member and the trading member at the same time.

On top of that information we will also provide a toolbox that will allow the clearing member to create their own alerts, so I think what you called the flexible alerts, that's the same thing here. The alert system can be defined by the clearing member for each individual trading members based on their risk characteristics. So that's sort of the future of risk management. Again we're just in the situation where on this level of risk we've providing the best possible tools for the clearing members to monitor the risk, to set parameters on a pretrade level how they want to accept trades and where they want to stop accepting trades from their trading members. That's sort of the quick overview. Thank you.

COMMISSIONER SOMMERS: Thank you, Peter. Does anybody have any questions specific to Eurex's presentation? If not I'll turn it to R.J. Cummings with the IntercontinentalExchange for their presentation.

MR. CUMMINGS: Thank you, Ms. Sommers. Ms. Taylor and Mr. Reitz are going to be a tough act to follow. Rather than going through a third version of risk controls, I'd like to echo that the collaborative approach with clearing members and the exchange to develop real-time risk systems is what ICE has tried to embrace and promote in not only our exchange design but in our approach to risk systems. Our approach has really been that the clearing members are probably in the best position to manage their risk systems, their position and their control, whether it be pretrade, posttrade, or within the matching engine and what we've tried to do is develop technology to accommodate their needs in conjunction with the members.

That technology really comes in three broad categories. One is reduction in response times which has been brought up from several folks of the panel here regarding latency, trip time, bandwidth usage, connectivity. The second which Ms. Taylor talked about is matching engine level checks, the execution checks. ICE has developed matching engine level checks which I will also echo are a very blunt instrument. They're not precision guided tools that the clearing members hand over to the exchange to use it for controlling risk so we offer pretrade, posttrade, and some netting algorithms that provide a blunt check for single order, long position, short position, or round-trip counts. These allow automatic cutoffs of inbound orders and when position levels have been reached.

Then the last is the drop copy that has also been spoken of several times. Getting drop copy trades to the clearing member in a real-time, low-latency process is important for them to take those trades that are executed on the exchange and compare them with positions that were done T plus 1, T plus 2 basis and in turn wrap their procedures around to the front end for some of the other access means through the exchange.

I'm going to move through a couple of my initial slides here pretty quickly. I'm sure you're familiar with ICE's unique position in the futures market undoubtedly from Mr. Sprecher's work on the Hill recently, so I'll leave it at that.

Going through the benefit and risk factors of direct market access, ICE's unique position within the futures markets has allowed us to meet the demands of a diverse and emerging market users with an eye for flexible market design. Rather than viewing technology as a risk that direct market access presents to intermediaries and members alike, ICE has rapidly designed, developed, and deployed technology as an enabler to allow intermediaries and clearing members to take full advantage of what technology has to offer to continue the growth of our markets. To adjust the risks brought by each type of market participants, ICE has created a number of unique features that help to avoid or mitigate those risks. For example, in the case of commercial users where many of ICE's business is conducted, many firms do not allow traders from the same company to cross with each other. While that's not necessarily a direct market access risk, it is a compliance risk and we have designed internal mechanisms to prevent this type of transaction as well as other types of transactions. As this category of users has expanded, the sophistication of the market monitoring and prevention transaction and connectivity risks to this user group has also risen.

The three most common risks that ICE faces in regard to this are incompatible client software, their conformance with they write to our API, overuse of connection bandwidth, and the ability of the exchange to respond to intra-day spikes in volume. In each case we've isolated the key detection and feedback tools to monitor each case around the clock; our API conformance team where client software is tested before being approved for the live production run rigorous testing programs to ensure compatibility and understanding of exchange-specific guidelines; user input message traffic from direct market access users is consistently monitored throughout the trading day to search for cases of unexpected increases or decreases in order traffic. This feedback loop is critical to the exchange in that it keeps our operations group close to the customer and their activities. ICE's operations teams monitor system capacity and performance statistics throughout the day on a customer-by-customer basis to ensure that market conditions and our customers' response to them falls within expected parameters. Behind the scenes ICE continues a rigorous capacity and infrastructure build-out to ensure peak performance for future demand as access to the exchange, reduced latency, and volumes continue to increase.

ICE's direct market access is premised on the fact that a given user is only allowed onto the system when guaranteed by a clearing member of the exchange. This distinction applies to those users who directly or indirectly pass through a firm's own infrastructure en route to the exchange. While the direct access to the clearing member -- binds the customer to certain jurisdictional rules and disciplinary guidelines, the burden of supporting facilities for clearing members to actively monitor and take action on the exchange if warranted is shared with the exchange. In short, the clearing members are our partners in building our business.

Firms writing directly to the exchange API must adhere to strict conformance standards and processes to ensure that their software is compatible. To ensure this conformance, we maintain a highly skilled and experienced market supervision team equipped with tool sets to react to emergency situations, conduct investigations, as well as enforce exchange policies with regard to access. In addition to this supervision, the trading platform also has built-in risk-management functionality such as matching engine level, pretrade, trade, and spread netting checks assignable by the clearing member for each user they guarantee. All ICE markets are managed on a FIFO basis and provide full depth of market to users. This single matching algorithm eases the transition for flood-based exchanges to the electronic world. The ICE platform has a variety of built-in features that are intended to ensure that clients can only retrieve data related to their accounts with zero interference from other market participants. Also the same security that grants authorized access captures unique order routing information that identifies the user connecting to the platform for downstream risk-management systems. Trade delivery is available in a near real-time basis to facilitate risk management and clearing member pre- and posttrade systems with additional controls provided by the exchange to guarantee that clearing members can cut off access to their clients at any time throughout the trading day.

The challenges in risk-management issues related to direct market access, I think we've already gone over a lot of these. On this side just in short I wanted to summarize some of the key issues facing the exchanges and I think they demonstrate why technology is a core competency of exchanges today. We believe this will be increasingly the case in the future. As products and customers increase in sophistication and markets become more global and connected, the ability to innovate while providing sound risk-management goals to facilitate the seamless and secure operation of markets is going to be more important than ever. This importance lies not only with the exchange but with our partners and the clearing members.

Continued investment by ICE in its network of trading architectures to outpace demand has not abated. With the growth in volume expected to increase, so does the demand for additional functional and technical capabilities by our customers. At ICE we keep focus on the horizon of where markets are going through lead times in planning, development, testing, and launching new initiatives. In terms of risk management, this is probably one of the areas of greatest opportunities for exchanges. Keep in mind that many of our markets and some today are fully --

ICE spends a good amount of time in research and development trying to innovate and develop new technology for its members. In this slide it's important to understand in that it demonstrates ICE's commitment to system performance in an environment of dramatically increasing demand for trading and market data. System performance is not just speed. It's all the features and functionality that we've developed to complement existing FCM risk-management systems. Our technologies are at the foundation of our markets because it's how we connect to our customers. Round-trip trades can now be executed in as few as 3 milliseconds in our commodity futures business. This is down from more than 30 milliseconds in early 2007. Impressively, our technologists are now measuring our performance in microseconds rather than milliseconds, and we do all this with the industry-leading pretrade risk- management functionality built in at the matching engine level. The rapid response times of trade execution, order response, and capture by clearing members via the exchange drop copy allows them to assess a customer's position in near real time and take appropriate action to either limit that client's activity through the firm's own infrastructure or alternatively directly on the ICE platform. In addition, the ICE proprietary front end supports a parent company concept that aggregates and displays real-time working orders of clients to clearing members to selectively cancel and revise for smaller FCMs.

The ICE operations team closely monitors volume ratio, that is orders to number of trades, to proactively set message throttle controls for futures and options traders. These are either for size of orders, number of executions within a limited timeframe, or number of executions as an aggregate. This facility allows ICE to provide yet another level of protection to both our customers and the markets as a whole. The recent rollout of our new ICE risk platform provides customers and traders with a real-time intra-day risk management package to track their trading activities as well as conduct real-time what- if analysis based on hypothetical market conditions.

Finally, we're one of only a few exchanges to provide our own widely used front end as well as multiple ways for customers, intermediaries, and data vendors to connect to our platform, including collocation through a traditional exchange telecom hub or over the internet. This modern and flexible technology has truly contributed to our ability to scale our business and to continue providing risk-management services to our members.

This slide is a little difficult to read. I think you've got a copy. As I highlighted before, ICE's trading platform design accommodates ease of scalability, infrastructure deployment by market independently to not only meet continuous client demand for reduced response times, but also allows clients to deploy their technology based on an individual market size and performance characteristics. Over the past 18 months ICE's input requests and averaging processing times have increased and decreased respectively by several-hundred percent. You might notice that the change in these figures are roughly equivalent. The increase in message traffic to the exchange is highly correlated to the decrease in response times. As ICE continues to be the industry leader in trading system response time, our clients continue to make use of it. By their logic, they don't have to wait as long to make a decision to submit the next order.

Users of ICE front-end technology while not as dependent upon subsecond response time as algorithmic traders, are one of the net beneficiaries of ICE's technology innovations. These users get the same representation of the market over the public internet with all the risk protections that are afforded to the high-velocity traders that can sometimes be artificially delayed through intermediary systems or individual firm infrastructure.

Lastly, ICE is going to continue to work in close cooperation with clearing members to develop lightweight, fast technology for risk management applications. By promoting these initiatives, exchanges are in a unique position to help firms reduce their risk from direct market access. Again, adoption and expansion of industry standards to new markets is going to be increasingly important going forward.

COMMISSIONER SOMMERS: Thanks, R.J. Does anyone have any questions specific to ICE's platform? If not, I'm going to turn to one of those important partners in risk management, Yvonne Downs with Newedge.

MS. DOWNS: I promise to keep this short. I know we've heard a lot of information today.

I wanted to go through a couple items. First, I wanted to go from a background perspective and tell you that automated order routing isn't a new phenomenon and I do think there's been a significant amount of evolution that's occurred in this area. Back in 2000-2002, and I know NFA was the one who first came out with a whole set of supervision and responsibilities and it addressed a variety of areas dealing with automated order routing systems, everything from the security, authentication, encryption and firewalls, authorizations, things dealing with making sure that we tested to make sure we've addressed the risks of dealing in an automated world, capacity issues, and obviously over time that's gotten to be an easier issue to address, but again it's another risk that we're dealing with and one that FCMs have had to set up a variety of procedures to handle. There's also disaster recovery. What happens when all of this fails, and obviously the different procedures that intermediaries have put into effect to address the risks.

In addition, obviously credit and risk controls were a part of that initial effort and again it deals with what's the nature of the clients who you're dealing with and that you need to assess the risks and control based on the nature of that client, everything from preexecution controls, potentially for example if you're dealing with retail risk which would be a whole different level of risk than I think we're sitting here dealing with right now and now we're dealing with large execution, large-volume traders. So the whole concept of what are we doing to address the different sets of risks is something that isn't new, but I do think technology has continued to change and I think that as you've certainly seen today, many of the exchanges have changed the controls to assist in that regard. It is the flow of information both on a real time, slightly real time, as well as coupled with what clearing firms do to look at our customers right up front. I do think you do have to look at the three-legged stool issue. I really think that's key and something we haven't spent enough time looking at today. On a three-legged stool is what are we doing first take on that client? We don't accept every client. I don't know about everybody else, but we actually vet every client that we take on, make a judgment call whether we're willing to take that risk on, assess the risk, assess the services we're providing, the nature of their trading, to make a judgment and one, yes, that's ours to make whether we want that client and how they're accessing the different markets.

We are a member of 70 markets and I know everybody's got lots of them. We're just trying to tell you that there are lots of markets around the world and to make that assessment is something that we do right up front when we first take a client on. We then ongoingly monitor that client, obviously the nature of their trading activities, whether it's OTC, whether it's listed, what is the nature of their trading strategies, all go into effect as to how we're going to set the risk. So, yes, we partner with the exchanges and the exchanges have done a great job of adding tools, but it's only one aspect of everything that we do and it's kind of vital to how we're handling automated order routing and something that with the advent of technology continues to be an issue and I'm here to tell you that I think we appreciate everything the exchanges have done, but we continue to talk to exchanges because we continue to need advancements in all of the things they do so that they can do our job and we can do ours.

I wanted to explain direct market access. Yes, it's high volume, generally people who don't take positions on overnight trading. Yes, they need lots of reduction in latency, that is critical, but we won't take on one of them, and I know many other firms won't, until we look at their own risk-management tools, not just ours, but we require that generally if we take on a client that we have to see their own internal systems of monitoring their own risk. Why is that? Because as much as we want these clients to only come 100-percent to us, we recognize that clients don't. Clients actually trade through multiple firms. So as much as we'd love to see all of their information and therefore have a great picture of every bit of risk they're taking on, that's not reality for us. So we ask them to look at what their controls are and how they're looking at them on a real-time basis, and they actually have preexecution controls in place. Then we do our assessment as well, and it's that balance that's key. No matter what we're doing here, I like to think of this as a pendulum, that if you tighten too many risk controls on one side, you're going to affect the business on the other and vice versa. So it is a balance and it's one that's critical to our ability to be an FCM and intermediary in this business and for the markets to work well.

So all of this discussion has been on preexecution controls and I will go back to my original statement that came when Kevin Davis talked about the fact that he said everybody needs preexecution controls. Yes, I think that everybody would love to say that, but as I said, customers don't clear through only one firm. We're not the only people who have risk here. And I will tell you that our customers trace across markets and I'd be very concerned about what happens to the markets if we were to have preexecution controls. If there is any kind of dislocation then you're going to have price discovery affected, you're going to have the ability for customers to hedge, and then they're going to go potentially to either overseas markets where it's not occurring, OTC markets where it's not occurring, so all you're doing is juggling something that you really need to balance as we go forward. So we'd hope that working together we can work through best practices, come up with some things as we continue forward, but I think rules and regulations in the area of risk management would be a little bit too far because as I said, it's a balance, it's an art, it's not just solely a science. I'll stop there since the hour is long. Thanks.

COMMISSIONER SOMMERS: Thanks, Yvonne.

Does anyone have any particular questions for Yvonne?

MR. RADHAKRISHNAN: Forgive me, but I have a hard time accepting the fact that we should not have preexecution controls because if we did, people would go to some other market. To me that's not a reason not to have risk management. And I don't understand what Yvonne is trying to say about the fact that if we had preexecution controls, and I agree with -- said that it's a three-legged stool or a four-legged stool or whatever it is, that if you had preexecution risk controls that it would somehow affect prices. I don't understand how that is.

MS. DOWNS: It's very simple. The price discovery mechanism, the first person to that market is what creates the price. If you set it up so there's a dislocation, there's not going to be a level playing field for people to discover the price.

MS. LITT: I also think it's a distraction. I think focusing too much on preexecution controls actually takes the debate to a place where it doesn't belong because preexecution controls are not realistic given the way our clients trade and I think Goldman Sach's business is very similar to Yvonne's. It's global. I don't even know what a preexecution control would be. Therefore, what you really want as regulators is for us to be making sure that our postexecution controls, that our risk-management function, is working effectively and that's why the things that Kim and Peter and R.J. talked about and the information that we're getting from exchanges that's so valuable in terms of interpreting aberrational trading and outsized trading that's inconsistent with the past, fat-finger limits which are preexecution, those are key. And then you want to make sure that we're getting that real- time input, we're using it effectively, we're getting the right people to see the aberrations immediately, and that we're acting on it. That's what you want to focus on.

Focusing on pretrade controls, most of

them will be artificial and meaningless, and that's what I hope that we can move you guys to, that I think that you've asked this question a number of times and it's very provocative and it's good for you to ask it, I just think it's the wrong question and I think we have to move to the right question, and I think the exchanges have gotten to the right question and they're helping us deal with it in giving us the information we need and I think all of us are in a place that's much better than we were probably 6 months ago, certainly 2 years ago, because of that information.

MR. DOWNEY: There is only a limited amount of people who really want that kind of split-second access. What you're asking the firms to do to put those risk controls in advance, they're going to have to think in a system-wide way and it's an expensive propositions. If the exchanges are going to provide them with a service at reasonable risk levels at a much cheaper cost it's reasonable for them to consider it. These are big players we're talking about. It's the traditional way that they have dealt with these customers in the past and other markets on the securities side and the credit side. It's something that makes sense to them. What you're asking for is that you put the controls in there in advance, you control it, you're asking them to spend an awful lot of money and it's not going to work for them.

MS. LITT: I don't want to have this debate, but I think it's much more than that. I don't think it's just about money. I think it's about the meaningfulness of what you develop and I think that if you work on a posttrade basis you're going to find something much more meaningful.

COMMISSIONER SOMMERS: Thank you, Bonnie. Thanks, David.

I want to ask a group of market participants who actually I think see a lot of benefit in direct market access. Eric, if you could share views from MFA.

MR. VINCENT: I don't have really

anything specific to add to the discussion in that I think it's been a pretty robust discussion and I've learned a lot. But as a general matter, FMA supports direct market access and believes that it leads to more efficient markets. However, I think we also recognize that it creates risk and as Ananda points out, even potential systemic risk that needs to be addressed. The challenge obviously is determining what exactly those pretrade risk controls should be and who should implement them. We would share the view of Mike Dawley and Yvonne that that should be a collaborative process among various market participants with input from the CFTC, but that the CFTC shouldn't be imposing standards in this area. I was extremely impressed with the presentation from CME in terms of the steps that they've taken to address this issue. I know that they've solicited input from many of our members. We want to continue to be an active participant in that dialogue both specifically with exchanges and clearing firms but also in terms of any industry-wide dialogue that's going on to ensure that we strike the right balance in this discussion.

COMMISSIONER SOMMERS: Thanks, Eric. Do any of my fellow Commissioners have questions?

CHAIRMAN LUKKEN: Just real quick. Something Yvonne mentioned is the idea of best practices and something in our statute allows us and the industry to develop best practices in this area. It seems to me that there are core principles for clearinghouses that require them to manage risk in a certain way and the fact that we're talking about this means that people are looking for guidance in this area, and I'm just wondering, we can certainly continue to facilitate discussions about this, but whether either the industry or the CFTC should try to help develop not rules because this is obviously so complex that I'm not sure we have the expertise to develop specific rules in this area, but at least principles or guidance or something to help lead the industry in the right direction, and it seems to me they're already heading there, but with some guidance from its regulator. I don't know if anybody has thoughts about that.

MR. HAHN: Just quickly, I think it was mentioned earlier, but the FIA I know is working on a document that will speak a lot to that issue in terms of guidance. The only comment I would make, Ananda, is I think you have to put your concern a little bit in to an historic context. There were no controls on locals. They had direct market access. There were no controls on brokers. They had direct market access. The circumstance that we have today where you have very close to real-time information to the clearing firm of what happened is a dramatic up-tick in terms of the risk. I think the focus is maturing that piece of the puzzle. There's a little work to be done. I think there are great strides that have been described by the exchanges getting the information to the member firms, the member firms have to have systems that they can take advantage of that information uniformly. That's probably a best practice. But the world today around this issue interestingly is better than it used to be because of this technology. There's more to be done. It has to be watched. But the give-in, give-up stuff was much worse than it is today.

COMMISSIONER SOMMERS: If there is nothing further, I think I will thank all of you who are here for making time in your day to be here and thank you for your input on these important issues. I want to also thank my staff for helping me put together this meeting. Andy Morton, Marsha Blaze, and Sharon Floyd, did all the work to put this meeting together. And also the Commission staff, OMO staff and OITS staff, for helping put this meeting together. Thanks very much, and with that we are adjourned. Thank you.

(Whereupon, at 4:30 p.m., the PROCEEDINGS were adjourned.)

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CERTIFICATE OF NOTARY PUBLIC

I, Carleton J. Anderson, III do hereby certify that the forgoing electronic file when originally transmitted was reduced to text at my direction; that said transcript is a true record of the proceedings therein referenced; that I am neither counsel for, related to, nor employed by any of the parties to the action in which these proceedings were taken; and, furthermore, that I am neither a relative or employee of any attorney or counsel employed by the parties hereto, nor financially or otherwise interested in the outcome of this action.

/s/Carleton J. Anderson, III
Notary Public # 351998
in and for the Commonwealth of Virginia
My Commission Expires:
November 30, 2008