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May 1, 2013

The Honorable Debbie Stabenow  
Chairwoman  
United States Senate  
Committee on Agriculture, Nutrition and Forestry  
328A Russell Senate Office Building  
Washington, D.C. 20510

The Honorable Thad Cochran  
Ranking Republican Member  
United States Senate  
Committee on Agriculture, Nutrition and Forestry  
328A Russell Senate Office Building  
Washington, D.C. 20510

Dear Chairwoman Stabenow and Ranking Member Cochran:

The Futures Industry (FIA) is pleased to submit this letter in response to your request for recommendations regarding potential amendments to the Commodity Exchange Act (Act) in connection with the reauthorization of the Commodity Futures Trading Commission (Commission). We commend you both for continuing the Committee's strong tradition of approaching issues in a bi-partisan manner and look forward to participating in an ongoing dialogue with you during the course of this process.

FIA is the leading trade organization for the futures, options and over-the-counter cleared derivatives markets. It is the only association representative of all organizations that have an interest in the listed derivatives markets. Its membership includes the world's largest derivatives clearing firms, as well as leading derivatives exchanges from more than 20 countries. FIA's core constituency consists of futures commission merchants, and the primary focus of the association is the global use of exchanges, trading systems and clearinghouses for derivatives transactions. Our members provide the majority of the funds that support derivatives clearinghouses and commit a substantial amount of their own capital to guarantee customer transactions.

FIA is uniquely situated to provide insight into the operation of the global derivatives markets, and the periodic Congressional reauthorization of the Commission presents a welcomed opportunity to review the current application of the Act to these markets.

## Customer Protection

The failures of MF Global Inc. and Peregrine Financial Group resulted in severe and unacceptable consequences for thousands of futures customers and the markets generally, and we agree that a review of current protections afforded to customers under the Act is warranted. The entire industry has been working collaboratively to identify and improve procedures required to better protect the integrity of these markets. A number of changes are already being implemented, many of which were recommended by FIA in the aftermath of these insolvencies<sup>1</sup>:

- The National Futures Association (NFA) and CME Group, the industry's principal designated self-regulatory organizations (DSROs), have adopted rules that subject all futures commission merchants (FCMs), to enhanced recordkeeping and reporting obligations, including: (i) transmitting daily customer segregation balances to their respective DSRO; and (ii) requiring the chief financial officer or other appropriate senior officer to authorize in writing and promptly notify the FCM's DSRO whenever an FCM seeks to withdraw more than 25 percent of its excess funds (*i.e.*, the FCM's "residual interest") from the customer segregated account in any day.
- NFA and CME Group have begun building an automated system for the daily monitoring of all customer segregated, secured, and cleared swaps amounts held by FCMs. As part of this project, NFA and CME contracted with AlphaMetrix360, a subsidiary of AlphaMetrix Group, to aggregate the data on customer segregated, secured, and cleared swaps amount accounts. The new system will allow NFA and CME to run an automated comparison of the balances in customer segregated, secured, and cleared swaps accounts at the depositories with the daily reports they receive from FCMs, and then quickly identify any discrepancies.
- NFA is also collecting additional financial information from FCMs and posting that information on its online Background Affiliation Status Information Center (Basic) system, a key step in giving customers the tools they need to monitor the assets they deposit with their FCMs. The new service provides the public with access to specific information about an FCM, such as the firm's adjusted net capital, the amount of funds held in segregated, secured, and cleared swaps accounts, and the types of investments that the FCM is making with those customer funds.
- FIA has issued Frequently Asked Questions on Customer Funds Protection<sup>2</sup>, which are being used by FCMs to provide their customers with increased disclosure on the scope of how the laws and regulations protect customers in the futures markets.

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<sup>1</sup> See Futures Industry Association, Futures Markets Financial Integrity Task Force - Initial Recommendations for Customer Funds Protection:

[http://www.futuresindustry.org/downloads/Initial\\_Recommendations\\_for\\_Customer\\_Funds\\_Protection.pdf](http://www.futuresindustry.org/downloads/Initial_Recommendations_for_Customer_Funds_Protection.pdf)

<sup>2</sup> See Protection of Customer Funds, Frequently Asked Questions: <http://www.futuresindustry.org/downloads/PCF-FAQs.PDF>

- Additionally, FIA, CME Group, NFA, and the Institute for Financial Markets have partnered to fund an evaluation of the costs and benefits of various asset protection insurance proposals. We look forward to sharing these findings with the Committee when available.

The FIA is very engaged in the development of industry and Commission-initiated efforts to proactively address many of the issues presented by these recent failures. We are also mindful that the effects of these recent enhancements may not yet be fully realized and expect Congress will want to see the ultimate results before making major changes to the statute. Even so the reauthorization process may present an opportunity for the following targeted improvements:

#### Foreign Futures and Foreign Options Secured Amount

Although the Act authorizes the Commission to adopt rules relating to the protection of customer funds deposited to margin transactions effected on foreign boards of trade, the Act does not specifically prescribe that the calculation methodology for secured amounts on such foreign markets be comparable to that required on US futures markets. As a result, the calculation method applicable to the secured amount requirement for foreign futures and options is different from the calculation method for transactions based on US futures markets.

While Congress and the CFTC have long and rightfully recognized customer funds deposited with an FCM to margin foreign futures and options transactions are inevitably subject to different risks because they are held outside of the US, and are subject to the bankruptcy and regulatory regime of the jurisdiction in which the market is located, we believe that customer asset protection for foreign futures and options could be increased by elimination of the differences in the calculation methodology of the secured amount.

#### Modifications to the Bankruptcy Code

Although outside of the Act, the Bankruptcy Code may also require amendment to account for apparent shortcomings identified in the aftermath of recent bankruptcies. FIA continues to coordinate with DSROs, derivatives clearing organizations (DCOs) and various customers to identify such potential modifications.

#### **Bona Fide Hedging**

In 2010, Congress amended the Act to statutorily instruct the Commission in how to define what constitutes a bona fide hedging transaction or position. The statutory definition correctly stipulates that the reduction of risk inherent to a commercial enterprise is essential in determining what qualifies as a bona fide hedging transaction. However, some of the risk reducing practices commonly used in the futures markets today have been excluded from a list of enumerated bona fide hedging transactions prescribed in Rule 151.5(a)(2). For example, please find attached for your consideration a complete petition prepared by the Working Group of Commercial Energy Firms which details the types of transactions that require further consideration as bona fide hedging tools<sup>3</sup>.

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<sup>3</sup> Petition for Commission Order Granting Exemptive Relief for Certain Bona Fide Hedging Transactions Under Section 4a(a)(7) of the Commodity Exchange Act:

<http://www.futuresindustry.org/downloads/WorkingGroup-BonaFideHedgingPetition.pdf>

## **Process Improvements**

Because the FIA appreciates the tremendous responsibility that the “Dodd-Frank Act” has bestowed upon the Commission, below are several suggested process improvements that seek to encourage more well-guided and efficient implementation of new regulations.

- As opposed to an obligation to “consider” costs and benefits, the Commission should be required to fully assess and quantify the costs and benefits associated with the rules and orders it puts forward.
- The application of new Commission-imposed regulations across international jurisdictions should be considered through a formal rule-making process to properly account for various stakeholders’ input and to further predictability and consistency among various jurisdictions.
- To date, the Commission has not exercised its statutory authority to exempt from registration comparably regulated foreign clearing organizations, which are clearing swaps. We are concerned that failure to stipulate the process for such an exemption may result in foreign regulatory authorities retaliating and making it more difficult for US FCMs and clearing organizations to conduct business globally. Congress, therefore, may want to consider requiring the Commission to provide guidance as to how this exemption, specifically allowed by the statute, may be achieved.

As you noted in your March 7 letter, the reauthorization comes at a particularly important and challenging time. The Committee will simultaneously review the Commission’s on-going implementation of newly granted responsibilities under the “Dodd-Frank Act” while also examining authorities of the Commission and the DSROs which are designed to ensure the protection of customer funds. This is no small task and, again, we commend you for your efforts. FIA is committed to working with you to achieve a positive outcome that both protects the integrity of these markets and maintains appropriate flexibility to adequately regulate their rapid evolution.

Sincerely,

A handwritten signature in cursive script that reads "Walt L. Lukken".

Walt Lukken  
President & Chief Executive Officer