

**TESTIMONY
OF
TERRENCE A. DUFFY
EXECUTIVE CHAIRMAN & PRESIDENT
CME GROUP INC.
BEFORE THE
SUBCOMMITTEE ON GENERAL FARM COMMODITIES AND RISK MANAGEMENT
OF THE HOUSE COMMITTEE ON AGRICULTURE
The Future of the CFTC: Perspectives on Customer Protections
October 2, 2013**

Good morning, Chairman Conaway and Ranking Member Scott. I am Terry Duffy, Executive Chairman and President of CME Group.¹ Thank you for the opportunity to testify today regarding the protection of customer property in the futures industry.

CME Group Exchanges, the National Futures Association (“NFA”) and other U.S. exchanges responded to failures at MF Global and Peregrine Financial Group (“PFG”) by enhancing the protection of customer property held by Futures Commission Merchants (“FCM”). These enhancements include:

- Daily segregation reporting by all FCMs,
- Increased surprise reviews of segregation compliance,
- Bi-monthly reporting on investment of customer funds,
- Periodic electronic confirmation of customer balances,

¹ CME Group Inc. is the holding company for five exchanges, CME, the Board of Trade of the City of Chicago Inc. (“CBOT”), the New York Mercantile Exchange, Inc. (“NYMEX”), the Commodity Exchange, Inc. (“COMEX”) and The Board of Trade of Kansas City Missouri, Inc. (“KCBT”) (collectively, the “CME Group Exchanges”). The CME Group Exchanges offer a wide range of benchmark products across all major asset classes, including derivatives based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. The CME Group Exchanges serve the hedging, risk management, and trading needs of our global customer base by facilitating transactions through the CME Group Globex electronic trading platform, our open outcry trading facilities in New York and Chicago, and through privately negotiated transactions subject to exchange rules.

- Daily feeds showing balances of cash and securities for all customer accounts at depositories, and
- CEO/CFO signoffs on significant customer fund distributions.

These programs and rules mitigate the risk of, and augment the early detection of, the improper transfer of customer funds and the improper reporting of customer asset balances, and improve our ability to check compliance with CFTC requirements for the investment of customer funds. Our efforts to enhance our monitoring continue today through the use of an account balance aggregation tool, which facilitates analysis of all of the firm's customer account balances across all of its reporting banks. Timely, including daily, access to this additional information is enabling us to better direct our regulatory resources at risk-based reviews of customer balances at clearing members and FCMs and their activity with respect to those balances.

The CFTC's proposed rules codify many of these initiatives.² In addition, the CFTC has required gross margining at the clearing house level. This further protects customers from the kind of losses caused by MF Global and PFG.

RESIDUAL INTEREST

CME remains fully committed to protecting customers against the full range of FCM conduct that may cause customer harm. But it is important to weigh the costs and consequences of each "protective" measure against the benefits to customers. We believe that the CFTC's proposal respecting the required residual interest that must be maintained by FCMs in the customer segregated account will adversely impact customers and fundamentally change the way in which futures markets operate.³ If a proposed "protective" measure is so expensive or its impact on market structure is so severe that customers cannot effectively use futures markets to mitigate risk or discover prices, there is no justification for implementing that measure. The proposal on "residual interest" fails this test. It has justifiably raised concerns among participants in the agricultural markets and many Members of Congress.

² NPR dated November 14, 2012 entitled, "Enhancing Protection Afforded Customers and Customer Funds held by Futures Commission Merchants and Derivatives Clearing Organizations." 77 FR 67866

³ CME Group filed comments to the CFTC's proposed rulemaking by letter dated February 15, 2013 from Kim Taylor, President, CME Clearing. (RIN 30-38-AD88)

The rule would require FCMs to insure that each customer's account is fully collateralized "at all times."⁴ FCMs cannot accurately calculate customer initial and variation margin requirements in real time. Practically, this means that customers will be required to double their margin requirements or FCMs will be required to contribute very large sums as "residual interest" on behalf of their customers. This rule will make the marginally profitable FCM business unsustainable for many firms that serve the agricultural community, and may deprive them and their customers of access to futures markets.

The residual interest rule is not necessary to protect customer funds. Its costs and negative consequences outweigh any added protection. This over-collateralization is unwarranted from a risk management standpoint. No regulatory risk model assumes that all customers with margin requirements will fail promptly to meet them. The proposed rule will unnecessarily drain liquidity and increase the cost of hedging financial and commercial risk especially for farmers and ranchers using our markets. Smaller and mid-sized firms that serve them will suffer the greatest impact of these increased costs, and may be driven out of business, leaving farmers and ranchers with fewer FCMs to facilitate their risk management goals. This will actually increase systemic risk by concentrating risk among fewer firms. Ironically, the proposal would force customers to place more collateral with their FCM – when they may be trying to actively avoid fellow-customer risk or FCM misconduct.

We understand the Commission is considering phasing in the rule, possibly to mitigate the consequences I just described. A phase-in does not cure the problem. Instead, CME supports the FIA alternative--that would permit an FCM to calculate its required residual interest as of 6:00 p.m. on the first business day after the trade date.⁵

⁴ It would require each FCM to maintain "at all times" residual interest in its customer accounts sufficient to exceed the sum of all customer margin deficits.

⁵ Comment Letter dated February 15, 2013 from Walt Lukken, President, FIA re: RIN 3038-AD88 Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 77 Fed. Reg. 67866 (November 14, 2012).

BANKRUPTCY CODE

We believe that Congress could further enhance customer protections through amendments to the Bankruptcy Code. Potential amendments range from fundamental changes that would facilitate individual segregation of customer property to narrower revisions that would enhance a clearinghouse's ability to promptly transfer positions of non-defaulting customers. While amending the Bankruptcy Code is a significant undertaking, CME Group believes that modification to the bankruptcy regime in light of recent experience would benefit customers and the market as a whole.

INSURANCE

In the wake of MF Global and PFG, some have advocated establishing an insurance scheme to further protect futures customers and restore their confidence in our markets. Like other "protective measures," an insurance proposal must be analyzed in light of the costs and potentially limited benefits of such an approach.

To that end, CME Group, the Futures Industry Association ("FIA"), the Institute for Financial Markets ("IFM") and NFA engaged Compass Lexecon to study the costs and benefits of adopting an insurance regime for the U.S. futures industry.

It's notable that Professor Culp's written testimony concludes that the only possible workable insurance is likely private insurance provided through a company owned by FCMs that choose to participate. There seems to be no commercial interest to provide insurance to individual customers or on a FCM specific basis.

He also explains that a government-mandated universal futures insurance, similar to SIPC for securities is not feasible. Professor Culp points out that its funding -- based on an FCM's gross revenues -- would be regressive with large FCMs paying a lop-sided share, while their customers would likely benefit the least from the \$250,000 coverage. He concludes that first year funding estimated at \$25million could barely cover an average loss caused by a default of small and medium FCMs.

Without a government backstop, the plan would be significantly underfunded relative to potential private solutions. And we certainly would not support imposing this burden on the taxpayers.

CONCLUSION

Customer protection is the cornerstone of our industry. We've strengthened our approach, and we will continually consider ways to enhance the safety of customer property. At the same time, we strive to avoid unnecessary cost or changes to market structure that would negatively impact the deep pools of liquidity our customers rely on to mitigate their risks.

Terrence A. Duffy, Executive Chairman and President

The Honorable Mr. Duffy has served as Executive Chairman and President since 2012. Previously he served as Executive Chairman since 2006, when he became an officer of the Company. He served as Chairman of the board since 2002 and our Vice Chairman from 1998 until 2002. Mr. Duffy has been a member of the Board since 1995. He was President of TDA Trading, Inc. from 1981 to 2002 and has been a member of CME since 1981. In 2002, he was appointed by President Bush to serve on a National Saver Summit on retirement savings. He also was appointed by President Bush and confirmed by the U.S. Senate in 2003 as a member of the Federal Retirement Thrift Investment Board (FRTIB). The FRTIB administers the Thrift Savings Plan, a tax-deferred defined contribution (retirement savings) plan for federal employees that currently has more than 3.5 million participants and \$190 billion under management. Mr. Duffy currently serves on the board of Directors of World Business Chicago, the Board of Trustees of Saint Xavier University, the Regional Advisory Board of The American Ireland Fund and is Co-Chair of the Mayo Clinic Greater Chicago Leadership Council. He is Vice Chairman of the CME Group Foundation, whose mission is to enhance economic opportunity, health and education, especially for disadvantaged youth. He also is a member of the Economic Club of Chicago, the Executives' Club of Chicago and the President's Circle of the Chicago Council on Global Affairs. Since 2003, Mr. Duffy has been recognized as one of the top 100 Irish Business Leaders by Irish America Magazine. Mr. Duffy attended the University of Wisconsin-Whitewater. In 2007, he received a Doctor of Humane Letters from DePaul University

Committee on Agriculture
U.S. House of Representatives
Required Witness Disclosure Form

House Rules* require nongovernmental witnesses to disclose the amount and source of Federal grants received since October 1, 2010.

Name: Terrence A. Doffy

Organization you represent (if any): CME Group

1. Please list any federal grants or contracts (including subgrants and subcontracts) you have received since October 1, 2010, as well as the source and the amount of each grant or contract. House Rules do NOT require disclosure of federal payments to individuals, such as Social Security or Medicare benefits, farm program payments, or assistance to agricultural producers:

Source: _____ Amount: _____

Source: _____ Amount: _____

2. If you are appearing on behalf of an organization, please list any federal grants or contracts (including subgrants and subcontracts) the organization has received since October 1, 2010, as well as the source and the amount of each grant or contract:

Source: _____ Amount: _____

Source: _____ Amount: _____

Please check here if this form is NOT applicable to you:

Signature: Terrence A. Doffy

* Rule XI, clause 2(g)(5) of the U.S. House of Representatives provides: *Each committee shall, to the greatest extent practicable, require witnesses who appear before it to submit in advance written statements of proposed testimony and to limit their initial presentations to the committee to brief summaries thereof. In the case of a witness appearing in a nongovernmental capacity, a written statement of proposed testimony shall include a curriculum vitae and a disclosure of the amount and source (by agency and program) of each Federal grant (or subgrant thereof) or contract (or subcontract thereof) received during the current fiscal year or either of the two previous fiscal years by the witness or by any entity represented by the witness.*

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