TESTIMONY
OF
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Chairman Johnson, Senator Shelby, Members of the Committee, thank you for the opportunity to testify respecting some lessons learned from the collapse of futures commission merchant ("FCM") and broker-dealer ("BD") MF Global, Inc. ("MFG") and possible policy responses to protect customers. I am Terry Duffy, Executive Chairman of CME Group ("CME Group" or "CME"), which is the world's largest and most diverse derivatives marketplace. CME Group includes four separate exchanges — Chicago Mercantile Exchange Inc. the Board of Trade of the City of Chicago, Inc., the New York Mercantile Exchange, Inc. and the Commodity Exchange, Inc. (together "CME Group Exchanges"). The CME Group Exchanges offer the widest range of benchmark products available across all major asset classes, including futures and options based on interest rates, equity indexes, foreign exchange, energy, metals, agricultural commodities, and alternative investment products. CME also includes CME Clearing, a derivatives clearing organization and one of the largest central counterparty clearing services in the world; it provides clearing and settlement services for exchange-traded contracts, as well as for over-the-counter ("OTC") derivatives transactions through CME Clearing and CME ClearPort®.

I have previously testified respecting MF Global's misuse of segregated customer funds and CME Group's efforts on behalf of customers. Today, I will summarize CME Group's and the industry's efforts to restore customer confidence, and our suggestions for strengthening customer protection and confidence going forward. I will also explain why the current system of front line auditing and regulation by clearing houses and exchanges should not be abandoned as a result of the misconduct of MF Global, and why you can be confident in the robust regulation that the SRO system provides.

Introduction

On October 31, the Securities Investor Protection Corporation ("SIPC") filed a petition with a Federal District Court in New York to place MFG into bankruptcy. Unlike in prior bankruptcies of CME member firms, our clearing house was unable to transfer all customer positions and property to another firm due to missing customer funds in segregated customer accounts under the control of the FCM. Indeed, this may be the first time in the industry's history that public customer will suffer ultimate losses with respect to their accounts for U.S. futures exchange trading.[1]

The shortfall in customer segregated funds occurred only in regard to funds under MFG's control. The customers' funds held in segregation at the clearing level at CME and other US clearinghouses were intact. However, the clearinghouses were not able to avoid market disruptions by immediately transferring those customer positions and any related collateral because of limitations under the

[1] As recent examples, in both *Refco* and *Lehman*, which had large FCM operations, while non-futures customers were significantly impacted by the bankruptcy proceedings, the regulated commodity customer accounts were transferred to new FCMs without any disruption. We had no reason to believe this situation would be any different at MFG until the segregation shortfall at MFG was discovered.

Bankruptcy Code. We believe that Congress can help protect customers whose collateral is safeguarded at clearing houses by changing the bankruptcy code to permit a clearing house that holds full collateral for a failed clearing member's customers to immediately transfer customer positions, along with the required collateral for those positions, to other clearing members.

The industry is united in its search for solutions that will restore confidence in the safety of funds invested in regulated futures and derivatives markets. Obviously, changes in the Bankruptcy Code are not the only answer, and it is constructive to look at a wide range of changes that can be implemented without legislation. In order to evaluate the proposals, it is necessary to begin with an understanding of the current system for protecting customer property and positions. A bit of background information regarding the clearing model in the futures industry, including the role and obligations of FCMs and derivatives clearing houses is my starting point.

The Futures Commission Merchant

An FCM is an individual or organization that (i) solicits or accepts orders to buy or sell futures contracts or options on futures contracts and (ii) accepts money or other assets from customers to support such orders. As such, FCMs are agents or intermediaries for their customers. Among other things, the Commodity Exchange Act ("CEA"), which is the main statute governing the FCM's legal obligations, expressly states that all money and other property of any customer received to margin or guarantee a derivative contract cleared though a derivatives clearing organization belongs to the customer and may not be commingled with the FCM's own trading accounts.

With respect to ensuring that such customer collateral received by the FCM is segregated, the CEA, applicable regulations of the Commodity Futures Trading Commission ("CFTC") and our clearing house rules require that money and other customer property must be separately accounted for and may not be commingled with the funds of the FCM or be used to margin, secure, or guarantee any trades or contracts of any person other than the person for whom the same are held. Additionally, CME Clearing has rules on its books directly addressing FCMs' obligations in this regard.

In practice, an FCM maintains a number of customer segregated accounts at custodians approved by the CFTC. As a customer establishes positions, the FCM transfers collateral from one of its customer segregated accounts to a customer segregated account maintained and controlled by the clearing house. In many cases, the FCM collects margin from its customers in excess of what is required by the clearing house to support the customer positions cleared through the clearing house; this "excess margin" is often held in the customer segregated accounts controlled by the FCM. The FCM also typically holds some of its own funds in the customer segregated accounts, in order to ensure that the accounts never fall below the required segregated amount. All assets in the customer segregated accounts are subject to various CFTC and clearing house rules, including limitations on permissible investment of these funds under CFTC Regulation 1.25. Different rules apply to the assets of customers who also trade on foreign exchanges.

Derivatives Clearing Houses

A clearing house acts as the seller to every buyer and buyer to every seller of every cleared contract. For futures contracts, it pays winners and collects from losers twice each day so that debt is eliminated from the system and systemic risk is minimized. When a firm fails to pay its losses, the clearing house must still pay the other firms that have profitable positions opposite the failed firm's trades. The Guaranty Fund is one of the principal means to make such payments possible.

Each clearing member contributes assets and agrees to pay an assessment, based on its risk profile, for the sole purpose of covering any loss suffered by the clearing house when it makes good on its commitment to honor its contracts despite the default of another clearing member. This guaranty is designed to protect against the systemic risk that could arise if the default of one clearing member were to lead to the failure of other clearing members. It is worth noting that the assets in and committed to the Guaranty Fund do not belong to CME Group, they belong to the clearing members who have contributed them.

Nearly 65 different U.S. FCMs hold approximately $155 billion in U.S. customer collateral and nearly $40 billion in collateral held for trading on foreign exchanges — much of which is not placed with regulated clearing houses. As of March 2011, the total amount of customer funds held by the top 30 FCMs was more than $163 billion. No clearing house, however large, could effectively or economically guarantee all such funds and all such activity. Some have suggested that a government insurance program similar to the equities markets' SIPC be established for futures markets. SIPC is designed to protect retail brokerage accounts up to $500,000, so even under SIPC, many larger securities accounts are not insured. While there are some smaller retail futures customers, many futures customers carry tens of millions or even more in their FCM accounts. The futures markets are mostly professional markets with very different risk profiles from the securities markets. Given the size and scope of the majority of the accounts in this business, a government insurance scheme may be a cost prohibitive and/or ineffective solution. Nevertheless, an insurance scheme is certainly an idea that should be explored, and CME will work closely with regulators and industry participants to find solutions that can help prevent a repeat episode of such magnitude and retain, or in some cases restore, the confidence of market users.

Industry Proposals to Protect Customers

On March 12th, a special committee composed of representatives from the futures industry's regulatory organizations, including CME, offered four recommendations to strengthen current safeguards for customer segregated funds held at the firm level. CME Group is already implementing these proposals, which will include:

- Requiring all Futures Commission Merchants (FCM) to file daily segregation reports.
- Performing more frequent periodic spot checks to monitor FCM compliance with segregation requirements.
- Requiring a principal of the FCM to approve any disbursement of customer segregated funds not made for the benefit of customers and that exceeds 25% of the firm's excess segregated funds.
- Requiring all FCMs to file bi-monthly Segregation Investment Detail Reports, reflecting how customer segregated funds are invested and where those funds are held.

In addition, in order to enhance intra-regulator coordination, we have recently established routine communications with FINRA for all of our common firms – the firm coordinators/relationship managers will reach out to each other to have these communications. We believe this will allow the coordinators on both sides to get to know one another better and to increase the sharing of information.

On February 29th, the Futures Industry Association proposed initial recommendations for enhancing the protection of customer funds. **http://www.futuresindustry.org/downloads/Initial_Recommendations_for_Customer_Funds_Protection.pdf** The specific recommendations include:

- Establishing a reporting requirement for the daily computation made by each FCM of customer funds on deposit in segregated accounts;
- Requiring FCMs to file twice-monthly reports on the investment of customer funds;
- Requiring FCMs to assure the appropriate separation of duties among individuals working at FCMs who are responsible for compliance with the rules protecting customer funds;Requiring FCMs to document their policies and procedures in several critical areas, including the valuation of securities held in segregated accounts, the selection of banks, custodians and other depositories for customer funds, and the maintenance and withdrawal of "residual interest," which consists of the excess funds deposited by firms in the customer segregated accounts.

CME has also challenged the industry and the Commission to consider whether other solutions will better serve the interests of customers and the industry. In addition to the proposed amendment of the Bankruptcy Code, CME is working with its clearing members and certain customers to find a structure that will protect their collateral against fellow customer and fraud risks. We are committed to finding a solution that will provide stronger protection for futures and swaps customers' segregated funds, from a legal, operational, and cost-benefit perspective without destroying the industry's business model.

In addition to these regulatory initiatives, we also recently launched the CME Group Family Farmer and Rancher Protection Fund to protect family farmers, family ranchers and their cooperatives against losses of up to $25,000 per participant in the event of shortfalls in segregated funds. Farming and ranching cooperatives also will be eligible for up to $100,000 per cooperative.

These steps, we hope, will help to rebuild the confidence in U.S. futures markets that was so badly shaken by the actions and failure of MF Global. While we think these initiatives are important to rebuilding that confidence, the misconduct of MF Global should not serve as a reason to undermine the current system of front line auditing and regulation by clearing houses and exchanges.

"Self-Regulation" is a Misnomer: Both the CFTC and Clearing Houses Play Key Regulatory Roles

Some critics suggest that the current regulatory framework is somehow to blame for MF Global's misconduct. As further detailed in the discussion below, "self-regulation" in the context of futures markets regulation is a misnomer, because the regulatory structure of the modern U.S. futures industry is in fact a comprehensive network of regulatory organizations that work together to ensure the effective regulation of all industry participants.

The CEA establishes the federal statutory framework that regulates the trading and clearing of futures and futures options in the United States, and following the recent passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act, its scope has been expanded to include the over-the-counter swaps market as well. The CEA is administered by the CFTC, which establishes regulations governing the conduct and responsibilities of market participants, exchanges and clearing houses.

CME was the designated self-regulatory organization ("DSRO") for MFG. As MFG's DSRO, CME was responsible for conducting periodic audits of MFG's FCM-arm and worked with the other regulatory bodies of which the firm is a member. CME conducted audits of MFG pursuant to standards and procedures established by the Joint Audit Committee ("JAC")[2] and reported such results to the CFTC.

[2] The JAC is a representative committee of U.S. futures exchanges and regulatory organizations which participate in a joint audit and financial surveillance program that has been approved and is overseen by the CFTC. The purpose of the joint program is to coordinate among the participants numerous audit and financial surveillance procedures over registered futures industry entities.

CME conducted audits of MFG, and all firms for which it was the DSRO, at least once every 9-15 months. The last audit of MFG was based on the firm's records for the close of business on January 31, 2011. This regulatory audit began subsequent to this audit date, and the audit was completed with a report date of August 4, 2011.

Some critics have suggested that the failure of MFG demonstrates that the current system of front line auditing and regulation by clearing houses and exchanges is deficient because of conflicts of interest. However, there is no conflict of interest between the CME Group's duties as a DRSO and its duties to its shareholders – both require that it diligently keep its markets fair and open by vigorously regulating all market participants.

Federal law mandates an organizational structure that eliminates conflicts of interest. In addition, we have very compelling incentives to ensure that our regulatory programs operate effectively. We have established a robust set of safeguards designed to ensure these functions operate free from conflicts of interest or inappropriate influence. The CFTC conducts its own surveillance of the markets and market participants and actively enforces compliance with the CEA and Commission regulations. In addition to the CFTC's oversight of the markets, exchanges separately establish and enforce rules governing the activity of all market participants in their markets. Further, the National Futures Association ("NFA"), the registered futures association for the industry, establishes rules and has regulatory authority with respect to every firm and individual who conducts futures trading business with public customers. The CFTC, in turn, oversees the effectiveness of the exchanges, clearing houses and the NFA in fulfilling their respective regulatory responsibilities.

The futures industry is a very highly-regulated industry with several layers of oversight. The industry's current regulatory structure is not that of a single entity governed by its members regulating its members, but rather a structure in which exchanges, most of which are public companies, regulate the activity of all participants in their markets - members as well as non-members - complemented with further oversight by the NFA and CFTC.

CME Group Regulation

As discussed above, no one has a greater interest than CME Group in ensuring that its industry-leading markets are perceived as -- and in fact are – safe, open and fair. CME Group does so by vigorously regulating the users of our markets. There is substantial evidence that such private regulation has served the markets and market participants very well. We have established a robust set of safeguards designed to ensure these functions operate free from conflicts of interest or inappropriate influence:

- Our ability to attract and retain business fundamentally depends on our customers' confidence in the integrity of our markets, and exceeding our customers' expectations in that regard is one of the cornerstones of our business model. Ensuring that our markets are defined by effective and appropriately balanced regulation is a competitive advantage that draws institutional, commercial and individual customers to CME Group.

- As a public company, it is only by performing our regulatory functions well that we avoid the severe reputational repercussions and associated impacts to shareholder value that would arise if lax regulation or improper conflicts were to compromise our commitment to fair, transparent and financially sound markets.

- CME Group's own capital is first at risk if a failed clearing firm's capital and collateral posted to CME is insufficient to cover a default at the clearing house, giving us the strongest possible economic incentive to ensure robust oversight of our clearing firms' compliance with our rules and CFTC regulations.

- In addition to strong economic and reputational self-interest, CME Group is subject to robust regulatory oversight, as further detailed in the next section, creating powerful regulatory incentives for CME Group to effectively regulate its markets.

The MF Global Bankruptcy

The MF Global bankruptcy was not a failure of exchange or government-sponsored regulation. Our Audit and other regulatory teams performed their responsibilities in regard to MF Global consistent with the highest professional standards. 100% of the customer segregated collateral posted to CME and held at the clearing level, amounting to $2.5 billion, was fully accounted for. The well-publicized shortfall in U.S. customer segregated funds came from funds held at the FCM level, not funds held at the clearing level.

MF Global's unlawful transfers of customer segregated funds were a very serious violation of the CEA and exchange rules. Unfortunately, no regulator, whether an exchange sponsored regulator or otherwise, can always detect and stop an individual who is intent on breaking the law. Regulators can seek to establish appropriate rules, monitor compliance with the rules to deter misconduct and correct infractions, and in cases where a rule is broken, deter future misconduct by taking vigorous action against persons liable for breaches of the rules.

Nor were there was no conflict of interest with respect to CME Group's regulation of MF Global. Indeed, in 2008 and 2009, CME Group fined MF Global $400,000 and $495,000, respectively, for supervision failures and other violations of trading practices rules, clearly indicating that CME Group's regulators actively monitored and enforced compliance with the rules by MF Global, just as we do with every other market participant.

Notwithstanding the fact that MF Global's misconduct was the cause of the shortfall in customer segregated funds, CME Group's efforts in the wake of these events speak to the level of our commitment to ensuring our customers' confidence in our markets:

- We made an unprecedented guarantee of $550 million to the SIPC Trustee in order to accelerate the distribution of funds to customers.
- CME Trust pledged virtually all of its capital - $50 million – to cover CME Group customer losses due to MF Global's misuse of customer funds.
- And, as noted above, CME Group recently launched the CME Group Family Farmer and Rancher Protection Fund to protect family farmers, family ranchers and their cooperatives against losses of up to $25,000 per participant in the event of shortfalls in segregated funds. Farming and ranching cooperatives also will be eligible for up to $100,000 per cooperative.

No other exchange or clearing house has taken such actions.

Government Oversight

Regulation at CME Group is subject to active government oversight, primarily by the CFTC.

- CME Group's exchanges are registered as designated contract markets (DCMs) with the CFTC, and our clearing house is likewise registered as a derivatives clearing organization (DCO).

- In order to achieve registered status, we are required to fulfill substantial regulatory obligations codified in the CEA's 23 core principles for DCMs and 18 core principles for DCOs. These include core principles requiring that we establish structures and enforce rules to minimize conflicts of interest in our decision making processes and that we have appropriate procedures for resolving potential conflicts.

- The CFTC's Division of Market Oversight actively oversees DCM compliance with core principles and its Division of Clearing and Risk oversees DCO compliance. Exchanges and clearing houses are continually subject to both formal and informal reviews of how effectively we fulfill our regulatory mandates. In the event CME Group's exchanges or clearing house were to fail to comply with the core principles, the company could face significant sanctions, reputational exposure and even compromise the registration status which allows us to operate our markets.

- With respect to regulatory coordination, the CFTC and SEC allow the SROs on the futures side and securities side to coordinate their financial surveillance. We are signors to an agreement under the Intermarket Financial Surveillance Group (IFSG). This agreement allows the "experts" to focus on their piece of the puzzle, as well as to share information on common firms where we have concerns. The IFSG also meets once or twice per year to share information on regulatory developments and common firms. As noted above, we have recently established routine communications with FINRA for all of our common firms – the firm coordinators/relationship managers will reach out to each other to have these communications. We believe this will allow the coordinators on both sides to get to know one another better and to increase the sharing of information.

Enforcement

CME Group's effectiveness and assertiveness in regulating its markets is also reflected in the results of our surveillance and enforcement programs.

- In 2011, CME Group's exchanges opened approximately 700 regulatory inquiries, in addition to conducting proactive regular surveillance, and took 138 formal disciplinary actions against market participants.

- Two of those recent actions, resulting in $850,000 in fines and remedial actions, were taken against one of our most active proprietary trading firms for failing to properly supervise and test its deployment of automated trading systems. In another recently resolved matter, eighteen brokers and locals in a particular market on the trading floor were fined more than $600,000 and subject to trading suspensions for engaging in non-competitive trades that disadvantaged other market participants.

Direct regulation by the exchange offers our regulators unique proximity to the markets, market participants and the broader resources of the exchange. This fosters the development of expertise that not

only makes our regulatory staff more effective, but also assists federal regulators in our common objective of preserving the integrity of the markets.

- Most of our interaction with federal agencies occurs with the CFTC, and its Division of Enforcement publishes a report of its activity for each fiscal year. Its most recent full report, for FY 2010, noted that it took 57 enforcement actions.[3] In 30% of those actions, CME Group either referred the matter to the CFTC or provided assistance to the CFTC.

- Excluding enforcement actions outside of CME Group's regulatory purview, such as fraud in the FX cash markets, the percentage of CFTC actions in which CME Group referred the matter to the CFTC and/or provided assistance to the CFTC was 68%.

- Another example of how exchange-sponsored regulation and federal regulation work together is a 2011 matter in which CME Group regulators initially acted to bar a party engaged in illegal practices from our markets and then referred the matter to the CFTC and Department of Justice. Both the CFTC and DOJ took enforcement action, and in December 2011, he was convicted in criminal court and sentenced to 44 months in prison and ordered to pay restitution of approximately $369,000 after having pled guilty to wire fraud.

- Last week, the CFTC acknowledged and thanked the NYMEX for its assistance in the recent Optiver market manipulation matter. "NYMEX's proactive surveillance program detected the subject trading by Optiver in the Crude Oil, New York Harbor Gasoline, and Heating Oil contracts and contributed to the cessation of the activity alleged in the complaint. NYMEX also provided the CFTC with important information from the NYMEX's own investigation of this matter, as well as other assistance."[4]

Exchange-sponsored regulation often allows for more expedient identification of potential issues given our knowledge of and proximity to the markets, as well as the ability to react more quickly and flexibly to potential market and regulatory issues; in certain matters, that speed can make all the difference between having the ability to freeze or recoup misappropriated money and losing it forever to wrongdoers.

- For example, in a series of three separate recent cases resolved in 2011, the CME Group exchanges were able to quickly identify suspicious activity in our markets involving off-shore parties seeking to misappropriate money from other unwitting market participants. We promptly referred those matters to the CFTC which subsequently filed suit against the parties in federal court. Our ability to quickly detect this activity and assist the CFTC in its subsequent investigatory efforts resulted in fines and restitution of more than $3.5 million and, by quickly freezing funds, prevented $7.2 million more from being stolen.

Conclusion

The protection of the interests of customers and restoration of public confidence following the failure and unlawful actions by MF Global continue to be CME Group's highest priority. We look forward to working with Congress and the regulators to enhance customer protections and foster confidence in our markets.

[3] The CFTC recently released statistics for FY 2011, which noted the filing of 99 enforcement actions and the opening of more than 450 investigations, but the full report is not yet available.
[4] http://www.cftc.gov/PressRoom/PressReleases/pr6239-12