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VIA ELECTRONIC DELIVERY

Mr. Jonathan G. Katz
Secretary
U.S. Securities and Exchange Commission
450 Fifth Street, N.W.
Washington, D.C. 20549

Re: SRO Governance; File No. S7-39-04; 69 *Fed. Reg*. 235 (December 8, 2004)

Dear Mr. Katz:

The Chicago Mercantile Exchange Inc. ("CME") welcomes the opportunity to comment upon the Securities and Exchange Commission's ("SEC" or "Commission") proposed rules relating to self-regulatory organizations ("SROs"). CME is currently the largest futures exchange in the United States and the largest derivatives clearing organization in the world. As an international marketplace, CME brings together buyers and sellers on its CME Globex® electronic trading platform and trading floors. CME offers futures and options on futures primarily in four product areas: interest rates, stock indexes, foreign exchange and commodities. CME is also a self-regulatory organization responsible for ensuring market integrity and financial security for all transactions in its products; however, our activities as a SRO are subject to the exclusive jurisdiction of the Commodity Futures Trading Commission ("CFTC").

CME is also the only demutualized and publicly-traded exchange in the United States.[1] As such, CME is subject to the corporate governance standards and listing requirements imposed by the New York Stock Exchange. While the Commission's proposed rules for securities industry SROs do not apply directly to CME, we believe that our experience and leadership in both exchange corporate governance and exchange self-regulation will be beneficial to the Commission in adopting industry-wide best practices for securities and securities options exchanges.

I. Fair Administration and Governance of National Securities Exchanges and Registered Securities Associations (Proposed Rules 6a-5 and 15Aa-3):

A. Scope of Proposed Rules 6a-5 and 15Aa-3.

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[1] All of CME's outstanding shares are held by Chicago Mercantile Exchange Holdings Inc. ("CME Holdings"), a Delaware for-profit corporation. CME Holdings completed its initial public offering in December 2002 and its Class A common stock is listed on the New York Stock Exchange (the "NYSE"). The Board of Directors of CME Holdings and CME are comprised of the same individuals.

CME supports the Commission's decision to exempt national exchanges registered pursuant to Section 6(g)(1) of the Securities Exchange Act of 1934 (the "Exchange Act") and limited purpose national securities associations registered pursuant to Section 15A(k)(1) of the Exchange Act.

As the Commission recognizes, exchanges that have notice-registered with the Commission pursuant to Section 6(g)(1) of the Exchange Act in order to trade security futures products, such as CME, should be exempt from compliance with respect to the proposed Rules 6a-5 and 15Aa-3 because the Commission does not have primary responsibility for the regulation of such exchanges. Rather, such exchanges are regulated by the Commodity Futures Trading Commission and are subject to the Commodity Exchange Act, as amended.

B. Board Consisting of a Majority of Independent Directors.

CME supports the Commission's proposal to require that boards of directors be comprised of a majority of independent directors. CME has both advocated and implemented such a position, which is consistent with accepted corporate governance "best practices" regarding board composition.

CME does not, however, believe that there is a "one-size-fits-all" approach with respect to composition requirements and bright-line definitions of "independence" that can ensure that a board functions effectively and independently. We do recognize that the inclusion of independent directors on the boards of SROs is important to mitigate any perceived conflicts of interest. However, we also believe that directors who are members or end-users of an exchange organization have an invaluable understanding of the business and can provide useful perspectives on significant risks and competitive advantages. Indeed, the inclusion of exchange members on CME's Board has been beneficial in transforming CME from a century-old mutual organization to a thriving publicly-traded company and from a largely floor-based open outcry business to one of the largest electronic trading platforms in the world.[2] We are thus concerned about the adoption of any bright-line standard that would automatically prohibit a board from finding a member of an exchange organization to be independent regardless of the particular facts and circumstances. Such a requirement would prohibit all members from serving on key board committees and would result in exchanges losing the benefit of their insight without the benefit of any analysis as to whether the membership actually results in an impairment of independence.

Although CME agrees with the general definition of independence (*i.e.*, that a director not have a "material relationship" with the exchange), we believe that membership in the exchange does not automatically constitute a material relationship with the exchange that would impair such director's ability to make independent judgments. As set forth in our categorical standards of independence (available at www.cme.com), we believe that so long as a director satisfies the independence requirements of the NYSE listing standards and our categorical independence standards relating to affiliations with charitable organizations, consulting services

[2] Since the completion of our IPO on December 6, 2002, our market capitalization has increased by 558.6% to $7.3 billion as of December 8, 2004. Similarly, the percentage of electronic trading in CME products has increased from 15% in 2000 to approximately 66% as of December 2004.

and share ownership, his or her independence will not automatically be impaired based on membership status.

CME believes that it should be the responsibility of the board to determine whether, based on all the facts and circumstances, including the level of trading activity and influence of the particular member, as to whether he or she is independent of the exchange. The Commission, therefore, should not broadly determine that no exchange member may meet the independence requirement.

Moreover, any conflicts that may arise from membership are adequately governed by the general independence standard that directors must be free of any *material* relationship with the exchange. State corporation laws generally require the board to exercise its business judgment to act in what it reasonably believes to be in the best interests of the company and its shareholders regardless of a director's status as a member of the organization. Directors must fulfill their responsibilities in a manner that is consistent with their fiduciary duty to their owners, in compliance with all applicable laws and regulations. We believe that rather than a blanket independence standard regarding membership, a comprehensive conflicts of interest policy is more appropriate to address any potential conflicts of interest that may arise due to an individual's trading activities. For example, CME keeps records as to the trading activities of its directors, if a matter is presented to the Board that could have an impact on a director's trading, that director is expected to recuse him or herself from the matter. (The foregoing procedures are set forth in more detail in the Company's Director Independence and Conflict of Interest Policy available at www.cme.com.)

C. Standing Committees.

The Commission proposes that each exchange have the following standing committees: Nominating Committee, Governance Committee, Compensation Committee, Audit Committee, and Regulatory Oversight Committee. The proposed rules would also require that each standing committee be comprised solely of independent directors and have a written charter.

CME was the first U.S. exchange to establish such committees as well as written charters governing the authority and activities of these committees (each of which is available at www.cme.com). Therefore, we agree with the Commission's proposed committee structure and that such committees should be comprised of independent directors and should operate pursuant to a written charter. However, for the reasons described above, we again urge the Commission to determine that the definition of independence does not automatically preclude a member of an exchange from serving on such key committees.

With respect to the Regulatory Oversight Committee, the Commission proposes that the Charter provide that the committee: 1) assure the adequacy and effectiveness of the exchange's regulatory program; 2) assess the exchange's regulatory performance; 3) determine the regulatory plan, program, budget, and staffing for the regulatory functions of the exchange; 4) assess the performance of, and recommend compensation and personnel actions involving, the Chief Regulatory Officer and other senior regulatory personnel to the Compensation Committee; 5) monitor and review regulatory matters relating to the exchange's surveillance, examination and enforcement units with the Chief Regulatory Officer; and 6) assure that the

exchange's disciplinary and arbitration proceedings are conducted in accordance with the exchange's rules and policies and any other applicable laws or rules.

Again, the Commission's proposals regarding the establishment of a Regulatory Oversight Committee comprised of independent members, closely mirrors CME's own Market Regulation Oversight Committee ("MROC"). On April 30, 2004, CME became the first futures exchange to appoint a board-level committee devoted to self-regulatory oversight. CME's MROC is comprised solely of independent, non-industry directors. As set forth in its charter, the MROC is charged with the following responsibilities:

- to review the scope of and make recommendations with respect to the responsibilities, budget and staffing of the Market Regulation Department and the Audit Department so that each department is able to fulfill its self-regulatory responsibilities;

- to oversee the performance of the Market Regulation Department and Audit Department so that each department is able to implement its self-regulatory responsibilities independent of any improper interference or conflict of interest that may arise as a result of a member of CME serving on the Board or participating in the implementation of CME's self-regulatory functions;

- to review the annual performance evaluations and compensation determinations and any termination decisions made by senior management of CME with respect to the Managing Director, Regulatory Affairs, and the Director, Audit Department, so that such determinations or decisions are not designed to influence improperly the independent exercise of their self-regulatory responsibilities;

- to review CME's compliance with its self-regulatory responsibilities as prescribed by statute and the rules and regulations promulgated thereunder; and

- to review changes (or proposed changes, as appropriate) to Exchange rules to the extent that such rules are likely to impact significantly the self-regulatory functions of the Exchange.

We believe that the newly empowered MROC represents an aggressive and appropriate step towards independence in self-regulation. Importantly, the formation of the MROC represents a best-practice model for exchange self-regulation, and we applaud the Commission for recognizing this model in the proposed rules.

The only material difference between the proposed Regulatory Oversight Committee's charter and the MROC's charter is with respect to item 3 of the Commission's proposed charter, which provides that the Regulatory Oversight Committee "determine the regulatory plan, program, budget, and staffing for the regulatory functions of the exchange." Rather than "determine" such plans, we believe that the committee should, as provided in the MROC's charter, "make recommendations regarding" such plans. Such a distinction is not only consistent with the nature of the oversight function of such a board-level committee, but ensures that directors are not put in the position of acting as management with respect to the exchange's employees.

D. Separation of Chairman of the Board and CEO Positions.

In the Release, the Commission states that it is not proposing to require that an exchange's Chairman of the board be an independent director in all circumstances. The Commission further states, however, that if the exchange's CEO is not also the Chairman, the Chairman must be an independent director.

CME's bylaws permit the Chairman and the CEO to be the same person; however, the Board currently believes that a separation of these roles and their attendant responsibilities should be separate and fulfilled by separate individuals. Notwithstanding the foregoing, CME does not believe that a mandate for the separation of the Chairman and the CEO is appropriate nor are specific independence requirements for the Chairman necessary. The Company believes that each individual organization should be allowed to adopt the structure that best allows the company to achieve the objectives of strong, independent board leadership.

As such, we disagree with the Commission's proposal that in the event the positions are served by two individuals the chairman should be independent. The Commission states in its Release that its proposed rules are designed to foster a greater degree of independent decision-making by the governing body of an exchange or association. However, given the fact that separate positions of the CEO and the Chairman are not required to satisfy such standard, we fail to see how the imposition of an independence requirement on a chairman who is not also the CEO advances the foregoing proposition. The role of the chairman is to control the flow of information to the board, set the agendas and to oversee the process of evaluating the CEO. The argument for the separation of the roles is to ensure that the Board serves as an effective check on management. As previously stated, we believe that it is the responsibility of the organization to determine whether such separation is necessary in light of its particular circumstances.

In addition, we also note that the SEC's proposed requirement to require executive sessions without the presence of management, including the CEO, also ensures that the Board serves as an effective check on management and promotes open discussions among the directors in the absence of the CEO. CME's Corporate Governance Principles, which are available at www.cme.com, already require that CME's Board meet in executive session on a quarterly basis.

E. Separation of Regulatory and Market Operations.

1. Independence of Regulatory Program.

The Commission proposes to require exchanges to establish policies and procedures that provide for the independence of their regulatory programs from the operation or administration of their trading facilities, to the extent that such exchanges' regulatory programs are *either* (1) structurally separated from the exchange's market operations by means or separate legal entities or (2) functionally separated within the same legal entity from the exchange's market operations and other commercial interests.

CME generally supports the Commission's proposal to functionally separate, within the same legal entity, the exchange's regulatory programs from the exchange's market operations and other commercial interests. Indeed, within CME, the Market Regulation Department is functionally separated from all other departments.

CME also supports the creation of a Chief Regulatory Officer position. CME does not, however, support the proposed requirement that the Chief Regulatory Officer report directly to the Regulatory Oversight Committee. At CME, the Managing Director of Regulatory Affairs, which serves as the head of the Market Regulation Department, reports directly to the Managing Director, General Counsel and Corporate Secretary of CME. CME does not believe that the Managing Director of Regulatory Affairs should report directly to the Market Regulation Oversight Committee because directors should not be put in the position of acting as management with respect to exchange personnel decisions. It is the responsibility of the board to oversee management's performance on behalf of the shareholders. Effective corporate directors are diligent monitors, but not managers, of business operations. Senior management is the party responsible for running the day-to-day operations of the company and properly informing the board of the status of such operations. In the event that senior management were to terminate the employment of the Chief Regulatory Officer, we do believe that the Regulatory Oversight Committee should have the authority, consistent with its oversight function, to review any such termination to ensure that it was not designed to influence improperly the independent exercise of his or her self-regulatory responsibilities.

CME does believe, however, that the Chief Regulatory Officer should have unfettered, *ex parte* access to the Regulatory Oversight Committee to discuss any issue, including a conflict or disagreement with management. Such access, however, can and should be addressed through a written charter – not by a jurisdictional mandate that reverses the roles of managers and directors. CME's model is based on the reporting structure and operational relationship that exists for many internal audit directors or managers and public company audit committees. While practices vary, it is most common for internal audit mangers to report to a Chief Financial Officer, Chief Executive Officer or General Counsel, while maintaining full, direct and independent access to the audit committee.

2. Use of Regulatory Fees, Fines and Penalties.

The Commission proposes to require an exchange to "direct monies collected from regulatory fees, fines or penalties ("regulatory funds") exclusively to fund the regulatory operations" of the exchange.

CME does not believe that exchanges should be required to use regulatory funds exclusively to fund the regulatory operations of an exchange. The imposition of such a directive could encourage regulators to impose sanctions consisting of fines rather than suspensions in an effort to bolster revenue, irrespective of the putative deterrent value of the sanction. Moreover, such a directive could encourage regulators to shift their focus from areas where surveillance is necessary to areas where large fines are likely to be obtained. Finally, we believe that the Commission would be improperly encroaching upon the discretion of exchange management to determine the best allocation of its resources. To the extent that the Commission believes that an exchange is not fulfilling its SRO responsibilities, the Commission has ample authority to take remedial steps, which includes the revocation of SRO status. To

ensure that SROs function properly, the Commission need not – and should not – orchestrate the use of company funds.

II. Periodic Reporting Obligations of Exchanges and Associations (Proposed Rule 17a-26):

A. Scope of Proposed Rule 17a-26

CME supports the Commission's decision to exempt national exchanges registered pursuant to Section 6(g)(1) of the Exchange Act and limited purpose national securities associations registered pursuant to Section 15A(k)(1) of the Exchange Act. As discussed above, the Commission does not have primary responsibility for the regulation of such exchanges.

B. Quarterly Reporting of Regulatory Information

The Commission proposes to establish a system of quarterly and annual reporting by eliciting specific information about exchanges' regulatory programs, including their surveillance and disciplinary operations. As part of the reporting system, the Commission would require exchanges to provide, as part of their periodic reports, the final agenda from any meeting of the board of directors or executive committee of the exchange, or any meeting of any committee of the board of directors or executive committee.

While CME is in favor of increased transparency and additional disclosure to its shareholders, it opposes any requirement to provide confidential board and board committee meeting materials to its shareholders. We do not believe that there is any benefit to making board and board committee agendas publicly available without any consideration as to their content or materiality. The goal of transparency is not to overload shareholders with the disclosure of information that is immaterial. We do not believe this process will promote an increased understanding of an exchange's self-regulatory responsibilities. Moreover, the proposed disclosure will be overly burdensome for exchanges that will have to review each agenda and make any appropriate confidential treatment requests relating to the materials. Absent a demonstrable need, the Commission should not require SROs to make publicly available all confidential board and board committee agendas.

Conclusion

Thank you for the opportunity to comment upon the Commission's proposed SRO governance rules. If you have any questions or comments, please do not hesitate to contact me or Matthew F. Kluchenek, Director and Associate General Counsel, at (312) 338-2861.

Sincerely,

Craig S. Donohue

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