

Memorandum

FEE POLICY BULLETIN

TO: Chief Financial Officers
Chief Compliance Officers
Corporate Members
Firm EFS Contacts 07-01

FROM: Audit Department, Clearing House Division

DATE: February 1, 2007

SUBJECT: Clearing and Globex® Fees for Member Firm Accounts

In September 2006, CME issued Audit Information Bulletin #06-03 concerning Clearing and Globex Fees. In response to questions and concerns raised on the stated policies, CME met with several trading firms to better understand their operations and the impact of our fee policies. As a result of those meetings as well as internal discussions, CME is issuing this Fee Policy Bulletin ("FPB") to better enunciate our member fee eligibility policies and to update and clarify them as needed. This FPB supersedes all previous bulletins discussing fee policy issues for member firm accounts.

The trading activity of member firms must adhere to our policies in order to be granted member fees – equity member or preferential fees as applicable. CME has established member firm trading policies to ensure that the trading activity conducted for the member firm account is for the sole benefit of the member firm itself and not the trading activity of individual customers/traders conducted in the name of the firm; i.e. to prevent arcade type trading under the guise of member firm trading and the "selling" of member firm rates. To that end, the financial benefit and risk of the trading activity must be solely of the member firm. Further the member firm may only profit/benefit from the member firm trading activity through the performance of the trade and not from any other source such as a commission or charge for trade execution.

The trading environment and the customer base has evolved and expanded over the years. We have seen a tremendous growth in both clearing and corporate membership for trading groups. These trading groups have their own unique capitalization, ownership structures, trader compensation and trading styles.

This FPB presents both Requirements (Absolutes) and Best Practices for defining when member firm trading activity will be granted member fees. In recognition of the varying trading operations, new Best Practices were established to allow member firms to utilize certain business practices (most not allowed in the past) which are generally prohibited. In order to do so, the member firm must clearly demonstrate to CME their application of these non-compliant practices is not inconsistent with CME's goal of providing member fees for trading activity for the account and sole benefit of the member firm.

1. REQUIREMENTS

1.1 Member Firm Trading Account

In order to obtain member clearing fees, CME rules require that the member firm trading account of clearing members¹, Rule 106.H. members, Rule 106.I. members, Rule 106.R. members and Rule 106.S. members must be 100% owned by the firm.

- For clearing members the trading activity conducted for the account of 100% owned subsidiaries is entitled to equity member clearing fees.
- For Rule 106.H./I./S. corporate members to receive member fees, all member firm trading must be conducted within the division of membership held. Member firm trading activity of a Rule 106.H./I./S. corporate member outside the division of membership held will receive non-member customer fees.
- For Rule 106.R. corporate members to receive member fees, all member firm trading must be conducted in accordance with the Questions & Answers Guide for Electronic Corporate Members under Rule 106.R. which may be found on CME's Web site at <http://www.cme.com/files/ECMQ&A.pdf>.
- Affiliates and subsidiaries of Rule 106.H. and Rule 106.R. corporate members are not entitled to the membership benefits of the corporate member.

A member firm trading account is evidenced through:

- The financial benefit and risk shall be solely of the member firm – only firm capital is at risk of loss.
- No non-owner traders may make any contributions or payments to the member firm or member firm trading account nor have any capital at risk in connection with their trading of the member firm account.
- All contributions by owners of the member firm are subject to risk of loss from any and all trading and business activities of the firm.
- All profits and losses of the member firm account are written off to the income of the member firm and are taxed to the member firm in accordance with IRS regulations.

These accounts must be registered in the Exchange Fee System ("EFS") as member firm accounts of the clearing or Rule 106.H./I./R./S. member as appropriate.

1.1.1 Joint Accounts with Individual Equity/Lessee Members

A clearing member or Rule 106.H./I./R./S. member may have a joint account with an equity or lessee member and receive preferential fees on contracts under the lowest division of

¹ For clarity, clearing members include inactive clearing members.

membership held. These accounts must be registered in EFS under the joint account owner with the lowest division of membership held. Further the account title field in EFS must identify all owners of the joint account.

1.2 Member Firm Traders for Globex Activity

The member firm trading activity must be conducted by traders including operators/administrators of Automated Trading Systems ("ATS") that are:

- Bona-fide IRS Form W-2 ("W-2") employees (or equivalent W-2 of a foreign jurisdiction) of the member firm; or
- Independent contractors and other self-employed individuals of the member firm whose total compensation (that is, all compensation) is reported on an IRS Form 1099-MISC ("1099-MISC") (or equivalent document of a foreign jurisdiction); or
- Owners who maintain at least \$500,000 in bona-fide capital for clearing and Rule 106.I. members; or
- Bona-fide owners of the firm for Rule 106.H./R. members; or
- Individual equity members of CME trading within their division of membership except for Rule 106.R. members. Traders of Rule 106.R. members may not own, hold, or have owned or held a membership in any of CME's divisions within the past two years; or
- Rule 106.F. Clearing Member Transfer and Rule 106.I. Related Party Transfer members; or
- Registered Commodity Trading Advisors ("CTAs"), exempt CTAs under CFTC Regulations 4.14(a)(4), 4.14(a)(5) or 4.14(a)(8)(i)(D), and Investment Managers authorized by the Financial Services Authority ("FSA").

All member firm traders must be assigned unique trader IDs, those IDs and the associated member firm trader must be appropriately registered in CME's EFS, and all Globex trades (orders) must be identified with the registered ID of the trader executing the trade.

- Clearing member and Rule 106.I./S. member firm traders must be further defined as "W-2 Employee", "Commodity Trading Advisor", "Independent Contractor 1099-MISC", "Rule 106.F. Trader" or "Owner w/ \$500K+ Interest" as applicable.
- Clearing member and Rule 106.I./S. firm traders which are compensated through a W-2 or 1099-MISC for their trading profitability must be registered in EFS as "W-2 Employee" or "Independent Contractor 1099-MISC", as appropriate, even if they are an owner of the firm with less than \$500,000 in bona-fide capital.
- For operators/administrators of an ATS and for the ID under which an ATS submits orders, the "ATS" box on the EFS registration screen must be checked.

1.2.1 Bona-fide Employees

Bona-fide employees of the member firm are evidenced through:

- Issuance of an W-2, or foreign equivalent, for all compensation (i.e. salary and bonus) to the trader by the member firm;
- Inclusion in the firm's payroll tax records; and
- The trader has no income until the firm pays the trader.

1.2.2 Independent Contractors

1099-MISC independent contractors/self-employed individuals of a member firm may receive member fees when trading a member firm's account.

The member firm trading activity of independent contractors and other self-employed individuals whose compensation is reported on an IRS Form 1099 which is not a 1099-MISC (e.g. an IRS Form 1099-B ("1099-B")) or equivalent document of a foreign jurisdiction will be assessed fees based on the lowest division of membership held by both the firm and the independent contractor/self-employed individual.²

If the 1099-B independent contractor/self-employed individual is not an equity, lessee or Rule 106.F. member and is trading a member firm account, non-member customer fees will apply on trades executed by the individual. These accounts should not be registered in EFS as member firm accounts and are not eligible for firm-based incentives or discounts.

1.2.3 Bona-fide Owners

Individual owners of clearing members and Rule 106.I. members who maintain at least \$500,000 of bona-fide capital in the firm may receive equity member fees on their trading activity of the member firm's account.

Individual owners of clearing members and Rule 106.I. members who do not maintain at least \$500,000 of bona-fide capital in the firm are not entitled to receive equity member fees on their trading activity of the member firm's account unless their trading profitability is reported to them on a W-2 or 1099-MISC or they are on one of the member firm's Rule 106.F. memberships.

Individual owners of clearing members and Rule 106.I. members with less than \$500,000 of bona-fide capital who trade the member firm account of the clearing or Rule 106.I. member and whose trading profitability is reported on a form other than a W-2 or 1099 MISC (e.g. an IRS Form K-1) are assessed fees based on the lowest division of membership held by the owner and the firm. If such owners are not equity, lessee or Rule 106.F members themselves, non-member customer fees will apply and these accounts should not be registered in EFS and are not eligible for firm-based incentives or discounts.

² Traders receiving compensation reported on a 1099-B are regarded as "holders" of the positions and, as such, the account would not qualify as a member firm account.

An investing LLC is prohibited from trading and/or having a specific interest in a clearing member firm account eligible for equity member rates unless (1) the investing LLC maintains an investment of \$500,000 of bona-fide capital in the clearing member for each owner (that is owner, member and/or equity participation member) of the investing LLC and (2) the trading is conducted by individual owners of the investing LLC.³

1.2.4 Individual Equity/Lessee Members

A member firm account traded by an equity/lessee member who is not a W-2 employee, 1099-MISC independent contractor/self-employed individual or Rule 106.F. member is assessed fees based on the lowest membership status of the firm and the equity/lessee member. These accounts must be registered in EFS under the party with the lowest division of membership held. Further the account title field in EFS must identify the member firm as the account owner.

1.2.5 Rule 106.F. Clearing Member Transfers

Traders on a clearing member's Rule 106.F. membership may receive their compensation in any manner including a W-2, 1099-MISC, 1099-B, or K-1 for their trading activity of the clearing member firm account. All other requirements for member firm trading must be met.

1.3 Member Firm Traders for Open Outcry Activity

The member firm trading of a clearing member or Rule 106.H./I./S. member is entitled to member clearing fees when an individual owning and holding a membership or the firm's Rule 106.F. or Rule 106.H./I./S. member executes it on the floor of the Exchange in open outcry.

The member firm trading of a clearing member or Rule 106.H./I./S. member conducted with discretion by a Rule 106.D. lessee member on the floor of the Exchange in open outcry will be charged fees based on the lowest membership status of the firm and the Rule 106.D. lessee member regardless if the lessee member is a firm W-2 employee or 1099-MISC independent contractor/self-employed individual. The Rule 106.D. lessee member must be registered as an account controller for the clearing or Rule 106.I./S. member firm account in CME's EFS.

1.4 Member Firm Trader Compensation and Profit Splits

Member firm trading and trader compensation must meet the following requirements:

- Traders cannot be responsible for losses beyond their share of profits earned and maintained in the account which have not yet been distributed to the trader.
- The firm must be allocated both a portion of the profits and losses of the member firm account.

³ There are no restrictions on passive investing LLCs of clearing members firms. Passive investing LLCs do not trade or have a specific interest in a trading account(s) and their return is based on the overall firm's profitability.

- The profit split on agreements with any trader, including owners acting as traders, may not exceed 80/20 (i.e. 80% to the trader/20% to the firm).
 - For member firm trading conducted by a team of traders, the profit split to the team in total may not exceed 80/20 (i.e. 80% to the trader team/20% to the firm).
 - Further the 80% limit on profit splits to a trader or team of traders includes any individual who has a specific interest in its profitability including those involved in the supervision/training of the account(s) and/or trader(s).
- Non-owner traders cannot leave their share of profits in the firm for greater than one year without becoming an equity owner.
 - Non-owner trader's share of capital in an account may not exceed the trader's share of net profit/loss in the previous 12 month period.
 - If a trader leaves their share of any profits in the account for greater than one year, they must become an equity owner.
- The firm is prohibited from:
 - Setting minimum account balances for its traders.
 - Charging margin on positions to traders.
 - Charging fees on draws taken by traders.
 - Requiring or accepting security deposits from its traders.

2. **BEST PRACTICES**

2.1 **Description of Best Practices**

CME recognizes that certain business practices may be utilized when conducting customer business as well as member firm trading activities. The Best Practices were established to allow member firms to utilize certain business practices (most not allowed in the past) which are generally prohibited. In order to do so, the member firm must clearly demonstrate to CME their application of these non-compliant practices is not inconsistent with CME's goal of providing member fees only for member firm trading activity. Such practices will be reviewed individually and in the aggregate in relation to the firm's entire trading activities and operation.

Review of such non-compliant practices will reflect the following key principles of CME's member firm trading policies. First and foremost, the trading activity eligible for member fees must be conducted for the account and sole benefit of the member firm itself. The trading activity of individual customers/traders conducted in the name of the firm is not eligible for discounted member firm fees in order to prevent arcade type trading under the guise of member firm trading and to prevent the "selling" of member firm rates. Further, a member firm may only profit/benefit from the member firm trading activity through the performance of the trade and not from any other source such as a commission or charge for trade execution.

Non-compliance with the Best Practices below is generally prohibited as it is indicative of arcade type trading, the selling of rates, and/or profiting from sources other than the performance of the member firm trade. **As such, while the Best Practices are not absolutes as the**

Requirements are, any non-compliance of the Best Practices will be carefully reviewed with the burden of responsibility on the member firm to clearly support and demonstrate to CME's satisfaction that the trading is of the member firm itself. Under limited circumstances in reviewing the totality of the member firm's trading operations and the violative practice(s), CME may deem the member firm's trading activities in accordance with our policies for member firm trading activity that is eligible for member firm fees.

2.1.1 Interest

The firm may not charge interest on debit balances to traders nor may it pay interest on credit balances to traders except where an options trading strategy is utilized in which interest on the premium is a key component of the overall profitability of the strategy.

The firm may not pay interest on holdbacks where holdbacks are permitted.

The firm may not pay interest on capital contributions.

2.1.2 Allocated Expenses

A firm may not allocate expenses to trades or traders in excess of actual direct and indirect expenses of the individual member firm trades or traders. Only actual expenses incurred may be allocated – a mark up on expenses is not permitted. Further, opportunity costs may not be allocated.

Expense allocations may be made on a per trade/contract basis and/or monthly, quarterly, yearly, or other time period basis.

Direct expenses may include items such as clearing and Globex fees, brokerage commissions (those charged by member firm's clearing firm), software, connection/line charges, licensing fees, and market subscriptions. Indirect expenses may include items such as rent, utilities, membership/share costs, and firm costs for accounting, legal, back-office, compliance, strategy development, programming, and human resource services.

For all expenses allocated the firm must maintain records of actual costs incurred. All rebates of expenses incurred must also be reflected in the allocated costs. Further total costs incurred may not be allocated only to traders but must be allocated to all areas of the member firm's operations which benefit; for example rent should be allocated across all areas of the firm utilizing office space. If an expense is otherwise allocated directly to a trader (for example a line charge) such expense may not be included in the allocated costs.

The total amount of expenses allocated must be reasonable to the actual costs incurred. Allocated expenses must be reviewed, and if necessary adjusted, routinely to ensure they continue to be reasonable in relation to actual expenses. Member firms must maintain and provide adequate supporting calculations and documentation of such allocated expenses and their reasonableness.

2.1.3 Capital Usage Fee

A firm may not charge a fee for capital usage to individual traders of the member firm's accounts.

2.1.4 Cost of Capital Fee

A firm may not charge a fee for the cost of capitalizing the firm (and thus the member firm's trading accounts) to individual traders.

2.1.5 Owners Interest in Member Firm Accounts

Individual owners and investing LLCs (as permitted) of a member firm may not have a specific interest in the profitability of a member firm account or group of accounts other than a member firm account that the individual owners or owners of the investing LLC trade or provide direct supervision/training to. Thus, an individual owner/investing LLC may not be entitled to a direct percentage of the profits of a member firm account traded by a specific "independent" employee(s) or contractor(s) of the member firm.

2.2 Application of Best Practices

As previously stated non-compliance with the Best Practices is indicative of profiting from sources other than the performance of the member firm trade and is generally indicative of a customer relationship versus a member firm trader relationship. Non-compliance with the above practices will be carefully reviewed with the burden of responsibility on the member firm to clearly support and demonstrate the trading as of the member firm itself. Upon review of the practice, CME will in its sole judgment determine whether the member firm's practices are consistent with CME's policies for member firm trading activity that is eligible for member firm fees.

If a member firm has any questions concerning the acceptability of its current or potential business practices that may appear inconsistent with the Best Practices, please contact the Audit Department at (312) 930-3230 for forwarding to the Fee Policy Team for discussion and review.

3. PENALTIES

The policies set forth herein will be strictly enforced by the Exchange. A member, clearing member, or corporate member found to have engaged in fraudulent or dishonest conduct or to have acted in bad faith will be subject to a charge of a major rule violation. Major rule violations are punishable by a fine up to \$1,000,000 plus the monetary value of any benefit received as a result of the violative activity.

If you have any questions, please call the Audit Department at (312) 930-3230.