

**APPLICATION FOR REGISTRATION OF THE BOARD OF TRADE OF THE
CITY OF CHICAGO, INC. AS A DERIVATIVES CLEARING ORGANIZATION**

I. INTRODUCTION

The Board of Trade of the City of Chicago, Inc. (“CBOT®”) hereby makes application to the Commodity Futures Trading Commission (“Commission”) for registration as a derivatives clearing organization (“DCO”) under Section 5b of the Commodity Exchange Act, as amended (“Act”), and Part 39 of the Commission’s Regulations. The CBOT will operate in accordance with the definition of a derivatives clearing organization contained in Section 1a(9) of the Act.¹

This application demonstrates that the CBOT has the ability to comply, and will continue to comply, with the Core Principles for DCOs set forth in Section 5b(c)(2) of the Act, through a comprehensive Clearing Services Agreement (“CSA”) with the Chicago Mercantile Exchange Inc. (“CME”), as described below. The CSA became effective on April 16, 2003, and establishes a “Launch Date” of no later than January 2, 2004. The Launch Date is defined as the first trading day for CBOT products as to which transactions are required to be cleared through CME. A redacted copy of the CSA has previously been provided to the Division of Clearing and Intermediary Oversight, and is also attached as Appendix A. The Initial Term of the CSA extends through January 10, 2008. Upon expiration of the Initial Term, the CSA will automatically renew for successive three-year terms, unless either the CBOT or the CME notifies the other of its intent not to renew, at least six months prior to the beginning of the next Renewal Term.

¹ The CBOT will not establish a separate DCO entity. The Exchange itself is seeking registration as a DCO.

CME's Clearing House will clear, settle, and guarantee all of the CBOT's pit, electronic, and ex-pit trades, pursuant to CME's Rules and Operational Policies and Procedures.² The clearing and settlement services are described in detail in Schedule A to the CSA, and are discussed below in the context of the Core Principles for DCOs. In performing clearing services for the CBOT, the CME will utilize the Clearing 21[®]³ system software, including any subsequent enhancements, that it applies to the clearing of its own futures and options contracts.

The CBOT's electronic trades will be matched before submission to the CME for clearing, while all other CBOT trades will be submitted for matching by the CME. The CME will guarantee the unmatched CBOT trades that it accepts for clearing upon its matching of such trades, and the CME will guarantee the matched trades that it accepts for clearing once it receives the relevant matched trade records. The CME will guarantee the CBOT's ex-pit trades upon payment of appropriate margin, in the same manner that it guarantees such trades at the CME.

² The CSA defines "Operational Policies and Procedures" as

CME's operational practices, policies and procedures related to implementing and performing Clearing Services, including, without limitation, establishing marking prices that vary from settlement prices submitted by CBOT, where such settlement prices materially deviate from appropriate market prices; the timeline for CME's receipt of information and data necessary to perform the Clearing Services and CME's delivery of information and data to CBOT, Clearing Members and other third Parties; data file formats; the manner in which CME makes information available to Clearing Members; and the mechanics of CME's automated delivery processes . . . including the automated delivery system to be developed by CME as provided by Schedule A

The CSA provides that these Operational Policies and Procedures will be the same as the CME's existing practices, policies and procedures.

³ Clearing 21 is the real time (trade and position processing) clearing system jointly developed by the CME and the New York Mercantile Exchange.

II. CORE PRINCIPLES

Core Principle A: IN GENERAL – To be registered and to maintain registration as a derivatives clearing organization, an applicant shall demonstrate to the Commission that the applicant complies with the core principles specified in this paragraph.⁴ The applicant shall have reasonable discretion in establishing the manner in which it complies with the core principles.

In the sections that follow, the CBOT addresses each Core Principle for derivatives clearing organizations, and discusses how it will comply with those Core Principles. In doing so, the CBOT has taken into consideration the Application Guidance contained in Appendix A to Part 39 of the Commission’s Regulations.

The CBOT has submitted various amendments to Chapter 7 (Clearing) of its Rulebook to the Commission, as well as other relevant rule amendments, pursuant to Part 40 of the Commission’s Regulations. Copies of all of these amendments are attached as Appendix B. A complete copy of the CBOT Rulebook, as of March 1, 2003, is attached as Appendix C. A current version of this Rulebook is available on the CBOT’s website at www.cbot.com. The CME has also submitted rule amendments to the Commission, as necessary, to facilitate the implementation of the CSA. A complete copy of the CME’s Rulebook, as of January 2003, is attached as Appendix D. The CME’s Rulebook is also available on its website at www.cme.com.

Core Principle B: FINANCIAL RESOURCES – The applicant shall demonstrate that the applicant has adequate financial, operational, and managerial resources to discharge the responsibilities of a derivatives clearing organization.

⁴ “This paragraph” is Section 5b(c)(2) of the Act.

A. Financial Resources

The CBOT has adequate financial, operational, and managerial resources to discharge the responsibilities of a derivatives clearing organization. A copy of the CBOT's year-end certified financial statements for 2002 and 2001 are attached as Appendix E.

Since the CBOT has outsourced its clearing operations and the guarantee function to CME, it will be CME's resources that will be utilized in the case of a clearing member default. For these purposes, CME will employ the so-called "Lamfalussy" Standard that calls for CME to continue to operate in the event of the default of its largest net debit counterparty. This standard resulted from an international study, and is set forth in the Statement of Best Practices for International Banking and Counterparty Clearing Organizations (1990). In meeting this standard, CME intends to stress-test the joint CBOT/CME portfolios to determine what a reasonable "worst-case" scenario might be, and will ensure that resources are indeed sufficient to cover this loss.

The CME's 2002 annual certified financial statement reflects the substantial financial and operational resources of the CME and its Clearing House. The Form 10-K, filed with the Securities and Exchange Commission by Chicago Mercantile Exchange Holdings Inc., the CME's parent company, is attached as Appendix F. A copy of its quarterly Form 10-Q, as of March 31, 2003, is attached as Appendix G.

According to the CME's 10-K, in 2002, its Clearing House processed an average of approximately 554,000 clearing transactions per day, and it currently has the capacity to clear more than 1.5 million transactions per day, with systems that give it the ability to substantially increase its capacity beyond that level. Additionally, as of December 31,

2002, the CME's Clearing House acted as custodian for approximately \$27.4 billion in collateral and, during 2002, it moved through its clearing system an average of approximately \$1.8 billion in settlement funds on a daily basis.

As the CBOT's Clearing Services Provider, the CME will provide the financial guarantees for all CBOT contracts that it clears, and it will maintain a joint security deposit pool (i.e., a guarantee fund) for CME and CBOT Clearing Members. (Schedule A to the CSA, page A-5). The available assets of the CME Clearing House, as of the December 31, 2002 date of its Form 10-K financial statement (page 18), revealed that the Aggregate Performance Bond Deposits by all CME Clearing Firms (in cash and securities) were approximately \$27.4 billion. In addition, the Market Value of Pledged CME Shares/Memberships was \$4.8 million, CME Surplus Funds were \$171.6 million, Clearing Firms' Security Deposits were \$869.2 million, and the CME's Limited Assessment Powers were approximately \$2.4 billion, resulting in Minimum Total Assets Available for Default of approximately \$3.4 billion. The foregoing numbers, as applicable, will increase substantially when the margin deposits of CBOT Clearing Members are transferred to the CME Clearing House and CBOT Clearing Members make their security deposit contributions. The methodology for determining the CME's security deposit requirements, which will also be applied to CBOT Clearing Members, is discussed below, in connection with Core Principle G.

The CME also has a secured, confirmed Line of Credit Agreement with a consortium of domestic and international banks, in the amount of \$500,000,000. The Line of Credit is collateralized by Clearing Members' security deposits. The full amount of the Line of Credit is readily available, if the CME gives notice by 3:15 p.m. Chicago

time. This credit facility has never been used. However, any such borrowed funds will also be able to be utilized to ensure that the CME could pay settlement variation to CBOT Clearing Members, if there is a temporary disruption of the domestic payments system that would delay settlements with such Clearing Members, or in the event of a CBOT Clearing Member default.

B. Managerial and Staff Resources

The CBOT has committed staff throughout the Exchange to perform the work necessary to ensure the effective implementation of the CSA and to perform the functions of a derivatives clearing organization. At this time, a number of joint review teams have been established, with both CBOT and CME representatives, to address transition issues relating to products, deliveries, large trader reporting, regulatory file layouts, membership, rule changes, trading operations, technology operations, and margin and collateral requirements, among others. The representatives consist of senior management, middle management, and other staff. At the CBOT, such staff represents many departments, including Exchange Operations, Screen Based Trading, Technology and Data Products, Business Development, the Office of Investigations and Audits, Legal, and Member Services. It is anticipated that a number of these staff, or others in their respective departments, will be involved with the facilitation of the Clearing Services on an ongoing basis.

The CME Clearing House has substantial and well qualified managerial and staff resources that will ensure the effective and efficient performance of the clearing and settlement services that it has undertaken to provide to the CBOT pursuant to the CSA.

Core Principle C: PARTICIPANT AND PRODUCT ELIGIBILITY – The applicant shall establish (i) appropriate admission and continuing eligibility standards (including appropriate minimum financial requirements) for members of and participants in the organization; and (ii) appropriate standards for determining eligibility of agreements, contracts, or transactions submitted to the applicant.

A. Eligibility of Clearing Members

The CBOT will continue to review applicants for CBOT Clearing Membership, as it does today. Current review procedures include obtaining detailed information about the nature of a firm’s business activity, its ownership, and its organizational structure, and analyzing its current financial statements to ensure its financial capacity. See: CBOT Regulation 230.02. In addition, the CBOT reviews the qualifications of the individuals who will register their memberships for the Clearing Member, pursuant to CBOT Rules 230.00 and 703.00.

Subject to the terms of the CSA, the CME will establish rules and procedures for the admission of CBOT Clearing Members as Special CME Clearing Members, for the purpose of clearing transactions in CBOT products.⁵ In addition to the CBOT review, applicants for CBOT Clearing Membership will be subject to review by the CME Clearing House Risk Oversight Committee. This Committee consists of six representatives of firms that are both CME and CBOT Clearing Members and one representative of a settlement bank, and has recently been expanded to include a representative of a CBOT-only Clearing Member. The CBOT and the CME are in the process of comparing their current admission procedures in an effort to develop a

⁵ Special CME Clearing Members will only be eligible to clear CBOT transactions unless they meet all requirements for CME Clearing Membership.

coordinated process that will provide for the sharing of information and the avoidance of any unnecessary duplication of efforts with respect to CBOT Clearing Member applicants.

All FCMs, non-FCMs and Sole Proprietors that were CBOT Clearing Members on April 16, 2003, will be admitted as Special CME Clearing Members. Any such entities that become CBOT Clearing Members after April 16, 2003, will also be admitted as Special CME Clearing Members, if they meet CME Clearing Membership requirements other than requirements regarding ownership of CME memberships or common stock.

The minimum capital requirements that will apply to CBOT Clearing Members are specifically addressed in the CSA. CBOT Clearing Members will continue to be subject to the applicable initial or admission minimum capital requirements imposed by the Board of Trade Clearing Corporation (BOTCC), if lower than the CME's minimum capital requirements for CME Clearing Members, if such CBOT Clearing Members met such BOTCC requirements on April 16, 2003, and continue to meet such requirements through the Launch Date. However, the minimum capital requirements for such Sole Proprietors will be subject to the special CME capital rules described below, after the Initial Term of the CSA, which ends on January 10, 2008.

In general, the initial capital requirements for CBOT Clearing Members that are FCMs are the greater of: \$1,500,000 in adjusted net capital if a partnership, \$2,500,000 in adjusted net capital if a corporation, or 8% customer risk margin plus 4% non-customer risk margin, or the CFTC/SEC minimum capital requirements. The initial capital requirements for CBOT Clearing Members that are non-FCMs are the greater of:

\$1,000,000 if a partnership, \$1,500,000 if a corporation, or 10% house risk margin. The initial capital requirements for CBOT Clearing Members that are Sole Proprietors are the greater of: \$250,000 or 10% house risk margin.

FCMs and Non-FCMs that become CBOT Clearing Members after April 16, 2003, will be subject to CME's existing minimum capital requirements for CME Clearing Members, if such requirements are higher than the applicable BOTCC requirements. CBOT memberships will be recognized as assets that may be used to satisfy the difference between such BOTCC capital requirements and the CME's minimum requirements.

Sole Proprietors that become CBOT Clearing Members after April 16, 2003, will be subject to special CME capital rules that have been agreed upon by the CBOT and the CME. Specifically, the CBOT and the CME have agreed that the minimum capital requirement for such new Sole Proprietor Clearing Members will be \$1,000,000.

Currently, the CME's minimum capital requirement for FCM Clearing Members is the greater of: \$2,000,000 in adjusted net capital, or 8% customer risk margin plus 4% non-customer risk margin, or the CFTC/SEC minimum capital requirements, with no distinction made between partnerships and corporations. Non-FCM CME Clearing Members are also subject to a \$2,000,000 capital requirement, and the CME does not currently recognize Sole Proprietor CME Clearing Members.

Notwithstanding the applicable grandfather provisions with regard to minimum capital requirements for any category of CBOT Clearing Members as a group, the CME may increase or decrease the capital requirements for CBOT Clearing Members, on a case-by-case basis, if the particular Clearing Member's risk profile changes materially.

Any such required increase may be met through the acquisition of additional CBOT memberships.

All CBOT Clearing Members, regardless of when admitted to CBOT Clearing Membership, will be subject to all of the rules and requirements of, and obligations to, CME's Clearing House, except with regard to ownership of CME memberships and common stock (and capital rules as described above). CBOT rules will continue to govern the requirements regarding the number and type of CBOT memberships that must be registered in order to qualify a firm for clearing status, as set forth in CBOT Rule 703.00.

The CBOT's Audit and Financial Surveillance Department, under the supervision of its experienced senior management, will continue to conduct risk-based financial examinations of those CBOT Clearing Member FCMs for which it is the DSRO (unless the DSRO responsibilities are reassigned for a particular firm). In addition, it will conduct financial examinations of CBOT Non-FCM and Sole Proprietor Clearing Members, on an as-needed basis. The CBOT will also conduct financial surveillance of all CBOT Clearing Members.

B. Eligibility of Products

The CME will develop systems and adopt practices necessary to support the product features and characteristics of the CBOT products that were listed for trading as of April 16, 2003, including fractional price formats and variable cabinet pricing. The CME will also support new features and characteristics of existing CBOT products, as well as new products that the CBOT lists for trading after April 16, 2003.

The CBOT will continue to apply the same considerations that it does today, in connection with its design of modifications to existing products and new products that it will clear through the CME Clearing House pursuant to the CSA. These considerations include, among other things, the potential for hedging benefits, and, of paramount importance, the need for market integrity. The CBOT strives to develop products that it will offer for trading (and that will be acceptable for clearing) that are not readily susceptible to manipulation. In this regard, the CBOT also adopts appropriate large trader reporting requirements and speculative position limits or position accountability requirements.

Core Principle D: RISK MANAGEMENT – The applicant shall have the ability to manage the risks associated with discharging the responsibilities of a derivatives clearing organization through the use of appropriate tools and procedures.

As discussed above, CBOT Clearing Members will remain subject to stringent minimum capital requirements. In addition, CBOT Clearing Members will be required to make security deposits to the CME's combined guarantee fund and will be subject to the CME's limited assessment powers.

The CME will support net margining of customer positions in CBOT products in substantially the same manner as it is done at BOTCC today. However, the CME will retain the discretion to adjust the formula for calculating security deposit requirements or assessment of security deposit contributions with respect to net-margined products, as it deems appropriate, to fairly and equitably calculate such security deposit requirements, given differences between positions subject to gross margining and positions subject to net margining.

The CME and the CBOT have agreed to develop a coordinated performance bond/margin review process, pursuant to which CBOT staff will meet with CME staff, on at least a monthly basis, to discuss the appropriate performance bond/margin requirements for CBOT futures contracts. As the Clearing Services Provider, the CME will retain ultimate control over performance bond/margin requirements at the clearing member level. The CBOT will continue to retain control over performance bond/margin requirements at the customer level.

The CBOT and the CME have already identified certain products of the respective exchanges that are appropriate for risk offsets. The CME will recognize these offsets at the clearing member level, through the application of appropriate spread credits, for CBOT and CME products. Both exchanges will also recognize these offsets at the customer level. Thus CBOT and CME Clearing Members will realize the benefits of portfolio margining that were envisioned by the CSA, at the same time that the CME will be engaged in prudent risk management on behalf of the CBOT.

The CME will support any cross-margining arrangement to which the CBOT is or becomes a party, unless the CME determines that a particular proposed cross-margining arrangement would present an unacceptable credit risk to the CME. The CME's current cross-margining programs are described in Chapter VIII of the CME's Clearing House Manual of Operations (Revised: June 2002), which is attached as Appendix H. See also: CME Rule 830 (Cross-Margining).

The CME's proprietary SPAN® (Standard Portfolio Analysis of Risk®)⁶ software determines appropriate performance bond/margin requirements by simulating the gains and losses of futures and options portfolios, and thus determining their overall risk, under changing market conditions. The CBOT has licensed and used the SPAN software for some time, for the purpose of determining customer level margin.

The CME will generate and distribute SPAN files to CBOT Clearing Members and customers that reflect SPAN margining of their positions in CBOT products (and, as applicable, any CME products and products of any other exchange for which the CME provides clearing services or linked clearing). Specifically, for FCMs that are Clearing Members of both the CBOT and the CME, their positions in the products of both exchanges will be combined for each of the customer and house performance bond/margin calculations. These combined SPAN files will be generated five times per day for risk management purposes. On-line reports will be available to CBOT Clearing Members, showing the relevant performance bond/margin calculations and risk arrays, twice a day, after the intraday and end-of-day settlement cycles.

The CME's current system for determining performance bond requirements by utilizing SPAN, and the various SPAN files that are created and distributed to CME Clearing Members, are described in detail in Chapter VI of the CME's Clearing House Manual of Operations, Appendix H. A detailed description of SPAN is also available on the CME's website at www.cme.com.

The forms of performance bond collateral that the CME accepts, and the methods of administering and valuing such collateral, are described in detail in Chapter VII of the

⁶ "SPAN" and "Standard Portfolio Analysis of Risk" are trademarks of the Chicago Mercantile Exchange. The Chicago Mercantile Exchange assumes no liability in connection with the use of SPAN by any person or entity.

CME's Clearing House Manual of Operations, Appendix H. A current list of acceptable collateral is also available on the CME's website, and in CME Rules 821 and 825.

CBOT Clearing Members will also be subject to the CME's policies with regard to such collateral.

In addition, the CME has agreed to review the forms of collateral currently accepted by BOTCC that are not currently accepted by the CME, and to amend its rules to accept such forms of collateral with respect to CBOT products, if it determines that they are frequently used and that their acceptance would not be unduly costly or risky.

The CBOT will, as it does now, monitor the risk of its member firms every day, in part through reviewing daily reports showing the combined settlements (pay/collect) from all domestic clearing houses for every member firm, and comparing the applicable settlements to each firm's regulatory capital. Thus, throughout the day, the CBOT monitors the ability of each CBOT Clearing Member to meet its daily settlements. The CME will also notify the CBOT when a CBOT Clearing Member has an unusually large pay due to the CME Clearing House.

The CBOT will continue to perform major market move surveillance and stress testing for CBOT Clearing Members based on CBOT large trader data, and will be examining and modifying its current procedures, as necessary. The CME will also use this data to perform the same type of account level stress testing that it performs with respect to its own products. The CBOT and the CME will coordinate their respective stress testing processes in order to effectively identify the concentration of customer exposure to CBOT Clearing Members.

As discussed above, the CBOT will continue to conduct risk-based financial examinations of those FCM Clearing Members for which it is the DSRO, on an ongoing basis, and will, as necessary, conduct financial examinations of CBOT Clearing Members that are Non-FCMs or Sole Proprietors. The CME conducts periodic reviews of CME Clearing Members' risk management practices, including such firms' liquidity needs, risk management procedures, and stress testing abilities, as deemed necessary. As the CBOT's Clearing Services Provider, the CME will conduct the same type of reviews with regard to CBOT Clearing Members.

CBOT Clearing Members that are FCMs currently file 1-FR financial statements, on a monthly basis, with the CBOT, and if they are also CME Clearing Members, with the CME. All FCM CBOT Clearing Members will be required to file such financial statements with the CBOT and the CME. In addition, Non-FCM and Sole Proprietor CBOT Clearing Members will be required to file quarterly financial statements with both the CBOT and the CME, on standard forms that are mutually agreed upon by the CBOT and the CME. The CBOT and the CME will both perform financial surveillance of all CBOT Clearing Members, utilizing their respective sophisticated programs for analyzing financial statements filed by FCMs, and developing appropriate procedures for analyzing financial statements filed by Non-FCMs and Sole Proprietors, to determine capital compliance and to detect unfavorable financial trends. The CBOT and the CME will also conduct intensified monitoring of high-risk firms.

Core Principle E: SETTLEMENT PROCEDURES – The applicant shall have the ability to (i) complete settlements on a timely basis under varying circumstances; (ii) maintain an adequate record of the flow of funds associated with each transaction

that the applicant clears; and (iii) comply with the terms and conditions of any permitted netting or offset arrangements with other clearing organizations.

As the Clearing Services Provider, the CME will use single, integrated clearing cycles to process transactions in both CME and CBOT products. As the CME currently does for its own products, it will routinely settle the gains and losses associated with CBOT trades and positions twice each business day – an intraday cycle and an end-of-day settlement. The CME will also conduct additional variation and performance bond/margin settlement cycles if it determines that they are warranted by market volatility.

The CBOT will continue to set daily end-of-day settlement prices, according to its established procedures. The CBOT will promptly transmit such settlement prices to the CME, both via a data file and a real-time quote stream, as described in Appendix A to the CSA.

The CME will apply its established deadlines and requirements to the clearing process for CBOT products, including trade report submission deadlines, out-trade report production, final reconciliation and option exercise deadlines, collateral substitution and withdrawal deadlines, and pay/collect procedures.

The CME's settlement procedures, including a description of the Clearing 21 Settlement application and the Clearing 21 Banking and Asset Management application, which will be utilized by CBOT Clearing Members, are described in detail in Chapter VII of the CME's Clearing House Manual of Operations, Appendix H. The CME's current operational timeline, which will also apply to CBOT transactions, is available on the CME's website.

Clearing 21 processes reported transactions on a real-time basis and provides users with instantaneous information on trades, positions and risk exposure. Its Position Management application is described in detail in Chapter V of the CME's Clearing House Manual of Operations, Appendix H. This application will allow CBOT Clearing Members to submit their open positions twice a day pursuant to the CME's Position Change Submission process, and to submit position adjustments, exercise options, and review current settlement variation estimates for cleared trades.

As described in greater detail in Chapter VII of the CME's Clearing House Manual of Operations, Appendix H, the CME requires Clearing Members to maintain demand deposit cash accounts and treasury security safekeeping accounts at one or more approved settlement banks where the CME maintains accounts. Clearing Members must generally sign an agreement with their settlement banks, authorizing such banks to debit or credit their accounts, on instructions from the CME, to meet daily performance bond and settlement requirements. Clearing Members utilize the Clearing 21 Banking and Asset Management application to effect performance bond collateral transactions, including deposits and withdrawals of securities. These requirements and procedures will also apply to CBOT Clearing Members.

The CME does not currently interface with all of the banks that currently serve as settlement banks for transactions in CBOT products, in particular, Lakeside Bank and Burling Bank. The CME has committed to use its best efforts to establish a settlement banking relationship with Lakeside Bank and, as appropriate, Burling Bank.

The CBOT will continue to manage the delivery process, and retain overall responsibility with regard to that process, through its Registrar function, which now

resides in the Market Surveillance Department of the Office of Investigations and Audits. The CME currently supports delivery processing through on-line, web-based deliveries applications that track deliverable positions and deliverable supply, accept tenders and retenders, report delivery assignments, and create invoices for CME products, and it is currently enhancing its applications to handle the CBOT's physically-delivered products. The CME is also developing a system that will support electronic shipping certificates and electronic warehouse receipts for those CBOT products that currently utilize these delivery instruments.

Core Principle F: TREATMENT OF FUNDS – The applicant shall have standards and procedures designed to protect and ensure the safety of member and participant funds.

The CME will apply the same standards and procedures to protect and ensure the safety of CBOT Clearing Member and customer funds that it applies to the funds of CME Clearing Members and their customers.

The CME segregates customer performance bond/margin deposits from house performance bond/margin deposits, in compliance with the Act and Commission regulations. In addition, the CME ensures that all funds deposited by Clearing Members are segregated from exchange operating funds.

Both the CME and the CBOT routinely monitor the segregation compliance of their respective Clearing Member FCMs through analysis of their periodic financial filings and through financial examinations of such firms for which they have DSRO responsibilities.

Core Principle G: DEFAULT RULES AND PROCEDURES – The applicant shall have rules and procedures designed to allow for efficient, fair, and safe management of events when members or participants become insolvent or otherwise default on their obligations to the derivatives clearing organization.

The CME has established procedures that would be followed in the unlikely event that a CME or a CBOT Clearing Member would default on its financial obligations to the CME. These procedures are described in the CME’s publication entitled “The Financial Safeguard System of Chicago Mercantile Exchange”© (2003), which is attached as Appendix I.

If the default were to occur with regard to the Clearing Member’s house accounts, the CME could act immediately to: attempt to transfer any and all segregated customer positions and funds to another solvent Clearing Member; take control of or liquidate the house positions; apply the Clearing Member’s security deposit and house margin deposits to the obligation; and invoke any parent guarantee of the Clearing Member’s obligations.

If the default were to occur with regard to a customer account carried by the Clearing Member, the CME could act immediately to: attempt to transfer non-involved customer positions and funds to another solvent Clearing Member; take control of or liquidate house and involved customer positions; and apply the Clearing Member’s security deposit and house margin deposits to the obligation.

If a Clearing Member were to default in connection with its house accounts, the CME would not use customer funds or liquidate their positions. However, Clearing Members’ customer funds are held in the aggregate, in accordance with CFTC regulations. Therefore, if necessary, the CME would be permitted to liquidate the

positions of all of the Clearing Member's customers, and apply all of its customers' funds, if the default resulted from the account activity of one of the Clearing Member's customers.

Whatever the nature of the default, the CBOT would offer any assistance that it could with regard to the transfer of customer accounts, or any other aspect of the procedures for responding to a default of a CBOT Clearing Member.

The security deposits that the CME requires to be made by CME Clearing Members are described in CME Rule 816.00, including the methodology for determining and adjusting the amounts of such deposits.⁷ This Rule also sets forth the types of assets that may be deposited, and defines how the CME may use the security deposits. Under the CSA, CME will calculate and collect security deposit contributions from CBOT Clearing Members in accordance with CME's Rules and Operational Policies and Procedures. Thus, CBOT Clearing Members will also contribute security deposits to the guarantee fund in proportion to their volume and margin requirements, with adjustments being made by the CME on a quarterly basis. As previously noted, CME will adjust the formula to address the fact that CBOT customer positions are net margined and CME customer positions are gross margined. The CME will have the authority to seize the security deposits of both CBOT Clearing Members and CME Clearing Members in the event of a default by either a CBOT Clearing Member or a CME Clearing Member.

⁷ The amount of the security deposit that is currently required of CME Clearing Members is the greater of: \$500,000 or the results of a formula under which 85% of the total requirement is based on the Clearing Member's proportionate contribution to aggregate performance bond requirements over the preceding three months and 15% is based on the Clearing Member's contribution to volume over the preceding three months.

If a CBOT or a CME Clearing Member were to default, and the losses were not covered through the utilization of the assets of the defaulted Clearing Member, the CME would be able to apply funds in the following order of priority: CME's surplus funds⁸, the security deposits of all non-defaulting CBOT and CME Clearing Members, the proceeds from any default insurance that the CME may maintain in the future, and assessments against all non-defaulting CBOT and CME Clearing Members. Although the assessment powers have never been used, CBOT Clearing Members may be assessed to the same extent as CME Clearing Members, i.e., up to 2.75 times their security deposit requirements. The order of priority outlined herein, and a description of the CME's assessment powers and Clearing Members' obligations, are set forth in CME Rule 802.

The Commission has approved the CBOT's amendments to its Rule 252.00, governing claims priorities, which provide that in the event of a default by a CBOT Clearing Member, the Clearing Services Provider, i.e., CME, would be given the first priority to assert claims against the proceeds of the sale of the Clearing Member's CBOT memberships that are required for CBOT Clearing Membership status. These amendments are included in Appendix B.

The procedures that would be followed with regard to cross-margin accounts are described in The Financial Safeguard System of Chicago Mercantile Exchange, Appendix I.

Core Principle H: RULE ENFORCEMENT – The applicant shall (i) maintain adequate arrangements and resources for the effective monitoring and enforcement of compliance with rules of the applicant and for resolution of disputes; and (ii)

⁸ Surplus funds are the working capital of the CME reduced by an amount necessary to support short-term operations.

have the authority and ability to discipline, limit, suspend, or terminate a member's or participant's activities for violations of rules of the applicant.

As recognized by the Commission in numerous Rule Enforcement Reviews over the years, the CBOT maintains adequate systems and resources for the effective monitoring and enforcement of compliance with its rules. The CBOT's enforcement program has historically addressed clearing-related issues, including, among other things, the accuracy of open interest reporting, compliance with delivery requirements and procedures, and the accuracy and timeliness of trade data submissions. The CBOT will continue to monitor and enforce compliance with all of its rules that facilitate the proper functioning of the clearing process.

The Commission has also documented the adequacy of the CBOT's financial examination and financial surveillance capabilities and performance in past Rule Enforcement Reviews. The CBOT has also used its enforcement powers in connection with rule violations relating to minimum capital requirements, and segregation and Commission Regulation 30.7 secured requirements, among others.

The CME will maintain a large trader database of CBOT Clearing Members' and customer accounts using the CBOT's method of assigning numbers used to aggregate accounts by beneficial owner.⁹ A daily data file of reported positions will be transmitted to the CBOT by the CME, as well as position limit reports against the large trader data. The CBOT will monitor and analyze the large trader data for purposes of market surveillance to address possible speculative position and hedge limit violations and any

⁹ The CBOT's rules pertaining to speculative position limits, hedge exemptions, and aggregation policies are contained in Chapter 4 of the CBOT's Rulebook.

potential manipulation concerns, as well as financial surveillance of CBOT Clearing Members.

The Commission has also repeatedly recognized the CBOT's effective use of disciplinary sanctions in its enforcement cases, including fines, access denials, suspensions, and expulsions from membership, as appropriate. In addition, the CBOT has had a long-standing and effective arbitration process for the resolution of disputes.

Core Principle I: SYSTEM SAFEGUARDS – The applicant shall demonstrate that the applicant (i) has established and will maintain a program of oversight and risk analysis to ensure that the automated systems of the applicant function properly and have adequate capacity and security; and (ii) has established and will maintain emergency procedures and a plan for disaster recovery, and will periodically test backup facilities sufficient to ensure daily processing, clearing, and settlement of transactions.

The CME will utilize the same automated systems to clear CBOT products that it currently uses to clear its own products, with any necessary modifications. The CME has an established program of oversight and risk analysis that ensures the functioning, capacity and security of its clearing systems.

The CME will also provide the same back-up and disaster recovery services, procedures and functions that it employs for its own contracts, in performing Clearing Services for the CBOT pursuant to the CSA.

The CME's Disaster Recovery & Business Continuity Plan is described in Appendix I, The Financial Safeguard System of Chicago Mercantile Exchange, at page 8.

Core Principle J: REPORTING – The applicant shall provide to the Commission all information necessary for the Commission to conduct the oversight function of the applicant with respect to the activities of the derivatives clearing organization.

As it already does as a designated contract market, the CBOT will provide the Commission with any information that it requires in order to conduct its oversight function of the CBOT as a registered derivatives clearing organization. The CBOT expects to have the full cooperation of the CME, as its Clearing Services Provider, in this regard.

In addition to the large trader files described above, the CME will, at a minimum, provide end-of-day transaction listing files, and end-of-day volume and open interest files to the CBOT for each trading day. The CME will provide the CBOT's customer and house positions to the Commission, in electronic form, in the same manner as it does for CME positions.

The CME will make the information specified in the CSA, Schedule A, page A-7, available to CBOT Clearing Members, in electronic form, on a daily basis. Each CBOT Clearing Member will be able to decide whether it wants to receive separate trade registers for CME and CBOT products, or one combined trade register. The CME's Clearing House Manual of Operations (Revised: June 2002), Appendix H, contains a number of exhibits that provide examples of current clearing-related reports produced by the CME.

The CBOT complies with Core Principle 8 (Daily Publication of Trading Information), applicable to designated contract markets, in making information about settlement prices, volume, and open interest, among other things, available to the public.

Core Principle K: RECORDKEEPING – The applicant shall maintain records of all activities related to the business of the applicant as a derivatives clearing organization in a form and manner acceptable to the Commission for a period of 5 years.

The CBOT will maintain copies of the records that are provided to it by the CME, as its Clearing Services Provider, in the manner specified by Commission Regulation 1.31 for a period of five years. These records will be readily available for at least the first two years, and will be open to inspection by the Commission or the U.S. Department of Justice in accordance with Regulation 1.31. The records will be maintained on electronic storage media that meets the specific requirements of Regulation 1.31(b)(1)(ii).

The CME will also meet all requirements of Regulation 1.31, with regard to the records it generates in the course of providing clearing services for the CBOT.

Core Principle L: PUBLIC INFORMATION – The applicant shall make information concerning the rules and operating procedures governing the clearing and settlement systems (including default procedures) available to market participants.

Both the CBOT's Rulebook and the CME's Rulebook are publicly available on their respective websites. These Rulebooks will be updated with the rule amendments that the CBOT and the CME adopt, as necessary, to implement the CSA. Appendix B contains the rule amendments that the CBOT has certified to the Commission, or that the Commission has approved.

The CME's Clearing House Manual of Operations (Revised: June 2002), Appendix H, is made available to all CME Clearing Members, and will also be made

available to CBOT Clearing Members. This Manual is generally updated on an annual basis.

The CME's brochure entitled "The Financial Safeguard System of Chicago Mercantile Exchange", Appendix I, is available on the CME's website.

The CME and CBOT websites, which are routinely updated, contain valuable information about the clearing and settlement systems, and default procedures.

The CBOT and the CME are currently cooperating in an effort to communicate detailed information to CBOT Clearing Members. Copies of the screens from a power point presentation made at a Member Firm Briefing held on April 29, 2003, are attached as Appendix J. A Common Clearing Link Agreement Question & Answer Reference, and an Operations Addendum, that were distributed at a CBOT Clearing Member meeting held on April 28, 2003, are attached as Appendices K and L. The CBOT's website has a link to the CME's website, which contains a number of advisories related to a variety of clearing-related operational issues.

Representatives of the CBOT and CME have met with all current CBOT Clearing Members to discuss the requirements and procedures that will be applicable, and to answer questions, and they will continue to have follow-up meetings. CBOT and CME staff will also meet with any new applicants for CBOT Clearing Membership, during and after the application process, in order to address clearing-related issues, among other things. In addition, the CBOT and the CME are cooperating in offering a series of workshops and informational seminars for Clearing Members and other interested parties. Training for back-office staff will also be available.

In addition, CBOT and CME staff have been meeting with groups of representatives of CBOT Clearing FCMs to obtain input on a variety of operational matters that will be impacted by the implementation of the CSA.

Core Principle M: INFORMATION SHARING – The applicant shall (i) enter into and abide by the terms of all appropriate and applicable domestic and international information sharing agreements; and (ii) use relevant information obtained from the agreements in carrying out the clearing organization’s risk management program.

The CBOT is a party to the following information sharing agreements: the Agreement to Share Market Surveillance and Regulatory Information among the Affiliate Members of the Intermarket Surveillance Group; the Intermarket Financial Surveillance Group’s Information Sharing Agreement; and an International Information Sharing Memorandum of Understanding and Agreement, among approximately sixty-five domestic and foreign markets and clearing organizations, dated March 15, 1996. The CBOT believes the Commission already has copies of these Agreements.

In addition, both the CBOT and the CME are parties to the Agreement for Services among the members of the Joint Audit Committee (“JAC”) that was established pursuant to Commission Regulation 1.52. This Agreement provides for the routine sharing of the reports of financial examinations, and the underlying workpapers upon request, among parties that have common members. The JAC Agreement is in the process of being updated. The Commission already has a copy of the JAC Agreement.

The CBOT and the CME Audit and Financial Surveillance staffs have had a cooperative relationship for many years. In the past, the CBOT and the CME have

regularly utilized the results of each other's examination reports or financial surveillance in connection with their own risk management and surveillance programs. In addition, the CBOT and the CME have shared adverse financial information relating to common members, on an informal basis, that has been obtained while examinations have been in progress, or which has otherwise come to the attention of one or the other of the exchanges.

In addition, CBOT Rule 546.00 makes it clear that the Board of Directors may require a Clearing Member (or any other member) to give testimony or produce records in connection with an investigation by another exchange, under appropriate circumstances.

Core Principle N: ANTITRUST CONSIDERATIONS – Unless appropriate to achieve the purposes of the Act, the derivatives clearing organization shall avoid (i) adopting any rule or taking any action that results in any unreasonable restraint of trade; or (ii) imposing any material anticompetitive burden on trading on the contract market.

The CBOT currently complies with this Core Principle in the context of its activities as a designated contract market, and will continue to comply as a registered derivatives clearing organization.

The CSA itself preserves competition by providing that the CME will clear all CBOT futures and futures options products, regardless of whether the CME also lists the same products for trading. In addition, the CSA permits the CME to offer and provide its clearing services to any exchange that offers products that are the same or substantially the same as CBOT products, as long as the CME gives appropriate advance notice to the

CBOT, thus providing the CBOT with the opportunity to determine whether to exercise its right to terminate the CSA.

III. CONCLUSION

The CBOT hereby requests that the Commission determine that it has demonstrated the ability to comply with each of the applicable Core Principles, as discussed above, and grant the CBOT's Application for Registration as a Derivatives Clearing Organization under Section 5b of the Act and Commission Regulations 39.3 and 39.5.