SUBMISSION COVER SHEET

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Registered Entity Identifier Code (optional): 18-339

Organization: Chicago Mercantile Exchange Inc. ("CME")

Filing as a: ☐ **DCM** ☐ **SEF** ☒ **DCO** ☐ **SDR**

Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): 08/08/18 Filing Description: Removal of the High Pay Threshold from the Concentration Margin Program

SPECIFY FILING TYPE

Please note only ONE choice allowed per Submission.

Organization Rules and Rule Amendments

☐	Certification	§ 40.6(a)
☐	Approval	§ 40.5(a)
☐	Notification	§ 40.6(d)
☒	Advance Notice of SIDCO Rule Change	§ 40.10(a)
☐	SIDCO Emergency Rule Change	§ 40.10(h)

Rule Numbers: See filing.

New Product **Please note only ONE product per Submission.**

☐	Certification	§ 40.2(a)
☐	Certification Security Futures	§ 41.23(a)
☐	Certification Swap Class	§ 40.2(d)
☐	Approval	§ 40.3(a)
☐	Approval Security Futures	§ 41.23(b)
☐	Novel Derivative Product Notification	§ 40.12(a)
☐	Swap Submission	§ 39.5

Official Product Name:

Product Terms and Conditions (product related Rules and Rule Amendments)

☐	Certification	§ 40.6(a)
☐	Certification Made Available to Trade Determination	§ 40.6(a)
☐	Certification Security Futures	§ 41.24(a)
☐	Delisting (No Open Interest)	§ 40.6(a)
☐	Approval	§ 40.5(a)
☐	Approval Made Available to Trade Determination	§ 40.5(a)
☐	Approval Security Futures	§ 41.24(c)
☐	Approval Amendments to enumerated agricultural products	§ 40.4(a), § 40.5(a)
☐	"Non-Material Agricultural Rule Change"	§ 40.4(b)(5)
☐	Notification	§ 40.6(d)

Official Name(s) of Product(s) Affected:

Rule Numbers:

CME Group

Christopher Bowen
Managing Director and Chief Regulatory Counsel
Legal Department

August 8, 2018

VIA ELECTRONIC PORTAL

Mr. Christopher J. Kirkpatrick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

Re: CFTC Regulation 40.10(a) Advance Notice. Removal of the High Pay Threshold from the Concentration Margin Program.
CME Submission No. 18-339

Dear Mr. Kirkpatrick:

Pursuant to Commodity Futures Trading Commission ("CFTC" or "Commission") Regulation 40.10(a), the clearing house division of Chicago Mercantile Exchange Inc. ("CME Clearing" or "Clearing House") hereby notifies the Commission that it plans on permanently removing the average high pay threshold, (hereafter referred to as the high pay threshold), from the concentration margin program (the "Program"), effective October 8, 2018, subject to regulatory review.

On May 18, 2018, CME Clearing issued advisory 18-199, communicating to the market that the high pay threshold would be temporarily suspended, effective May 21, 2018, pending further review. The high pay threshold is binary , whereby the stress loss in a given portfolio must be exceeded for concentration margin to apply[1]. This threshold offers one measure of a clearing member's ability to meet its financial obligations. While the high pay threshold remains valuable in some circumstances, its application specific to the Program has recently caused variability in margin requirements. Generally, such variability is viewed as problematic by CME Clearing, its clearing members and regulators due to the potential for impacts on liquidity risk management. Upon further review, CME Clearing determined that the high pay threshold should be permanently removed from the Program.

As explained in more detail below, the change will have a de minimis impact on the financial resources on deposit at CME Clearing and will not necessitate any changes to the manner in which the Clearing House conducts its clearing cycles and collects margin from its clearing members. Consequently, CME Clearing does not believe that the change could materially affect the nature or level of risks presented to CME Clearing as a systemically important derivatives clearing organization ("SIDCO"). However, for the abundance of caution, CME Clearing has filed this change to the Program under CFTC Regulation 40.10(a) – *Special certification procedures for submission of rules by systemically important derivatives clearing organizations*.

Analysis & Results

To better understand potential impacts of removing the high pay threshold, CME Clearing analyzed the impacts of a permanent revision to the concentration margin program, using the hypothetical assumption that the high pay threshold was removed on January 1, 2018. The analysis focused primarily on the prevalence of firm-specific impacts, as well as the magnitude of those impacts. The results of the review concluded that three clearing member firms[2], (hereafter referred to as Firms A, B, and C), were affected on <u>the majority of observations</u> between January

[1] Going forward, margin deposited to the Clearing House under the Program will only increase since the high pay threshold will not serve as a bar to the application of concentration margin to firms that would otherwise be subject to it based on either their capital levels or the absolute value of their stress losses.
[2] Includes only firms that were not charged concentration margin during the observation period but would have been were the high pay threshold removed.

1, 2018 and May 18, 2018. Firms A, B, and C, were chosen as the sample. To estimate potential maximum impacts, each firms' stress losses were assigned a percentage margin add-on, where they were now subject to a concentration charge, in accordance with the existing tier structure, below:

Tier	1	2	3	4	5	6	7	8	9
Add-On	10%	15%	20%	25%	30%	35%	40%	45%	50%
Absolute Stress Loss	500M	750M	1B	1.5B	2B	2.5B	3B	4B	5B
ANC	1x	1.5x	2x	2.5x	3.0x	3.5x	4.0x	4.5x	5.0x

The highest concentration margin add-ons were then ranked. Of the three firms, Firms A and B exhibited the large dollar value changes to their concentration margin requirements, though insignificant compared to their collateral on deposit and capital position as evidenced by Charts C through E. Firms A and B are large, bank-affiliated FCMs and given their high levels of adjusted net capital ("ANC"), their concentration margin charge would have been triggered by the absolute value thresholds rather than the ANC threshold. In contrast, Firm C is a smaller FCM and its concentration charge would have been triggered by the ANC threshold. Consistent with the Firms A and B, Firm C's concentration margin charge was insignificant compared to its collateral on deposit.

CME Clearing used these individual firm results, as well as historically observed trends in aggregate concentration margin across all firms, when making its determination to permanently remove the high pay threshold. This data was evaluated in light of three considerations: concentration margin stability, significance of concentration margin changes, and concentration margin conservativeness. Additional data is included in the following narrative and attached exhibits.

i) Concentration Margin Stability

CME Clearing observed substantial volatility in its equities markets during the first week of February 2018. This volatility often results in above average settlement variation (mark-to-market) payments, as well as increased hypothetical stress losses, given the fact that the concentration margin stress parameter is 150% of margin. Following these observations, many market participants in the equity market showed a significantly larger average high pay threshold in the Program than they had previously. In the weeks following, volatility returned to normal levels, as did stress losses. CME Clearing then observed that in some instances the new high pay thresholds were similar in size to certain portfolios' stress losses under the Program. Because the high pay threshold will remain static until a tail-sized settlement variation pay occurs, or 12 months have passed, and stress losses are dynamic, a negligible reduction is exposures could result in the complete elimination of the portfolio's concentration margin requirement.

CME Clearing's market participants are focused on the predictability of their margin changes to ensure they can appropriately manage their liquidity risk. While concentration margin is a small component in the broader scheme of CME Clearing's margining framework, it created unnecessary variability for clearing members and customers. Given that the high pay threshold is binary and the remaining two criteria allow for more granular scaling, going forward, market participants will have a better sense of how changes to their portfolio relate to shifts in concentration margin requirement.

ii) Concentration Margin Conservativeness

During risk management staff's review of the Program, it was determined that the stress losses of Firm C's portfolio, though not greater than their high pay threshold, often would have triggered concentration margin based on the capital threshold, and that without the high pay threshold, the member would have been charged concentration margin. The Program is designed to target large or directional exposures, in particular, in relation to the ANC of a given clearing member. The permanent removal of the high pay threshold will better enable CME Clearing to preclude large shifts in margin requirements that are unsubstantiated by changes in portfolio size or composition.

iii) Significance of Concentration Margin Changes and Management of Identified Risks

Significance

CME Clearing reviewed whether the proposed change had a significant effect on both firm-specific and aggregate margin requirements to determining whether it was prudent to permanently remove the high pay threshold. In terms of the portfolios supported by the sample clearing members, concentration margin comprised a de minimis percentage of their collateral held at CME Clearing (see Charts C – E in Exhibit 3: Significance). On a collective basis, concentration margin has accounted for an average of 2.25% of total margin requirements since June 2016[3], a de minimis portion of aggregate financial resources on deposit at CME Clearing. The majority of CME Clearing's membership base is not impacted by the Program, with less than 30% of firms being charged as of July 31, 2018. The impact of the temporary suspension on aggregate concentration and total margin is shown in more detail in Exhibit 3. In aggregate, and for individual firms, the removal of the high pay threshold will negligibly increase financial resources on deposit at CME Clearing. This negligible increase is best observed by reviewing the concentration margin on deposit on May 18, 2018 (the day before the threshold was suspended) and May 21, 2018 (the day the threshold was no longer in place). The suspension resulted in about a $570 million increase in concentration margin on deposit from $1.26 billion to $1.83 billion.

The minor change to the amount of concentration margin on deposit (less than 1% of total financial resources on deposit) and the overall de minimis impact the Program has had on financial resources at CME Clearing historically make clear that the permanent removal of the high pay threshold will not have a significant impact on the nature or level of risks faced by CME Clearing. And since the suspension of the high pay threshold will have only a de minimis impact on the financial resources on deposit at CME Clearing, and can only result in more concentration margin on deposit, this change will not negatively impact the Clearing House's ability to perform essential clearing, risk management and settlement services.

The impacts on CME Clearing's clearing members and the market are also relatively insignificant. As demonstrated above and in the Exhibits, the impacted firms will only be posting a relatively small amount of additional collateral with CME Clearing due to the removal of the high pay threshold from the Program. Further, concentration margin is collected as part of CME Clearing's standard settlement cycle, so we do not foresee any negative operational impacts to CME Clearing, our clearing members or the market due to the removal of the high pay threshold. To the extent there is any impact, we expect the removal of the threshold to reduce operational risk by limiting the variability of the application of concentration margin to our participants.

Management of Identified Risks

CME Clearing has not identified any significant risks that will stem from the removal of the high pay threshold from the Program. This conclusion has been reached due to the fact that the removal will result in a net increase in concentration margin resources on deposit at CME Clearing and the increased financial resources requirements on impacted clearing members are de minimis relative to their total collateral on deposit, Further, the removal will not have any impact on CME Clearing's operational risk since concentration margin will continue to be collected as part of regular settlement cycles. In light of the above, CME Clearing does not foresee a reasonable possibility that the change could affect the performance of essential clearing and settlement functions or the overall nature or level of risk presented by the Clearing House.

Core Principle Review

CME Clearing reviewed the derivatives clearing organization core principles ("DCO Core Principles") as set forth in the Commodity Exchange Act ("CEA" or "Act") and identified that the proposed amendment may have some bearing on the following principles:

- DCO Core Principle B – Financial Resources. DCO Core Principle B requires that CME Clearing maintain financial resources sufficient to enable the clearing house to meet its financial obligations to clearing

[3] This time series was chosen to ensure that the volatile markets associated with the UK Referendum and the US Election were included in the data set.

members notwithstanding a simultaneous default by the two clearing members creating the largest exposure to the clearing house. CME Clearing will continue to maintain sufficient resources to meet such requirements. Collateral on deposit in relation to concentration margin requirements is de minimis relative to aggregate margin held by CME Clearing. The removal of the average high pay threshold simply serves to stabilize margin requirements across clearing members and customers while, in most cases, negligibly increasing total financial resources on deposit at CME Clearing. This change cannot reduce the amount of concentration margin collected by CME Clearing under the Program.

- DCO Core Principle D – Risk Management. DCO Core Principle D requires CME Clearing to use margin and other risk controls to limit the exposures of both the clearing house and its clearing members and participants in the event of default. CME Clearing will continue to employ its current array of tools, including concentration margin, to limit such exposures.

- DCO Core Principle E – Settlement Procedures. DCO Core Principle E requires that CME Clearing complete settlements in a timely manner and employ arrangements that eliminate or limit the exposure of the clearing house to settlement bank risks. The removal of the high pay threshold will have no impact on the execution of the settlement cycle and any concentration margin charges will be collected in line with current procedures.

- DCO Core Principle L – Public Information. DCO Core Principle L requires CME Clearing to provide information to market participants with information related to the risks and costs associated with its services. In addition to this public filing, CME Clearing will release a Clearing House Advisory Notice ("CHAN") to the marketplace regarding the implementation of the change on a permanent basis in advance of it being finalized. The CHAN will be publicly available on the CME Group website.

CME Clearing certifies that proposed changes comply with the Act and regulations thereunder. There were no substantive opposing views to this action.

CME Clearing certifies that this submission has been concurrently posted on the CME Group website at http://www.cmegroup.com/market-regulation/rule-filings.html.

If you require any additional information regarding this submission, please contact me at 212.299.2200 or Maureen Guilfoile at 312.930.8141, or you may contact us by email at CFTCSubmissioninquiry@cmegroup.com Please reference CME Submission No. 18-339 in any related correspondence.

Sincerely,

/s/Christopher Bowen

Managing Director and Chief Regulatory Counsel

Attachments:

Exhibit 1 – Stability (Confidential Treatment Requested)
Exhibit 2 – Conservativeness (Confidential Treatment Requested)
Exhibit 3 – Significance (Confidential Treatment Requested)

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EXHIBIT 1: Stability

(Confidential Treatment Requested)
(Attached under separate cover as CME Submission 18-339S Appendix A)

EXHIBIT 2: CONSERVATIVENESS

(Confidential Treatment Requested)
(Attached under separate cover as CME Submission 18339S Appendix B)

EXHIBIT 3: SIGNIFICANCE

(Confidential Treatment Requested)
(Attached under separate cover as CME Submission 18-339S Appendix C)