

SUBMISSION COVER SHEET

IMPORTANT: Check box if Confidential Treatment is requested

Registered Entity Identifier Code (optional): 18-388

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

Filing as a: DCM SEF DCO SDR

Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): 09/19/2018 Filing Description: Amendments to CME Rules Chapter 8-G ("Interest Rate Derivative Clearing") to Implement Mandatory IRS Clearing Member Participation in Hedging Auctions

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: 8G04; 8G14; 8G25; 8G802.B

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:

September 19, 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 40.6(a) Certification. Notification Regarding Amendments to CME Chapter 8-G (“Interest Rate Derivative Clearing”) to Implement Mandatory IRS Clearing Member Participation in Hedging Auctions.
CME Submission No. 18-388**

Dear Mr. Kirkpatrick:

Pursuant to Commodity Futures Trading Commission (“CFTC” or “Commission”) Regulation 40.6(a), Chicago Mercantile Exchange Inc. (“CME” or “Clearing House”) hereby notifies the Commission that it is self-certifying amendments to CME Rules 8G04. (“IRS Clearing Member Obligations and Qualifications”); 8G14. (“Mitigation of IRS Loss”); 8G25. (“IRS Default Management Committee”); and 8G802.B. (“Protection of Clearing House – Satisfaction of Clearing House Obligations”) (collectively, the “Rule Amendments”) effective on October 4, 2018.

Currently, IRS Clearing Members are required to participate in auctions to liquidate the portfolio of a defaulted IRS Clearing Member (“Liquidation Auction”) but are not required to participate in auctions to hedge risk of an IRS Clearing Member’s portfolio prior to its liquidation (“Hedging Auction”). Participation in a Hedging Auction is both voluntary and incentive-based.

The Rule Amendments will mandate IRS Clearing Members to submit bids in Hedging Auctions as required by the Clearing House for currencies in which they have open interest at commencement of the default management process.¹ Incentives and penalties will be introduced to align the interests of IRS Clearing Members with the risk management aims of the clearing house. The Rule Amendments will operate to increase the bidder base in Hedging Auctions and better ensure reduction of a large or complex portfolio’s risk earlier in the default management process, which is expected to lower the cost of managing the default and thus the likelihood that losses arising from an IRS Clearing Member default will trigger application of the mutualized layers of the IRS financial safeguards.

The requirements and associated penalties for failure to participate in a Hedging Auction under the Rule Amendments align with those in place today for Liquidation Auctions. The Rule Amendments apply the IRS Guaranty Fund seniorization and juniorization incentive mechanism in place for Liquidation Auctions today to Hedging Auctions. The Hedging Auction framework will permit up to 75% of the IRS Clearing Member’s Guaranty Fund contribution to be seniorized or juniorized.

¹ De minimis open interest in any IRS currency, as determined in the discretion of the Clearing House, may qualify a clearing member for an exemption from the requirement to submit a bid for such currency. However, swaptions Clearing Members will be mandated to participate in all Hedging Auctions for portfolios containing swaptions regardless of the amount of open interest in swaptions, if any, due to unique factors associated with such products.

Core Principle Review

CME reviewed the DCO core principles (“Core Principles”) as set forth in the Commodity Exchange Act (“Act”) and identified that the Rule Amendments may have some bearing on the following DCO Core Principles:

- Core Principle D – Risk Management. The Rule Amendments are designed to increase the bidder base in Hedging Auctions and enhance the framework by which CME may, in its discretion, reduce a portfolio’s risk via hedging. Where appropriate, mandatory participation in Hedging Auctions is expected to lower the cost of managing the default of an IRS Clearing Member with a large portfolio and thus the likelihood that losses arising from an IRS Clearing Member default will trigger application of the mutualized layers of the IRS financial safeguards.
- Core Principle G – Default Rules and Procedures. Mandatory participation in Hedging Auctions enhances the ability of CME and its IRS Clearing Members to take timely action to contain losses arising from a default and better allows for the efficient, fair and safe management of an IRS Clearing Member default event.
- Core Principle L – Public Information. The Rule Amendments will be added to the publicly available CME Rulebook available on the CME Group website. In addition, CME will release a notice to the marketplace regarding the amendments in advance of the effective date.

Exhibit A, attached hereto, sets forth the Rule Amendments in blackline format.

CME certifies that the Rule Amendments comply with the Act and regulations thereunder. There were no substantive opposing views to the Rule Amendments.

CME 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 via e-mail at CMEGSubmissionInquiry@cmegroup.com.

Sincerely,

/s/Christopher Bowen
Managing Director and Chief Regulatory Counsel

Attachment: Exhibit A – Rule Amendments to CME Chapter 8G (blackline format)

Exhibit A

Rule Revisions to Implement Mandatory Participation in Hedging Auctions

(additions underlined; deletions ~~overstruck~~)

CME Rulebook

Chapter 8-G

Interest Rate Derivative Clearing

8G04. IRS CLEARING MEMBER OBLIGATIONS AND QUALIFICATIONS

IRS Clearing Members shall be subject to the requirements for IRS Clearing Members set forth in Chapter 8G and Rule 8F04, all CME Rules applicable to IRS Products, and the Clearing House Manual of Operations unless an exemption has been granted by the Clearing House Risk Committee or the IRS Risk Committee, as applicable. In addition, IRS Clearing Members are subject to all CME, CBOT and NYMEX Rules, as applicable, when clearing products traded on, or subject to the rules of, CME, CBOT or NYMEX. IRS Clearing Members must execute all agreements and documents required by the Clearing House.

An IRS Clearing Member must satisfy the requirements set forth below:

...

6. Each IRS Clearing Member shall bid in ~~an auction~~each hedging or liquidation auction conducted by the Clearing House for part or all of a defaulted IRS Clearing Member's IRS Contracts (each a "Default Management Auction"), as required by the Clearing House. Each IRS Clearing Member shall participate in IRS default drill exercises as prescribed by the Clearing House. Each IRS Clearing Member shall have the ability to provide quotations to CME for hedging transactions for the IRS portfolio of a defaulted IRS Clearing Member.

7. Each IRS Clearing Member shall use systems and appropriate procedures to track accurately, and to provide to the Clearing House accurately, the IRS positions and collateral of each of its cleared swaps customers.

8G14. MITIGATION OF IRS LOSS

In the event of a default by an IRS Clearing Member, all IRS Clearing Members shall work cooperatively with their customers, other IRS Clearing Members and the Clearing House to administer the mitigation of any losses that may occur as a result of such default and shall ensure that resources required to be provided by IRS Clearing Members to the IRS Default Management Committee are promptly made available.

IRS Clearing Members shall work cooperatively with the Clearing House, the IRS Risk Committee and the IRS Default Management Committee to (i) mitigate any losses that may occur as a result of a default, (ii) liquidate the defaulted IRS Clearing Member's IRS Contracts, (iii) bid in ~~an auction of each~~Default Management Auction as required by the defaulted IRS Clearing Member's IRS Contracts and (iv) take any other action reasonably requested by the IRS Risk Committee.

8G25. IRS DEFAULT MANAGEMENT COMMITTEE

In the event of a potential or actual default with respect to IRS Contracts, an IRS Default Management Committee shall be convened which shall be comprised of traders nominated by IRS Clearing Members and approved by the Clearing House. The purpose of this committee shall be to advise the Clearing House with respect to issues arising from the potential or actual default of an IRS Clearing Member and to manage the process of the liquidation and/or transfer of such IRS Clearing Member's portfolio of IRS Contracts. Such advice may include advice on hedging the risk associated with a defaulted IRS Clearing Member's portfolio, structuring the defaulted IRS Clearing Member's portfolio for liquidation or transfer, and administration of the ~~default auction~~Default Management Auction process.

8G802. PROTECTION OF CLEARING HOUSE

...

8G802.B. Satisfaction of Clearing House Obligations

1. Application of Clearing House and non-defaulting IRS Clearing Member contributions

If the IRS Collateral and the IRS Customer Collateral, as described in Rule 8G802.A, is insufficient to cover the IRS Loss produced by the default, the Clearing House shall cover, or reduce the size of, such IRS Loss by applying the following funds to such losses in the order of priority as follows (the "IRS Priority of Payments"):

- (i) First, the corporate contribution of CME for IRS Products (the "CME IRS Contribution"), which shall equal \$150,000,000;
- (ii) Second, the IRS Guaranty Fund (excluding the contribution of the defaulted IRS Clearing Member), which shall be applied in the following manner:
 - (a) the IRS Guaranty Fund contribution of Subordinated Bidders equal to the relevant Aggregate Subordinated Amounts of such Subordinated Bidders applied on a *pro rata* basis until the entire IRS Loss is allocated; then, to the extent not all IRS Losses have been applied after application pursuant to this sub-section (a);
 - (b) the (remaining) IRS Guaranty Fund of all IRS Clearing Members (excluding an amount of the IRS Guaranty Fund of each Winning Bidder equal to the Final Aggregate Seniorized Amounts for such Winning Bidders) will be applied *pro rata* until the entire IRS Loss is allocated; then, to the extent not all IRS Losses have been applied after application pursuant to this sub-section (b); and
 - (c) the (remaining) IRS Guaranty Fund of all Winning Bidders will be applied *pro rata*;
- (iii) Third, IRS Assessments against all IRS Clearing Members (excluding any defaulted IRS Clearing Members), which shall be assessed against each non-defaulted IRS Clearing Member *pro rata* in proportion to their required contributions to the IRS Guaranty Fund in accordance with Rule 8G07. Assessments against non-defaulted IRS Clearing Members shall be subject to a maximum of the maximum IRS Assessment assigned to such IRS Clearing Member pursuant to Rule 8G07 at the time of the default, and also subject to the limits set forth in Rule 8G802.H in the case of multiple successive defaults.

Non-defaulted IRS Clearing Members and their customers shall not take any action that would interfere with the ability of the Clearing House to collect and apply assets and proceeds in accordance with this Rule 8G802.B, including, but not limited to, attempting to obtain a court order. Determinations under this Rule 8G802.B that are based upon an IRS Clearing Member's IRS Guaranty Fund deposit and/or IRS Assessment requirement shall be based upon the requirement in effect at the time of the default.

As used herein:

"Aggregate Subordinated Amount" means the sum of all subordinated amounts as determined by the Clearing House in accordance with the IRS Default Management Guidelines.

"Final Aggregate Seniorized Amount" means the sum of all seniorized amounts as determined by the Clearing House in accordance with the IRS Default Management Guidelines.

"Subordinated Bidder" means in respect of each ~~auctioned portfolio~~ [Default Management Auction](#), the IRS Clearing Member(s) whose IRS Guaranty Fund contribution is subject to subordination as determined by the Clearing House in accordance with the IRS Default Management Guidelines.

"IRS Default Management Guidelines" means the IRS Default Management Guidelines of the Clearing House.

"Winning Bidder" means, in respect of each [Default Management Auction](#), the IRS

Clearing Member(s) designated as such by the Clearing House ~~at the end of an auction in with~~ respect ~~of such~~ to such Default Management Auction.

2. *IRS Product Limited Recourse*

If a default occurs, IRS Collateral, IRS Customer Collateral and the IRS Priority of Payments shall be the sole source of payments to cover the IRS Loss until the default is fully and finally resolved. In the event the IRS Collateral, IRS Customer Collateral and the IRS Priority of Payments are insufficient to cover the IRS Loss, IRS Clearing Members and the holders of IRS Contracts shall have no recourse to any other funds or any other entity, including without limitation the guaranty funds that support clearing of other products, CME, CME Group Inc. or any of its affiliates. If at any time following a default: (a) the Clearing House is unable to cover a settlement variation payment obligation when due and has no expectation of accessing funds to permit it to cover such payment obligation (for example through access to credit lines or assessment funds), (b) the Clearing House determines (after consultation with the IRS Risk Committee) that the available IRS Collateral and the IRS Priority of Payments will be insufficient to satisfy ~~an~~ Default Management Auction bid results for the defaulted IRS Clearing Member's portfolio, (c) the Clearing House otherwise determines (after consultation with the IRS Risk Committee) the IRS Loss will exceed the available IRS Collateral and IRS Priority of Payments, or (d) a Bankruptcy Event of the Exchange (each an "IRS Termination Event"), then all IRS Contracts shall be terminated and the IRS Collateral and IRS Priority of Payments shall be distributed in accordance with Rule 8G802.B.3 below. If the IRS Customer Collateral attributable to a cleared swaps customer of the defaulted IRS Clearing Member is sufficient to satisfy any IRS Loss associated with such cleared swaps customer, the IRS Customer Collateral shall be so applied and any remaining IRS Customer Collateral shall remain in such customer account class the Clearing House shall, in a manner that is consistent with the requirements of the Commodity Exchange Act and the regulations adopted thereunder (including, without limitation Part 190 of the Regulations, if applicable) fix a U.S. dollar amount (the "IRS Close-Out Value") to be paid to or received from the Clearing House in respect of all IRS Contracts to be terminated by conducting a special settlement cycle to determine a final settlement price for all open IRS Contracts.

3. *Termination of IRS Contracts; Netting and Offset*

If an IRS Termination Event occurs as described in Rule 8G802.B.2, all IRS Contracts shall be closed promptly and the Clearing House shall determine the amount to be paid to or collected from each non-defaulted IRS Clearing Member as follows:

(i) The net obligation of the Clearing House to a non-defaulted IRS Clearing Member (a "collect"), or the net obligation of a non-defaulted IRS Clearing Member to the Clearing House (a "pay"), shall be determined separately for (a) its proprietary positions in IRS Contracts (an "Proprietary IRS Collect" or an "Proprietary IRS Pay") and (b) the positions of each of its customers in IRS Contracts (each, an "Individual Customer IRS Collect" or an "Individual Customer IRS Pay") using the IRS Close-Out Value for IRS Contracts. The Clearing House shall also determine an Individual Customer IRS Collect or an Individual Customer IRS Pay for each non-defaulted cleared swaps customer of a defaulted IRS Clearing Member. The sum of all Proprietary IRS Collects and Individual Customer IRS Collects shall be the "Aggregate Collects". The sum of all Proprietary IRS Pays and Individual Customer IRS Pays shall be the "Aggregate Pays"

(ii) The Clearing House shall determine the amount of each non-defaulted IRS Clearing Member's remaining payment obligations, if any, in respect of IRS Assessments (which, together with the CME IRS Corporate Contribution and any remaining IRS Guaranty Fund amounts and any IRS Assessments previously funded, constitute the "Remaining IRS Priority of Payments").

(iii) The Clearing House shall add any remaining IRS Collateral, IRS Customer Collateral (if applicable as described in Rule 802.B.2. above) and Remaining IRS Priority of Payments to the Aggregate Pays, and deduct the amount of any uncovered IRS Loss (the sum of such amount, the "Aggregate IRS Available Funds").

(iv) The Clearing House shall then notify each IRS Clearing Member of the amount of its remaining IRS Assessments, Proprietary IRS Pay and Individual Customer IRS Pays and each IRS Clearing Member shall pay all such amounts no later than the time specified by the Clearing House in such notice. If an IRS Clearing Member does not make such payment, the Clearing House shall determine such IRS Clearing Member to be in default and may take any of the actions specified in 8G802.A with respect to such IRS Clearing Member and its customer.

(v) If the amount of Aggregate IRS Available Funds received by the Clearing House

exceeds the Aggregate Collects, the clearing House shall calculate reimbursements of the excess funds, in reverse order of the IRS priority of payments.

(vi) If the Aggregate Collects exceed the amount of Aggregate IRS Available Funds received, the Clearing House shall haircut the amount of each Proprietary IRS Collect (such haircut amount, the "Allocated Proprietary IRS Collect") and Individual Customer IRS Collect (such haircut amount, the "Allocated Individual Customer IRS Collect") on a pro rata basis based on the amount of Aggregate IRS Available Funds received relative to the of the Initial Proprietary IRS Collect and Initial Individual Customer IRS Collect.

(vii) For non-defaulted IRS Clearing Members, the Clearing House shall pay the Proprietary IRS Collect or Allocated Proprietary IRS Collect, as applicable, and Individual Customer IRS Collect or Allocated Individual Customer IRS Collects, as applicable, as soon as practicable after receipt of the Aggregate IRS Available Funds. For non-defaulted customers of a defaulted-IRS Clearing Member, the Clearing House will make arrangements to pay directly to such non-defaulted customers.

(viii) Upon the completion of payments, all IRS Contracts shall be extinguished, and the Clearing House shall have no further access to funds or collateral in respect of IRS Contracts or IRS clearing activity of a non-defaulting IRS Clearing Member. IRS Clearing Members, their Affiliates and their customers shall have no claim against any other guaranty fund established by the Exchange, CME Group Inc. or any of its affiliates with respect to losses suffered as a result of the application of this Rule 8G802.B, nor shall any beneficial holder of an IRS Contract have any claim against its non-defaulting IRS Clearing Member as a result of the application of this Rule 8G802.B.

4. *Non-Petition*

No IRS Clearing Member and no customer of an IRS Clearing Member shall institute against, or join any other person in instituting against, the Exchange any bankruptcy, reorganization, arrangement, insolvency, moratorium, liquidation or examinership proceedings, or other similar proceedings under U.S. federal or state bankruptcy laws or other applicable law arising out of any claimed default by the Clearing House on an IRS Contract as a result of the termination of such IRS Contract and related payments in accordance with these Rules.

5. *Fedwire and Satisfaction of IRS Assessments*

All amounts assessed by the Clearing House against an IRS Clearing Member pursuant to this Chapter and any advance assessments pursuant to Rule 8G802.C where notice of such assessment is delivered to an IRS Clearing Member during the hours in which the Federal Reserve's wire transfer system (Fedwire) is in operation shall be paid to the Clearing House by such IRS Clearing Member prior to the close of the Fedwire on such day; provided, however, that where notice of such assessment is delivered to an IRS Clearing Member within one (1) hour prior to the close of Fedwire or after the close of Fedwire shall be paid to the Clearing House within one (1) hour after Fedwire next opens.

Any IRS Clearing Member that does not satisfy an assessment shall be in default. Any loss that occurs as a result of such default shall itself be assessed by the Clearing House to non-defaulted IRS Clearing Members pursuant to Rule 8G802.A and 8G802.B.

After payment of an IRS Assessment pursuant to Rule 8G802.B, an IRS Clearing Member shall charge other clearing members for whom it clears contracts or carries positions on its books to recover their proportional share of the assessment. Such other clearing members shall promptly pay the charge.

6. *Details of Implementation*

While adherence to the provisions of this Rule 8G802.B shall be mandatory, the detailed implementation of the process of finalizing an IRS Loss with respect to a default, including the liquidation, [hedging](#), auction or sale of positions or assets of the defaulted IRS Clearing Member, shall be conducted by the Clearing House in consultation with the IRS Default Management Committee.

...