

SUBMISSION COVER SHEET

IMPORTANT: Check box if Confidential Treatment is requested

Registered Entity Identifier Code (optional): 18-425 (3 of 4)

Organization: New York Mercantile Exchange, Inc. ("NYMEX")

Filing as a: DCM SEF DCO SDR

Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): 10/05/2018 Filing Description: Adoption of New CME/CBOT/NYMEX/COMEX Rule 857. ("Post-Trade Multilateral Compression")

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

October 5, 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 Adoption of New CME/CBOT/NYMEX/COMEX Rule 857. (“Post -Trade Multilateral Compression”).
NYMEX Submission No. 18-425 (3 of 4)**

Dear Mr. Kirkpatrick:

Pursuant to Commodity Futures Trading Commission (“CFTC” or “Commission”) Regulation 40.6(a), Chicago Mercantile Exchange, Inc. (“CME”), The Board of Trade of the City of Chicago, Inc. (“CBOT”), New York Mercantile Exchange, Inc. (“NYMEX”) and Commodity Exchange, Inc. (“COMEX”) (collectively, the “Exchanges”), hereby notify the Commission they are self-certifying the adoption of new Rule 857. (“Post Trade Multilateral Compression”) in relation to the establishment of a post-trade multilateral compression service for listed options on futures and related underlying futures contracts (the “Proposed Rule”) effective on trade date Tuesday, October 23, 2018.

The Proposed Rule will create the legal framework for post-trade multilateral compression of open positions in Exchange options on futures products and related underlying futures (the “Compression Service”). The Compression Service will initially be available in relation to certain listed equity index options on futures and related underlying futures contracts traded on the CME and CBOT¹ and is expected to be extended to other products in the future, including options on futures and related underlying futures contracts listed on NYMEX and COMEX as anticipated under the Proposed Rule. The Exchanges have designed the Compression Service to reflect feedback provided by market participants active in listed equity options markets, including clearing members and customers of clearing members.

The overall objective of the Compression Service is to attempt to identify potential offsetting efficiencies between the open interest of market participants in Exchange products and, through compression, to promote more favorable capital treatment for participating clearing members and their customers subject to Basel III standardized capital requirement formulas. The Compression Service helps to achieve this objective by providing a centralized mechanism operated by CME Clearing (the “Clearing House”) under which market participants are able, subject to the terms of the Compression Service, to elect to attempt to compress portfolios of the Exchanges’ contracts on a multilateral basis. A successful compression cycle would identify offsetting positions for compression which once compressed would result in a reduction of a participating firm’s overall open interest and dollar-equivalent notional with minimal impact to the relevant market risk profile, which shall be maintained within pre-agreed parameters.

¹ The initial CME and CBOT equity index options products (and related underlying futures) eligible for the Compression Service are derivative contracts with significant volume and open interest. Such contracts have been identified as being subject to high capital requirements relative to risk as a result of the leverage ratio under the Basel III capital requirements. See CFTC Policy Brief “Assessing the Impact of the Basel III Leverage Ratio on the Competitive Landscape of US Derivatives Markets: Evidence from Options”, June 15, 2018. Compression has been identified as a potential solution to reduce the effect of the leverage ratio in relation to such contracts.

In terms of its objective, effect and operational mechanisms, the Compression Service is similar to multilateral compression services currently available in the over-the-counter (“OTC”) derivatives clearing market which are familiar to many market participants of the Exchanges. It is proposed that the Compression Service will be available to market participants subject to the terms and conditions set out in the Proposed Rule and in additional legal and operational documentation made by the Exchanges and the Clearing House under the Proposed Rule.

Purpose, Operation and Effect of the Proposed Rule

Purpose of the Compression Service. The purpose of the Compression Service is to offer market participants a facility under which a portfolio of Exchange options on futures and related underlying futures contracts may be compressed into a smaller portfolio in terms of dollar-equivalent notional size and number of contracts, thereby reducing the amount of open interest in the relevant Exchange products held by the market participant (each instance, a “Compression Cycle”). Compression results in the offset (close-out) of open positions in Exchange futures and options on futures contracts within a cleared portfolio and the establishment of new cleared positions in Exchange contracts that reflect the compressed end-state reduced dollar-equivalent notional amount and number of contracts.

Compression of portfolios into smaller portfolios in terms of outstanding dollar-equivalent notional, contract line items and open interest can be achieved with minimal impact on the market risk profile of the relevant portfolio or otherwise can be effected so as to maintain the risk profile of the portfolio within pre-agreed risk parameters. As a result, a firm can elect to utilize compression services to reduce the overall size of a portfolio with minimal impact on its risk exposures and market position. By reducing the overall size of its portfolio and, in particular, by reducing the gross notional amounts, an affected firm is able through compression to reduce its total exposures relevant for the purposes of calculating its capital requirements under applicable capital regulations. Compression can therefore enable a participating firm to reduce its total exposures so as to benefit from a potential corresponding reduction in capital requirements under the standardized Basel III capital requirement formulas.

Compression is widely used by participants in OTC derivatives markets (on both a bilateral and multilateral basis) and has been effective in reducing outstanding notional amounts and reducing the capital requirements of affected firms. The Exchanges believe that there is considerable support for similar initiatives in relation to listed equity index options and also potential to provide compression services in other asset classes in the future².

Operation of the Compression Service. The Compression Service will be operated by the Clearing House in accordance with the terms of the Proposed Rule and with relevant customer contractual and operational documentation made pursuant to the Proposed Rule. The Proposed Rule provides that the Compression Service will be provided in relation to such futures and options on futures contracts to be determined by the Clearing House from time to time in its absolute discretion. The Clearing House will determine the Exchange products and contract months eligible for inclusion in any Compression Cycle from time to time and will notify market participants of contract eligibility.

The Clearing House will determine the frequency and operating timetable of the Compression Service from time to time, including scheduling of Compression Cycles, and this will be made public pursuant to the operational protocol governing the Compression Service (the “CME Group Multilateral Compression Process Protocol”). The form of the CME Group Multilateral Compression Process Protocol is attached under separate cover as Exhibit B.

Participation in the Compression Service shall be optional. Each firm wishing to participate in the Compression Service and any Compression Cycle must meet eligibility criteria as determined from time to time and set forth in the CME Group Multilateral Compression Process Protocol. The CME Group Multilateral Compression Process Protocol shall be made publicly available on the CME Group website. In addition, the

² We note that CBOE Exchange, Inc. already provides open outcry “compression forums” to facilitate closing transactions in certain listed equity options.

firm must have entered into any applicable contractual documentation specified in accordance with the Proposed Rule. Where the participating firm is not also a clearing member of the Exchange, the relevant clearing member of such firm must also agree to participation of the firm in the Compression Service and to be bound by the results of each Compression Cycle, implemented at the instruction of the participating firm.

The Compression Service is designed to identify opportunities for compression of eligible portfolios on a multilateral basis between participating firms and therefore requires participation of multiple firms in order to be effective. The Compression Service will operate to compress portfolios submitted on an optional basis by participants within risk constraints determined in advance by the participants and approved by clearing members, subject to any additional risk constraints imposed by the Clearing House which shall take priority in the event of a conflict. For each Compression Cycle and each portfolio submitted by participants, the Clearing House will generate a compression proposal utilizing the Clearing House multilateral compression algorithm, taking into account applicable portfolio constraints for all participating portfolios (a "Compression Proposal"). The Compression Proposal will identify eligible participant cleared contracts for compression within the relevant parameters and constraints related to each portfolio.

Where a participant wishes to participate in the Compression Cycle on the terms set out in the Compression Proposal the participant must confirm acceptance of the Compression Proposal to the Clearing House within the relevant timeframe specified in the CME Group Multilateral Compression Process Protocol. Each participant is required to accept or reject the Compression Proposal within the specified time period for the Compression Cycle to proceed. Failure of all participants to accept the relevant Compression Proposal will result in the entire Compression Cycle being aborted.

Pursuant to the Proposed Rule, the Clearing House retains the right in its absolute and sole discretion to suspend or terminate any Compression Cycle prior to completion for any reason. Where the Clearing House determines to implement the Compression Cycle the Clearing House shall offset (close-out) the relevant cleared contracts identified in the Compression Proposal for each portfolio and, simultaneously and contingent on such termination, create and register the replacement positions as cleared contracts in the account of the relevant participant with its carrying clearing member in accordance with the relevant Compression Proposal. Such termination and establishment of new positions shall take place in accordance with the Proposed Rule and shall be binding on the participant and its clearing member.

Effect of the Compression Service. The immediate effect of each Compression Cycle would be the offset (close-out) of the relevant positions in Exchange contracts and the establishment of new positions in Exchange contracts, in each case identified in each Compression Proposal, effected in accordance with the Proposed Rule. This would result in the reduction in dollar-equivalent notional size and open interest of the relevant portfolios of market participants taking part in the Compression Service. There will be a corresponding reduction in the overall open interest amounts in the relevant Exchange contracts cleared by the Clearing House.

The quantitative effect of any compression cycle on an individual portfolio will ultimately depend on the nature and content of the portfolio and the extent of participation amongst market participants active in the relevant products subject to the Compression Cycle. As noted above, it is anticipated that a participating firm may benefit from a reduction in its total exposures resulting from a Compression Cycle so as to benefit from a corresponding reduction in its capital requirements but, again, the overall effect will depend on the nature and size of the total exposures of the individual firm.

Core Principle Review

The Exchanges reviewed the designated contract market core principles ("DCM Core Principles"), as set forth in the Commodity Exchange Act ("Act"), and identified that the Proposed Rule and the Compression Service may have some bearing on the following principles:

- DCM Core Principle 7 - Availability of General Information. The Proposed Rule provides for a mechanism through which a market participant may terminate open positions by offset (close-out) and enter into new positions in Exchange futures and options on futures contracts other than by

execution on the Exchange market. The termination and establishment of contracts pursuant to the Compression Service is to be carried out in accordance with the relevant Rulebook, as set out in the Proposed Rule. The Exchanges will update each Rulebook on the effective date of the Proposed Rule. In addition, the Exchanges will publish a Special Executive Report (“SER”) to advise the marketplace of these amendments. The SER will be posted on the CME Group website. The eligibility criteria for participation and fees relating to the Compression Service will be made publicly available on the CME Group website.

- *DCM Core Principle 8 – Daily Publication of Trading Information.* The Exchanges will make public overall open interest following the operation of each Compression Cycle as part of existing end of day reporting processes. The Exchanges will also make public information identifying the effect of each Compression Cycle on overall open interest in the relevant products subject to a Compression Cycle.
- *DCM Core Principle 9 – Execution of Transactions.* The Proposed Rule provides for a mechanism through which a market participant may offset (close-out) open positions and enter into new positions in Exchange futures and options on futures contracts other than by execution on the Exchange market. The termination and establishment of contracts pursuant to the Compression Service is to be carried out in accordance with the relevant Rulebook, as set out in the Proposed Rule.

Core Principle 9 requires a designated contract market (“DCM”) to provide “a competitive, open, and efficient market and mechanism for executing transactions that protects the price discovery process of trading in the centralized market of the board of trade.” Core Principle 9 also permits a board of trade to authorize, under its rules, certain non-competitive trades for bona fide business purposes.

The Compression Service is not inconsistent with the responsibility of a DCM to provide for meaningful price discovery. The service is a mechanism for removing unnecessary positions from a participant’s portfolio, but in a manner that materially preserves the economic exposure of the portfolio; in other words, the compression replacement transactions do not represent new trading interest, and thus would not contribute in any meaningful way to price discovery as expressions of current market views. The important price discovery occurs when the positions subject to compression are first established on the Exchange, because those positions represent market participants’ trading interest in gaining particular market exposures. In that regard, the original positions will generally be ones that are executed competitively through the Exchanges, thereby contributing to meaningful price discovery.

The non-competitively executed trades resulting from the Compression Service will be established in a manner similar to the enumerated trades permitted by paragraph (B) of Core Principle 9, as a type of transfer trade or office trade, and in accordance with the relevant Exchange Rulebook. The positions resulting from the Compression Service are also consistent with CFTC Regulation 1.38, which allows for the non-competitive execution of transactions in accordance with the written rules of a contract market which have been submitted to and approved by the Commission.

The Proposed Rule will serve a bona fide business purpose, and one that also furthers the important policy objective of efficient risk management for cleared positions. Through the Proposed Rule, the Clearing House is offering in the context of cleared transactions a compression service analogous to the portfolio compression procedures each swap dealer and major swap participant must conduct pursuant to CFTC Regulation 23.503, and that a derivatives clearing organization (“DCO”) must offer to clearing members as a risk management tool pursuant to CFTC Regulation 39.13(h)(4) for swaps. Although the listed equity option transactions that are the initial focus of the Compression Service are not swaps, the relevant options on futures span a wide range of strikes, resulting in cleared portfolios that can be as complex, and present the same types of inefficiencies, as swaps portfolios.

As with swaps compression, the Compression Service will replace an existing cleared portfolio with a smaller number of cleared transactions to decrease notional principal value while maintaining materially the same market exposure, thereby reducing the risk, cost and inefficiency of maintaining unnecessary positions in a participant's portfolio. Thus, the Proposed Rule will help market participants achieve capital efficiencies in relation to their open interest and thereby reduce capital charges applicable under Basel III³. For example, by reducing the burden that Basel III capital requirements impose on many Futures Commission Merchants providing clearing services for participants in the CME's equity index futures options complex, the Proposed Rule will increase liquidity across the CME's equity index futures options complex.

- *DCM Core Principle 18 - Recordkeeping*. The information collected by the Exchanges in relation to the operation of the Compression Service will be kept in accordance with the requirements of this Core Principle.

Pursuant to Section 5c(c) of the Act and CFTC Regulation 40.6(a), the Exchanges certify that the Proposed Rule complies with the Act and regulations thereunder.

Comments / Opposing Views:

In developing the Compression Service, discussions were held with clearing members and customers of clearing members active in the listed options market during the second and third quarters of 2018. There were no substantive opposing views to the Compression Service or the substance of the Proposed Rule.

The text of the Proposed Rule is set out in the attached Exhibit A, with additions underlined.

The Exchanges certify 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 the undersigned at 212-299-2200 or via e-mail at CMEGSubmissionInquiry@cmegroup.com.

Sincerely,

/s/Christopher Bowen
Managing Director and Chief Regulatory Counsel

Attachments:

Exhibit A – Amendments to CME/CBOT/NYMEX/COMEX Rulebooks Chapter 8 (blackline format)

Exhibit B – Form of CME Group Multilateral Compression Process Protocol (attached under separate cover)

³ See Richard Haynes, Lihong McPhail & Haoxiang Zhu, Assessing the Impact of the Basel III Leverage Ratio on the Competitive Landscape of US Derivatives Markets: Evidence from Options, CFTC Policy Brief (2018), https://www.cftc.gov/sites/default/files/About/Economic%20Analysis/oce_leverage_and_options.pdf (discussing the impact of the Basel III leverage ratio on equity options markets).

Exhibit A

Amendments to CME/CBOT/NYMEX/COMEX Rulebooks

(additions underlined)

CHAPTER 8 CLEARING HOUSE AND PERFORMANCE BONDS

...

857. POST-TRADE MULTILATERAL COMPRESSION

The Clearing House may from time to time and in its absolute and sole discretion provide a multilateral compression service under which eligible Exchange futures and options contracts cleared through the Clearing House may be offset (closed-out) and, where relevant, replaced with new Exchange futures and options contracts cleared through the Clearing House.

With the consent of the account controller, a Clearing Member, account controller or person duly authorized by the Clearing Member or account controller may submit a list of positions in eligible contracts which remain open at the Clearing House pursuant to Rule 805 and that the account controller wishes to offset (close-out) and replace with new contracts via the multilateral compression service in accordance with this Rule.

The specific products and contract months eligible for inclusion in the multilateral compression service and the frequency and timing of providing such service will be determined by the Clearing House in its absolute and sole discretion.

All contracts submitted to the Clearing House pursuant to this Rule must be submitted in accordance with the procedures established by the Clearing House for this purpose as amended from time to time.

Clearing Members participating in the multilateral compression service agree and acknowledge that the multilateral compression service may operate to offset (close-out) certain existing open positions and establish new open positions for the benefit of the relevant account holder. Any termination of or entry into replacement Exchange cleared futures and options contracts will take place in accordance with and subject to the terms of this Rule and such procedures and conditions established by the Clearing House from time to time.

The Clearing House may utilize a third party approved by the Clearing House for the facilitation of the multilateral compression service provided in accordance with this Rule, which may be an affiliate of the Clearing House or CME Group Inc. or such other entity appointed by the Clearing House from time to time and duly notified to participants (an "Authorized Compression Service Provider").

The Clearing House may in its absolute and sole discretion determine to suspend or terminate the multilateral compression service and any compression cycle at any time.

Positions in a customer account of a Clearing Member shall not be compressed pursuant to this Rule with positions in the proprietary account of the Clearing Member.

...

The remainder of Chapter 8 is unchanged.

Exhibit B

CME Group Post-Trade Multilateral Compression Process Protocol

(attached under separate cover)