

SUBMISSION COVER SHEET

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Registered Entity Identifier Code (optional): 20-404

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

Filing as a: DCM SEF DCO SDR

Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): October 19, 2020 Filing Description: Request for Approval to Commingle Customer Positions and Related Collateral in Listed Options on Interest Rate Futures Contracts and Interest Rate Swaps

SPECIFY FILING TYPE

Please note only ONE choice allowed per Submission.

Organization Rules and Rule Amendments

- | | | |
|-------------------------------------|-------------------------------------|------------|
| <input type="checkbox"/> | Certification | § 40.6(a) |
| <input checked="" type="checkbox"/> | Approval | § 40.5(a) |
| <input type="checkbox"/> | Notification | § 40.6(d) |
| <input type="checkbox"/> | Advance Notice of SIDCO Rule Change | § 40.10(a) |
| <input type="checkbox"/> | SIDCO Emergency Rule Change | § 40.10(h) |

Rule Numbers: See filing.

New Product

Please note only ONE product per Submission.

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|--------------------------|---------------------------------------|------------|
| <input type="checkbox"/> | Certification | § 40.2(a) |
| <input type="checkbox"/> | Certification Security Futures | § 41.23(a) |
| <input type="checkbox"/> | Certification Swap Class | § 40.2(d) |
| <input type="checkbox"/> | Approval | § 40.3(a) |
| <input type="checkbox"/> | Approval Security Futures | § 41.23(b) |
| <input type="checkbox"/> | Novel Derivative Product Notification | § 40.12(a) |
| <input type="checkbox"/> | Swap Submission | § 39.5 |

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

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|--------------------------|---|----------------------|
| <input type="checkbox"/> | Certification | § 40.6(a) |
| <input type="checkbox"/> | Certification Made Available to Trade Determination | § 40.6(a) |
| <input type="checkbox"/> | Certification Security Futures | § 41.24(a) |
| <input type="checkbox"/> | Delisting (No Open Interest) | § 40.6(a) |
| <input type="checkbox"/> | Approval | § 40.5(a) |
| <input type="checkbox"/> | Approval Made Available to Trade Determination | § 40.5(a) |
| <input type="checkbox"/> | Approval Security Futures | § 41.24(c) |
| <input type="checkbox"/> | Approval Amendments to enumerated agricultural products | § 40.4(a), § 40.5(a) |
| <input type="checkbox"/> | “Non-Material Agricultural Rule Change” | § 40.4(b)(5) |
| <input type="checkbox"/> | Notification | § 40.6(d) |

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

Rule Numbers:

October 19, 2020

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 40.5 Submission. Request for Approval to Commingle Customer Positions and Related Collateral in Listed Options on Interest Rate Futures Contracts and Interest Rate Swaps.
CME Submission No. 20-404**

Dear Mr. Kirkpatrick:

Pursuant to Commodity Futures Trading Commission (“CFTC” or “Commission”) Regulations 39.15 and 40.5, Chicago Mercantile Exchange Inc. (“CME” or “CME Clearing”) respectfully requests that the Commission approve its proposal to amend CME Rule 8G831 to permit the commingling of customer positions in options on interest rate futures contracts that are listed for trading on CME and The Board of Trade of the City of Chicago, Inc. (“CBOT”) (collectively, “Interest Rate Options”) and interest rate swap (“IRS”) contracts that are cleared at CME, and any money, securities, or property used to margin, guarantee, or secure such positions, in accounts subject to Section 4d(f) of the Commodity Exchange Act (the “Act”).¹ By way of background, on October 12, 2012, the Commission granted approval for CME to commingle customer positions in interest rate futures contracts and related collateral and IRS. Through this submission, CME is requesting that the Commission expand the scope of such permissible commingling to include Interest Rate Options. As further explained below, approving this proposal will benefit customers and the overall derivatives markets by: (1) enabling customers who clear trades through CME to obtain the benefit of margin offsets between Interest Rate Options and IRS, thus reducing their trading costs and allowing for more efficient capital usage; (2) improving the efficiency and effectiveness of CME’s risk management framework; and (3) encouraging greater utilization of clearing, thereby facilitating systemic risk reduction. CME intends for this proposal to become effective on the earlier of December 4, 2020 or the receipt of regulatory approval.

I. Background

CME is registered with the Commission as a derivatives clearing organization (“DCO”) and is one of the largest central counterparty clearing services in the world. CME also has been designated as a systemically important financial market utility under Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act. CME also is registered with the Commission as a designated contract market (“DCM”) and CME Clearing is the DCO for contracts listed for trading on CME and its affiliates, CBOT, New York Mercantile Exchange, Inc. (“NYMEX”) and Commodity Exchange, Inc. (“COMEX”) each of which is also a registered DCM. The Interest Rate Options covered by this submission are currently listed for trading on CME and CBOT. However, CME intends to implement this proposal in a gradual manner. Thus, assuming this proposal is approved by the Commission, CME would first commingle listed options on

¹ CME has determined to adopt this amendment in accordance with its standard internal policies and procedures and pursuant to CME Rule 230.j.

Eurodollar futures contracts with IRS and then gradually add other listed options on interest rate futures contracts to the commingled portfolio over time.

CME Clearing launched its IRS clearing services in October 2010, initially offering USD swap products out to a 31-year maturity. CME Clearing has since expanded its IRS offering to 24 currencies including USD, Euro (EUR), and Sterling (GBP) products out to a 51-year maturity, and Canadian Dollar (CAD), Japanese Yen (JPY), Swiss Franc (CHF), Australian Dollar (AUD), and five other currencies out to an 30 year maturity, several non-deliverable IRS currencies, and USD OTC Swaptions. As of the date of this submission, IRS total open interest at CME was over \$13 trillion.

Interest Rate Options and IRS share similar risk characteristics and are significantly and reliably correlated. Permitting customers to commingle Interest Rate Options and IRS in 4d(f) or “customer cleared swaps” accounts will provide capital efficiencies to customers by allowing them to utilize margin offsets between their related positions in these options and swaps under CME’s risk management framework for portfolio margining.² Such portfolio margining promotes sound risk management by allowing a DCO, its clearing members and their customers to view a portfolio of positions based on the portfolio’s overall economic and risk impact, rather than dividing a portfolio based on regulatory “account class” distinctions that may not fully reflect commercial and economic realities. By approving CME’s proposal, the Commission will (i) provide customers with additional economic incentives and capital efficiencies necessary to promote clearing of swaps, and (ii) facilitate the Dodd-Frank Act’s goal of reducing systemic risk.

The enclosed rule amendments consist of revisions to CME Rule 8G831 (Commingling of Eligible Futures and Swaps Positions). A copy of the proposed amendments to Rule 8G831 is enclosed as Exhibit A, with additions underlined and deletions overstruck. The portfolio margining benefits achieved through commingling Interest Rate Options and IRS in 4d(f) accounts will not be available to market participants unless the Commission approves CME’s rules.

II. Information Required Under CFTC Regulation 39.15(b)(2)

Subparts (A) through (L) of CFTC Regulation 39.15(b)(2) describe information a DCO must include in a submission seeking to commingle options with cleared swaps in 4d(f) accounts. In adopting this Regulation and the “legally segregated, operationally commingled” (“LSOC”) customer protection model for 4d(f) accounts, “a DCO could more easily justify the approval of rules ... allowing the commingling of futures, options and swaps, since the impact of any different risk from the product being brought into the portfolio would be limited to the customer who chooses to trade that product.”³ We address each category of information identified in subparts (A) through (L) of Regulation 39.15(b)(2) below.

A. Products Eligible for Commingling

CME’s IRS offering currently includes 24 currencies, each with varying contract attributes. The specifications for these contracts are in Chapters 900 (Interest Rate Products)⁴ and 901 (Interest Rate Swaps Contract Terms)⁵ of the CME Rulebook.

² Allowing risk offsets between Interest Rate Options and IRS commingled in 4d(f) accounts is consistent with Regulation 39.13(g)(4) (Spread and Portfolio Margins), which states, in relevant part, that a DCO “may allow reductions in initial margin requirements for related positions if the price risks with respect to such positions are significantly and reliably correlated.”

³ 76 Fed. Reg. 69391, n. 189 (Nov. 8, 2011).

⁴ <https://www.cmegroup.com/content/dam/cmegroup/rulebook/CME/VIII/900/900.pdf>.

⁵ <https://www.cmegroup.com/content/dam/cmegroup/rulebook/CME/VIII/901/901.pdf>.

Under CME Rule 8G831, CME may commingle positions in base guaranty fund products⁶ with positions in interest rate swap contracts in order to provide risk offsets for proprietary and customer positions if the price risks with respect to such positions are significantly and reliably correlated. Any such commingled positions are subject to the risk methodology associated with interest rate swap contracts.

CME is currently permitted under Rule 8G831 to commingle customer positions in interest rate futures contracts and related collateral and IRS in accounts that are subject to Section 4d(f) of the Act. This proposal would permit CME to expand the scope of such permissible commingling to include Interest Rate Options to the extent that the price risks of such options are significantly and reliably correlated with the other products that are currently eligible for commingling under Rule 8G831.

Under the proposal, the following Interest Rate Options will initially be eligible for commingling with IRS in customer cleared swaps accounts:

- *Eurodollar Options*: The specifications for these contracts are located in Chapter 452A (Options on Three-Month Eurodollar Futures), Chapter 452D (Options on Three-Month Eurodollar Futures Calendar Spreads), and Chapter 453A (Options on One-Month Eurodollar Futures) of the CME Rulebook.
- *SOFR Options*: The specifications for these contracts are located in Chapter 460A (Options on Three-Month SOFR Futures) and Chapter 461A (Options on One-Month SOFR Futures) of the CME Rulebook.
- *Treasury Options*:
 - *U.S. Treasury Bonds*: The specifications for these contracts are located in Chapter 18A (Standard Options on U.S. Treasury Bond Futures), Chapter 18B (Flexible Options on U.S. Treasury Bond Futures), Chapter 40A (Standard Options on Long-Term U.S. Treasury Bond Futures), and Chapter 40B (Flexible Options on Long-Term U.S. Treasury Bond Futures) respectively, of the CBOT Rulebook.
 - *Treasury Notes*: The specifications for these contracts are located in Chapter 21A (Standard Options on Short-Term U.S. Treasury Note Futures), Chapter 21B (Flexible Options on Short-Term U.S. Treasury Note Futures), Chapter 20A (Standard Options on Medium-Term U.S. Treasury Note Futures), Chapter 20B (Flexible Options on Medium-Term U.S. Treasury Note Futures), Chapter 19A (Standard Options on Long-Term U.S. Treasury Note Futures), Chapter 19B (Flexible Options on Long-Term U.S. Treasury Note Futures), Chapter 26A (Standard Options on 10-Year U.S. Treasury Note Futures), and Chapter 26B (Flexible Options on 10-Year U.S. Treasury Note Futures) respectively, of the CBOT Rulebook.
- *Federal Funds Options*: The specifications for these contracts are located in Chapter 22A (Standard Options on 30-Day Federal Funds Futures) of the CBOT Rulebook.
- Any other interest rate offered within the listed rates asset class with similar risk characteristics to those mentioned above.⁷

⁶ CME Clearing has two independent financial safeguards waterfalls that support the products for which it provides clearing services, where the contributions to one waterfall cannot be used to cure losses in a different waterfall. CME Clearing has a financial safeguards waterfall for interest rate swap products and a separate financial safeguard waterfall for futures, options on futures and cleared OTC products other than IRS. Interest rate futures contracts and listed options thereon are base guaranty fund products under CME rules. CME currently expects that only interest rate products will be commingled with IRS under Rule 8G831.

⁷ In accordance with CFTC Regulation 39.13(g)(4), CME will permit listed options on futures contracts that reference interest rates other than those specified above to be eligible for commingling under Rule 8G831 to the extent that the price risks of such options are significantly and reliably correlated with the other products that are eligible for commingling under Rule 8G831. The price risks of such options will only be considered to be reliably correlated if there is a conceptual basis for the correlation in addition to an exhibited statistical correlation.

As further discussed below, these Interest Rate Options were identified as currently eligible for commingling based on their exposure to similar or correlated risk factors as IRS, thus allowing for margin offsets. In accordance with CME Rule 8G831 (Exhibit A), Interest Rate Options may only be commingled with IRS in 4d(f) accounts if they are risk reducing.

B. Risk Characteristics of Interest Rate Options and IRS

The primary categories of risk that apply to Interest Rate Options and IRS (collectively, “Eligible Products”) include:

- (a) interest rate risk,
- (b) foreign exchange rate risk,
- (c) futures risk,
- (d) volatility risk, and
- (e) liquidity/concentration risk.

These risk categories apply in varying degrees to the Eligible Products, depending on the type of the product and the currency of a given position. The management of these risks are addressed in the CME IRS Margin Model, explained more fully below in Section II, Subpart I.

Interest rate risk is the most important risk characteristic of the Eligible Products. Interest rate risk relates to the movement of interest rate levels for each currency. Foreign exchange rate risk relates to the movement of foreign exchange rates, which is relevant for any multicurrency portfolio and is especially important for non-deliverable currency products. Futures risk relates to the movement of futures prices and the added risk of futures in addition to its underlying interest rate risk, e.g. convexity risk. Volatility risk captures the movement in options’ implied volatility and is only relevant for Swaptions or Interest Rate Options. Liquidity/concentration risk captures the additional risk of medium to large portfolios that could pose added cost of hedging and auctioning under a stressed market environment.

CME Clearing has considerable experience clearing and managing the risks of Interest Rate Options and has been clearing IRS since October 2010. Under amended Rule 8G831, Interest Rate Options are determined to be eligible for commingling based on the fact that the price risks of such products are significantly and reliably correlated with IRS. For example, the price changes for options on Eurodollar futures are related to the changes in LIBOR rates, and the LIBOR curve serves as an input to CME Clearing’s USD-based IRS, thus providing a natural correlation, and potential margin offsets, between the two. The U.S. Treasury curve is highly correlated with the LIBOR curve (swap spreads are a widely known and traded strategy), hence listed options on Treasury futures contracts should be eligible for commingling with IRS.

Given the extensive volume, market depth, CLOB-based trading, and contract-standardization of Interest Rate Options,⁸ these products can be classified as highly liquid. Further, when Interest Rate Options are commingled in a cleared swaps account, they will be subject to CME’s IRS margin model, which utilizes a five-day margin period of risk and is therefore more conservative than the minimum of one-day margin period of risk to which Interest Rate Options are subject today. CME’s margin model for IRS also considers liquidity add-ons on a per-currency basis.

C. Execution Venues

Interest Rate Options are executed on a DCM (CME and CBOT), in accordance with the DCM’s rules. The primary method of execution for Interest Rate Options is electronic through the CME Globex platform. Interest Rate Options are also traded on the floor of the relevant Exchange and can be privately negotiated and submitted for clearing in accordance with applicable CME and CBOT rules. IRS are executed bilaterally

⁸ Globex volume for Interest Rate Options is available at <https://www.cmegroup.com/trading/interest-rates/options.html>.

and sent to CME Clearing through an execution and/or affirmation platform. The manner of execution for Interest Rate Options and IRS will not be affected by this proposal.

D. Analysis of the Liquidity of the Respective Markets for the Eligible Products, the Ability of Clearing Members and the Derivatives Clearing Organization to Offset or Mitigate the Risk of Such Eligible Products in a Timely Manner, Without Compromising the Financial Integrity of the Account, and, As Appropriate, Proposed Means for Addressing Insufficient Liquidity

As a general matter, CME considers liquidity among other factors in determining whether to clear Interest Rate Options and assesses the liquidity of Interest Rate Options under its risk management framework. CME also considers the liquidity of related products when determining the appropriateness of current or potential risk offsets. Additionally, CME and representatives from Clearing Members conduct default management drills that includes a liquidity component at least twice a year. These drills provide CME with a top-down view from external bidding firms into the relationship between margin levels and liquidity levels. Based on the results of these drills, CME may adjust the extent of offsets to account for the liquidity of the markets for each product.

Interest Rate Options have had an average daily volume of 2.7 million contracts and over 2 million contracts, respectively, in 2019 and 2020 (year-to-date), and open interest has averaged approximately 49 million contracts in 2020. Trading in Interest Rate Options is supported by a large group of market makers that provide deep and liquid markets for these products via streaming quote and request for quote functionality where the average response time is typically under 3 seconds. Request for quotes are displayed on an anonymous basis to all market participants.

We anticipate that adding Interest Rate Options to the suite of products that may be commingled under CME Rule 8G831 will further enhance the liquidity of these products by permitting market participants to trade these products in a more cost-effective manner. Accordingly, we believe that the liquidity of Interest Rate Options are such that CME and its Clearing Members will have the ability to offset or mitigate the risk of these contracts, together with other commingled contracts, in a timely manner and without compromising the financial integrity of a customer account.

We note that in the event of a default by a Clearing Member, CME attempts to minimize the impact of the default on non-defaulting Clearing Members pursuant to its default management procedures. The goal of such procedures is to limit the risk associated with a Clearing Member's default and to conduct an orderly close-out or mitigate the risk relating to the defaulting Clearing Member's positions. Permitting Interest Rate Options to be commingled with other eligible products will enhance CME's ability to conduct an orderly close-out because it will increase the likelihood that these positions will be part of a hedged portfolio, thus facilitating CME's ability to sell or auction or otherwise dispose of these positions to non-defaulting Clearing Members. As a result, CME believes that it will be able to manage its risk under a broad range of liquidity scenarios.

E. Availability of Reliable Prices for Interest Rate Options and IRS

Daily settlements for out-of-the-money ("OTM") options are based on market activity throughout the day, on all venues (including, but not limited to, CME Globex, CME ClearPort, CME Direct, and the trading floor, as applicable). Once the underlying futures have been settled, the implied volatility skews are used in conjunction with the futures settlement price to derive settlement prices for the options. In-the-money ("ITM") options are settled automatically by the relevant DCM in accordance with the put-call parity equation, taking into account the appropriate cost of carry. The cost of carry is rounded to the nearest minimum increment of the underlying futures contract. For all products, the interest rate used is the rate on the Overnight Index Swap (OIS) curve corresponding with the expiration date for each contract.⁹ More

⁹ For Eurodollar Options, the following settlement guidelines apply. Orders eligible for settlement consideration are as follows:

information regarding option settlement procedures is available at <https://www.cmegroup.com/confluence/display/EPICSANDBOX/CME%2C+CBOT%2C+NYMEX%2C+COMEX+Daily+Option+Settlement+Procedures>.

With respect to IRS, CME obtains pricing data from a number of third-party sources and derives prices based upon CME's internal settlement process. This process uses a blending algorithm to combine price data from multiple third-party sources and calculates the exponentially weighted price of the market activity in the last five minutes before the close. Similarly, for OTC Swaptions, CME obtains prices from liquidity providers and uses a blending algorithm to determine the prices.

F. Financial, Operational, and Managerial Standards for Clearing Members

To be permitted to commingle Interest Rate Options and IRS in 4d(f) accounts for its customers, a firm must be a futures commission merchant ("FCM") and an IRS clearing member of CME, and it must be a clearing member of CME and/or CBOT in order to clear Interest Rate Options. Each category of clearing membership requires successful completion of the membership application process. All applicants for clearing membership are presented to the appropriate CME Clearing Risk Committee for review and feedback and CME's Clearing House Oversight Committee ("CHOC") for approval. CME conducts regular reviews of, and requires regular reporting from, existing Clearing Members that is designed to ensure that they continue to satisfy applicable membership standards.

1. *Financial Standards*

FCM Clearing Members must satisfy minimum regulatory capital requirements under applicable law (including Commission regulations), in addition to the requirements imposed under CME and/or CBOT rules. Currently, under CME Rule 8G04, an IRS Clearing Member that is an FCM must maintain minimum capital (as defined in Regulation 39.12(a)(2)) of \$50 million. In addition, an IRS Clearing Member must maintain capital at least equal to 20% of the aggregate performance bond requirement for its proprietary and customer IRS. Under the proposed amendments to Rule 8G831 (Exhibit A), the term "IRS Contracts" will include Interest Rate Options commingled with IRS in 4d(f) accounts.

All IRS Clearing Members must deposit performance bond, also known as margin, to ensure that they can meet their obligations to their customers and to CME Clearing. Performance bond requirements vary by product and market volatility, and CME Clearing applies prudent margin coverage standards to effectively account for potential future exposures that consider the unique characteristics of the products it clears. Greater detail on CME Clearing's margining practices is set forth below.

All IRS Clearing Members must make a Guaranty Fund deposit with the Clearing House. Under CME Rule 8G07, the minimum amount of this deposit is the greater of \$15 million or the Clearing Member's proportionate share of the IRS Guaranty Fund based on the 30-day trailing average of its portfolio residual loss and the 30-day trailing average gross notional open interest outstanding at the Clearing House. A predetermined weight is applied to the portfolio residual loss and gross notional for determine each IRS Clearing Member's proportionate share of the Guaranty Fund.

2. *Financial Reporting*

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1. Outright Orders (OTM only)
 2. Straddles (at-the-money ["ATM"] only, no contingent futures)
 3. Strangles (equidistant from ATM only)
 4. Call and Put Spreads (OTM/ATM only)
 5. Butterflies/Iron Butterflies/Ratios (1X2 only)
 6. Condors/Christmas Trees
 7. Outright Options vs. Futures (market delta only)
 8. Intermonth Straddle (ATM only) and Call/Put Spreads (OTM only)

FCM Clearing Members are subject to monthly financial statement reporting requirements. This typically requires submitting monthly CFTC Form 1-FR or Securities and Exchange Commission (“SEC”) FOCUS reports (if the Clearing Member is a U.S. registered broker-dealer). Clearing Members which are banks are required to file any and all financial reports which are filed with its primary banking regulator with such reports filed on at least a quarterly basis. These financial reports must demonstrate compliance with CME’s minimum capital requirements.

Clearing Members must submit annual certified financial statements to CME. In addition, Clearing Members which are FCMs must submit daily customer segregated and cleared swaps customer account statements and bimonthly reports on customer segregated and cleared swaps customer investments. A Clearing Member must provide written notice to CME whenever it fails to maintain minimum capital, fails to maintain early warning capital, fails to maintain sufficient funds in customer segregated or cleared swaps customer accounts, fails to maintain current books and records, determines the existence of a material inadequacy as specified in CFTC regulations, fails to comply with additional accounting, reporting, financial and/or operational requirements as prescribed by CME, changes its fiscal year, or changes its public accountant. Additional notification is required for significant business transactions or significant changes in operations.

3. *Operational and Managerial Standards*

In addition to complying with applicable Commission regulations and rules of the National Futures Association (“NFA”), Clearing Members permitted to commingle Interest Rate Options with IRS in 4d(f) accounts for their customers will be required to comply with CME Clearing’s operational and risk-management rules and requirements for IRS and CME/CBOT Clearing Members.

To become a CME and/or IRS Clearing Member, a firm must demonstrate (among other things) sufficient risk-management capabilities. Clearing Members permitted to commingle Interest Rate Options and IRS in 4d(f) accounts will be subject to CME Rules 982 and 8F010, both of which address the subject of risk management:

CME Rule 982. RISK MANAGEMENT

All clearing members must have written risk management policies and procedures in place to ensure they are able to perform certain basic risk and operational functions at all times. At a minimum, the following areas must be considered in the firm’s policies and procedures, depending on the firm’s size and its business and product mix:

A. Trade Submission and Account Monitoring. Clearing members must have procedures in place to demonstrate compliance in the following areas for trades executed through both electronic platforms and open outcry:

1. Monitoring the credit risks of accepting trades, including give-up trades, of specific customers.⁸
2. Monitoring the risks associated with proprietary trading.
3. Limiting the impact of significant market moves through the use of tools such as stress testing or position limits.
4. Maintaining the ability to monitor account activity on an intraday basis, including overnight.⁹
5. Ensuring order entry systems include the ability to set automated credit controls or position limits or requiring a firm employee to enter orders.
6. Defining sources of liquidity for increased settlement obligations.

B. Additional and/or Alternative Requirements. Exchange or Clearing House staff may prescribe additional and/or alternative requirements in order for clearing members to comply with this Rule.

C. Each clearing member shall promptly provide to Clearing House staff, upon request, information and documents regarding its risk management policies, procedures and practices, including, without limitation, information and documents relating to the liquidity of its financial resources, settlement procedures and operational issues.

D. Each clearing member shall make information and documents regarding its risk management policies, procedures and practices available to the CFTC upon the CFTC's request. In addition, all FCM clearing members must comply with the risk management requirements set forth in CFTC Regulation 1.11: Risk Management Program for futures commission merchants.

CME Rule 8G10. RISK MANAGEMENT

IRS Clearing Members will be subject to risk management and monitoring practices by CME relating to transactions submitted to the Clearing House. IRS Clearing Members shall promptly provide all information requested by Clearing House staff, including, without limitation, information respecting risk, settlement, liquidity, and operational issues. IRS Clearing Members shall make information and documents regarding their risk management policies, procedures and practices available to the CFTC upon the CFTC's request.

IRS Clearing Members shall permit on-site risk reviews in accordance with CME Rules and subject to reasonable standards of confidentiality. IRS Clearing Members will also be subject to on-going oversight by the IRS Risk Committee regarding their IRS activities related to the Clearing House. All such inquiries shall be conducted in a manner consistent with oversight of IRS Clearing Members and in accordance with reasonable standards of confidentiality.

G. Systems and Procedures to Oversee Clearing Members' Risk Management of Commingled Customer Positions

In compliance with Regulation 39.13(b),¹⁰ CME has developed a Risk Management Framework, which includes procedures to monitor clearing member risk management. We believe this Risk Management Framework will be equally effective with regard to oversight of risk management by Clearing Members permitted to commingle Interest Rate Options and IRS in 4d(f) accounts. Furthermore, customer commingled Interest Rate Options and IRS will be kept in CME's clearing system at the level of individually registered customer accounts.

Credit Risk Assessment

Under CME's Risk Management Framework, CME Clearing conducts a credit assessment of its counterparties at least annually to evaluate the creditworthiness of its direct counterparties and inform its daily risk monitoring practices. Where appropriate, assessments are supplemented with on-site reviews, at least annually or biennially, based on counterparty type. Additionally, select counterparties elect to conduct annual on-site credit due diligence reviews of CME Clearing, as well as send written due diligence questionnaires to aid in their assessment of CME Clearing. These formalized means for evaluating risks supplement the open line of communication that CME Clearing maintains with its counterparties.

CME Clearing's credit assessment of its counterparties is conducted using its internal credit rating methodology. The internal credit ratings for CME Clearing's counterparties are based on a variety of quantitative and qualitative metrics. Quantitative metrics include, but not limited to, profitability, leverage, liquidity, asset quality, and capitalization metrics. Qualitative measurements include, but are not limited to, an assessment of a counterparties' business strategy, operating environment, regulatory regime, and risk management practices. Within the credit rating methodology, counterparties are classified based on their business type. The composition of the internal credit rating templates is based on counterparty type and

¹⁰ Regulation 39.13(b) requires each DCO to "establish an appropriate risk management framework that, at a minimum, clearly identifies and documents the range of risks to which the [DCO] is exposed, addresses the monitoring and management of the entirety of those risks, and provides a mechanism for internal audit. The risk management framework shall be regularly reviewed and updated as necessary."

industry, among other factors. Outside of internal credit ratings being reviewed at least annually, they are also updated as necessary to reflect current market information.

Counterparties are also monitored daily through CME Clearing's key risk indicator dashboard to help identify matters that may lead to a change in rating or more rigorous reviews. Alerts are set to notify the Risk Management team of notable movements in credit default swap price, stock price, or external credit ratings. Additionally, CME Clearing monitors its counterparties against noteworthy news items and financial standing and reports. Noteworthy items are reported out in a timely manner to the senior members of the Risk Management team and addressed accordingly. Based on CME Clearing's daily monitoring and internal credit ratings, CME Clearing maintains a Watch List of counterparties that are subject to heightened monitoring. Through ongoing monitoring, CME Clearing continually assesses its exposures to its counterparties.

Daily Risk Monitoring

As part of CME's Risk Management Framework, CME's risk management staff monitors Clearing Members' exposures throughout the day. Such daily monitoring includes the following components:

- Monitoring price moves of products in relation to current margin levels.
- Examining real-time profit/loss for each Clearing Member to detect large losses or large short options positions, as well as large changes in margin levels.
- Examining Clearing Members' trading activity to identify large increases in positions, as well as transfers and/or give-up activity that could trigger a significant margin call.
- Monitoring for extreme abnormalities in a Clearing Member's trading behavior and individual trade characteristics to identify potential erroneous trade entries (e.g., "fat finger" trades).

CME assigns to each Clearing Member tolerance thresholds for monitoring their intra-day and aggregate trading activity. CME's daily monitoring and annual credit assessment process, which encompasses its internal credit rating methodology, contributes to determining tolerance thresholds for a Clearing Member. Tolerance thresholds are used to flag Clearing Member settlement variation and/or margin payment obligation amounts that exceed pre-set levels benchmarked against their typical activity. When a threshold is exceeded, the matter is reviewed by the Risk Management team and escalated accordingly.

In addition to daily risk management procedures, CME conducts on-site reviews of Clearing Member firms approximately every one-to-two years, as appropriate under the circumstances particular to each firm. The reviews are conducted by CME Clearing risk management staff. CME evaluates a Clearing Member's credit, market, and liquidity risk management practices in risk reviews, as well as operational preparedness. Risk reviews cover topics including customer credit risk monitoring and control, proprietary trading risk monitoring and control, risk management, monitoring, and stress test reports, demonstration of risk management systems and credit control functionality, counterparty credit risk management, process for satisfying payment obligations to CME, collateral policy, and liquidity/capital plans. Results of on-site reviews are presented to members of CME Clearing's senior Risk Management team and may be the basis for corrective actions to the extent that potential weaknesses or other areas of concerns are identified.

Effectiveness of CME Clearing's Risk Management Tools

CME Clearing continually strives to effectively and efficiently structure its clearing and settlement services, while supporting prudent risk management. This encompasses maintaining and utilizing effective tools for monitoring the risks of its Clearing Members' exposures. In part, the effectiveness of CME Clearing's risk management policies, procedures, and systems are evaluated through the annual review and approval of the Risk Management Framework. The appropriateness of CME Clearing's risk management tools is also assessed through the validation of its risk models, sensitivity analysis, and daily back-testing and stress testing. These practices are designed to proactively address potential model risk. Additionally, changes to risk models are vetted internally by senior members of the Risk Management team, as well as by qualified

independent parties, depending the materiality of the change. Additionally, CME Clearing's risk management practices are subject to annual regulatory examination by the CFTC and the Board of Governors of the Federal Reserve System.

H. CME Clearing's Financial Resources for Commingled Customer Positions

1. *General*

CME Clearing maintains two separate financial safeguards packages: one for IRS (the "IRS Waterfall") and one for Base products, which includes all other products cleared by CME Clearing, including but not limited to futures and options on futures. Each financial safeguards package is governed by and complies with Regulation 39.11, which implements DCO Core Principle B (Financial Resources).

Interest Rate Options and IRS in 4d(f) accounts will be covered by the IRS Waterfall. In accordance with CME Rules 8G07 (IRS Financial Safeguards and Guaranty Fund Deposit) and 8G802 (Protection of Clearing House). The IRS Waterfall is comprised of: (1) performance bonds (or margin) of the defaulting Clearing Member (and, under the Commission's LSOC regulations, of any customer that caused the clearing member's default);¹¹ (2) the Guaranty Fund contribution of the defaulting Clearing Member to the IRS Waterfall; (3) CME's capital contribution to the IRS Waterfall (currently set at \$150 million); (4) the Guaranty Fund contributions of non-defaulting Clearing Members to the IRS Waterfall; and (5) CME's rights to assess non-defaulting Clearing Members to make additional contributions to the IRS Waterfall. As of the date of this submission, the Guaranty Fund contributions for the IRS Waterfall on deposit with CME equaled \$3,599,044,034, and the assessments portion of the IRS Waterfall amounted to \$1,176,808,299.¹² The IRS Waterfall is sized to cover simultaneous defaults by the two IRS Clearing Members (and their affiliates) creating the largest financial exposures to CME in extreme but plausible market conditions.

2. *Performance Bond*

CME Clearing applies prudent margin coverage standards to effectively account for potential future exposures that consider the unique characteristics of the products it clears. CME Clearing has set its margin levels to meet at least a 99% portfolio level coverage standard on an ex post basis within the minimum defined margin period of risk for the product. Further, CME Clearing monitors Clearing Members' customer and house portfolios for concentration risk and other portfolio level risks, and may require additional margin as warranted. CME Clearing calculates performance bond requirements for a Clearing Member's customer activity on a gross basis, which means performance bond is calculated for each customer account at the Clearing Member individually and the aggregate sum is the customer related performance bond requirement for that the Clearing Member. Greater detail on CME Clearing's margining practices is set forth in Section I. below.

3. *Guaranty Fund*

CME's coverage standards for the IRS Waterfall enable it to satisfy its obligations under Regulation 39.33(a)(1), which requires each SIDCO to maintain financial resources sufficient to meet the SIDCO's financial obligations to its Clearing Members "notwithstanding a default by two clearing members creating the largest financial exposure for the [SIDCO] in extreme but plausible market conditions....". Defaults by the two Clearing Members creating the first and second largest exposures are covered by the pre-funded portion of the IRS Waterfall; defaults by clearing members creating the third and fourth largest financial exposures are covered by CME Clearing's assessment powers (utilizing the assumption that no assessments will be forthcoming from any of the defaulting Clearing Members).

¹¹ See Regulation 22.15 (Treatment of Cleared Swaps Customer Collateral on an Individual Basis).

¹² Clearing Member assessments are not on deposit with CME Clearing. Rather, Clearing Members are required to pay assessments to CME Clearing when circumstances warrant pursuant to Rule 8G802.B.5.

The size of the IRS Guaranty Fund is determined through stress testing, utilizing numerous scenarios that capture extreme but plausible market conditions, which are specifically designed to capture the unique risks of the products covered by the IRS Waterfall. CME Clearing utilizes a scenarios-based Value-at-Risk (“VaR”) methodology as the foundation for its stress testing framework for the IRS Guaranty Fund. Stress scenarios are designed to stress movements across different risk factors. Both historical and hypothetical stress scenarios utilize a 99.9% confidence interval within a stress period. Stress testing scenarios are utilized to size the potential stress losses of the two largest exposures from IRS Clearing Members and their affiliates. Scenarios, whether historical or hypothetical, used to size the IRS Guaranty Fund are designed to represent extreme but plausible market movements and resulting potential losses, considering the current market environment (e.g., interest rate levels).

Stress testing is conducted daily, and results are analyzed by CME Clearing’s Risk Management team and reported to senior members of the Risk Management team. The IRS Guaranty Fund is re-sized on at least a monthly basis, but where warranted, the Risk Management team may re-size the IRS Guaranty Fund more frequently, outside of the regular resizing schedule. In addition, fluctuations of the stress shortfall relative to the overall size of the IRS Guaranty Fund above a defined threshold are escalated to and addressed by the CME Clearing’s internal Stress Testing Committee, which is comprised of members of CME Clearing’s Risk Management team.

CME Clearing’s Stress Testing Committee is the primary governing body within the CME Clearing that oversees the stress testing framework, which is the basis for the sizing of the IRS Guaranty Fund. On at least a monthly basis, stress testing results and parameters are reviewed by the Stress Testing Committee. The Stress Testing Committee’s review is designed to ensure that the calculated size of the IRS Guaranty Fund is appropriate to cover potential future exposures within the IRS Waterfall arising from the default of the two Clearing Members and their affiliates with the largest potential stress shortfalls. Additionally, assumptions and parameters used to construct stress scenarios are reviewed by the Stress Testing Committee. Substantive changes to the stress testing framework are brought to CHOC and the IRS Risk Committee for review and approval. Independent validations of CME Clearing’s risk models are performed at least annually.

In the event of an IRS Clearing Member default, the defaulted Clearing Member’s financial resources, including its performance bond and Guaranty Fund contributions to the IRS Waterfall would be used first to satisfy its obligations to CME Clearing. If those resources are insufficient, the next layer of the IRS Waterfall is used, which is CME’s contribution. Only after the utilization of the defaulted Clearing Member’s resources and CME’s contribution to the IRS Waterfall would the Guaranty Fund contributions of non-defaulting Clearing Members to the IRS Waterfall be utilized. Additionally, in the highly unlikely event that the funded portions of CME Clearing’s IRS Waterfall are insufficient to cure the losses, CME Clearing can assess Clearing Members for additional funds pursuant to CME Rule 8G07.

I. Margin Methodology

CME Clearing’s margin models for Interest Rate Options residing with IRS in 4d(f) accounts is rooted in a Historical Value-at-Risk (“HVaR”) methodology. Such methodology is used to calculate performance bond requirements for IRS products that are designed to meet a 99% coverage standard on an ex post basis that captures possible price moves over a minimum of five business days. HVaR is used for both its scalability across multiple currencies, as well as its transparency to the industry; it is a standard, well understood model for many financial services firms and is easily replicable.

The margin model for IRS products developed by CME Clearing is based on two primary aspects to capture the market risk of IRS products: i) filtered HVaR components weighted at 75%; and ii) unscaled components weighted at 25%. The IRS products’ margin model also has a specific event risk component that is designed to capture anticipated moves in the market arising from event-specific risks. The IRS products’ margin methodology generates scenarios for the risk factors relevant for IRS products (e.g., volatility curves for Interest Rate Options). In order to achieve a 99% coverage standard of potential losses over a given five

business day period, CME Clearing's IRS products margin model leverages a 99.7% confidence interval to capture possible interest rate moves.

The filtered HVaR components utilize at least a five-year rolling lookback period and adjusts historical returns based on Exponentially Weighted Moving Average ("EWMA") volatility forecasting. Under the HVaR methodology for IRS products, past events are used for generating possible scenarios in the future. In addition to the HVaR components, the unscaled components incorporate historical scenarios from longer lookback periods, in addition to the rolling five-year lookback. The unscaled components also allow for the injection of hypothetical scenarios.

The margin model for IRS products appropriately covers the variety of risks associated with the products that could comprise an IRS products portfolio, including multi-currency portfolios, and portfolio margined exchange-traded derivatives (Futures and Options on Futures).

Since options that are IRS products (e.g., Swaptions and Interest Rate Options) add volatility risk to portfolios for IRS products, the CME IRS Margin Model incorporates additional calculations to address those risks. The volatility risk of these options that are IRS products is decomposed into at-the-money ("ATM") volatility and skew volatility risks. ATM volatility risk is accounted for as an additional risk factor in the IRS products' margin model calculation. Offsets between IRS products that are options and other types of IRS products are accounted for with the volatility risk factors considered in the margin model calculation.

The performance bond calculation for options that are IRS products includes a skew charge component which accounts for volatility skew risk and is calculated using additional scenarios. The skew charge for these options portfolios is calculated at a defined percentile among all selected skew scenarios.

CME Clearing accounts for the dispersion of settlement price submissions using a valuation uncertainty margin add-on to the skew charge. This is calculated using dispersion of historical settlement prices to determine an average difference between different dealer submissions or difference between settlement prices and calibrated prices.

As described above, CME Clearing's margin model leverages historical data that covers the variety of risks associated with all products. For OTC products, the model leverages historical data of the OTC curves and Swaptions volatility surfaces; for portfolio margining futures and options, the model leverages historical futures price data and options volatility surfaces. The historical data for OTC products and listed products are utilized to generate historical scenarios that are then used to capture the appropriate margin level. The offsetting benefit between different products are naturally implied from historical correlation observed in historical data, e.g. between OTC products and listed products.

Some portfolios of IRS products are subject to liquidity and concentration charges. Liquidity and concentration risks are accounted for separately for each currency for IRS products. The liquidity charge accounts for the potential additional cost of liquidating sufficiently large portfolios of IRS products in the event of a Clearing Member default. For IRS products, CME Clearing utilizes industry polls, assuming stressed market conditions, to define the charges it imposes to account for potential liquidity costs associated with large or concentrated positions. Liquidity polls are regularly updated, which is designed to ensure that current market dynamics are appropriately reflected in the applicable liquidity charges.

Based on the results of the liquidity polls for IRS products, a cost function is defined to determine the applicable liquidity charge. Each cost function is defined based on portfolio Greeks, such as Delta, Gamma, and Vega. The cost functions for IRS products are currency specific and based on the polls solicited from market participants and then determined by the Risk Management team and designed to be progressive in nature.

In accordance with Regulation 39.13(g)(4), CME Clearing will continue to monitor the ability of its IRS margin methodology to provide sufficient coverage for commingled customer portfolios and will adjust the

model parameters or adapt the methodology used to calculate margins, as necessary and appropriate, to ensure adequate margin coverage.

J. CME Clearing's Default Management Abilities with Respect to Commingled Positions

CME is confident in its abilities to manage a potential default with respect to Interest Rate Options commingled with IRS in 4d(f) accounts. Any default involving such commingled positions would be covered by CME's IRS Waterfall, as explained in Section H above. In accordance with the proposed amendments to Rule 8G831 (Exhibit A), such commingled positions will be subject to CME's default management procedures for IRS products. Those procedures are discussed in the following section.

K. Procedures for Clearing Member and Customer Defaults Involving Commingled Positions

A default by an IRS FCM clearing member may involve Interest Rate Options commingled with IRS in 4d(f) accounts. Such positions residing in 4d(f) accounts, including the customer commingled Interest Rate Options and IRS (and collateral associated therewith), would be part of the "customer cleared swaps" account class under the Commission's Part 190 Bankruptcy Rules,¹³ and would be treated in accordance with the Commission's Part 22 LSOC regulations.¹⁴

Any default by an IRS clearing member – including a default involving customer commingled positions in Interest Rate Options – would also be governed by CME's rules and default management procedures for IRS. This includes but is not limited to Rules 8G802 (Protection of Clearing House), 8G14 (Mitigation of IRS Loss), and 8G975 (IRS Emergency Financial Conditions). In extreme circumstances (e.g., where the monetary impact of a default exceeds the IRS Waterfall), Rule 8G28 (Wind Up of IRS Clearing Operations) may also be implicated. These rules are available at <https://www.cmegroup.com/rulebook/CME/>. CME's default management guidelines for IRS are enclosed as Exhibit B (marked for Confidential Treatment).

CME's default management rules and procedures incorporate input from IRS clearing members and market participants and CME's depth of default management experience from many years as a derivatives clearing house, and are reviewed and updated as circumstances warrant. For example, when new types of IRS are listed for clearing (e.g., IRS referencing non-USD interest rates), the procedures are revised to reflect new risks that may arise in connection with a default involving a multi-currency IRS portfolio. CME Clearing makes these updates in consultation with the IRS Risk Committee. The IRS Risk Committee is comprised of members representing entities with diverse experience in IRS markets, including risk managers, buy-side and sell-side market participants, and independent committee members.

A default by an IRS clearing member would prompt the convening of the IRS Default Management Committee, also known as the Active Default Management Committee ("ADMC"), which would advise the Clearing House on strategies for hedging and liquidating the defaulting Clearing Member's portfolio to minimize risk. Any hedging strategy would be dependent upon prevailing market conditions, with the goal of establishing a sufficiently risk-neutral portfolio to ensure a successful auction. Post hedging, the default portfolio would be auctioned among non-defaulting IRS clearing members, who are required to provide bids subject to available exceptions from the Clearing House.¹⁵ Default portfolios would typically be auctioned by currency, with only those IRS clearing members with open interest in each currency being required to bid on that particular currency subset, subject to an exemption process.

A commingled portfolio of Interest Rate Options and IRS (whether in a proprietary account or a customer account) reduces overall risk by taking two separate portfolios with directional risk and combining them into

¹³ 17 CFR § 190.01, *et seq.*

¹⁴ 17 CFR § 22.1, *et seq.*

¹⁵ In accordance with CME Rule 8G802.B.1 and CME's default management procedures, an IRS clearing member that fails to provide a bid, or submits a significantly off-market bid, would be penalized via the treatment of its guaranty fund contribution relative to other clearing members that comply with the requirement.

a commingled portfolio with reduced overall risk exposure. A commingled portfolio does, however, present certain different risks, such as convexity risk between options on Eurodollar futures and IRS, swap spread risk between options on U.S. Treasury Futures and IRS, and exposure to interest rate volatility. These risks will be monitored by CME Clearing, which would provide the ADMC with information necessary for hedging and liquidation purposes. The introduction of commingled portfolios also provides certain additional hedging and liquidation mechanisms. An important additional liquidation mechanism for the Interest Rate Options in commingled portfolios is CME Globex, a source of significant liquidity and market depth (particularly with respect to short-dated yield curve risks). We believe Globex may be a cost- and time-efficient way of reducing the risk of a commingled portfolio in the event of default.

In a hypothetical scenario where the financial impact of an IRS clearing member default exceeded the size of the IRS Waterfall, CME would be entitled under Rule 8G28 to terminate all IRS Contracts after a final mark-to-market cycle. If this were to occur, remaining commingled Interest Rate Options of the defaulting clearing member would be liquidated and the mark-to-market gains of IRS participants would be haircut to make up for any shortfall.¹⁶ Commingled Interest Rate Options of customers would remain in 4d(f) accounts until such time as the positions were liquidated or transferred to 4d(a) accounts at a non-defaulting clearing member.

L. Arrangements for Obtaining Position Data for Interest Rate Options and IRS in 4d(f) Accounts

For IRS, positions are kept in CME's clearing system at the level of individually registered customer accounts. This is accomplished by requiring IRS clearing members to register their IRS customers with CME Clearing.¹⁷ For each such customer, (i) a separate position account is created at the clearing level, and (ii) the clearing member specifies an account ID that is recorded when trades for that customer are submitted for clearing. Trades for which the customer account ID matches the registered value are posted to that customer's clearing-level position account. Commingled Interest Rate Options will also flow into the relevant customer's clearing-level position account. Accordingly, CME Clearing will have daily position data at the individual customer level for IRS and such Interest Rate Options in 4d(f) accounts.

III. Conclusion

For the reasons stated above, CME respectfully requests that the Commission approve CME's proposal to allow the commingling of customer positions in Interest Rate Options, and any money, securities, or property used to margin, guarantee, or secure such positions, in 4d(f) accounts, and to allow margin offsets for such positions in accordance with CME Clearing's portfolio margining program.

CME certifies that the proposal complies with the Act and regulations promulgated thereunder. More specifically, the proposed commingling rules are potentially relevant to the following Core Principles discussed below: (1) DCO Core Principle D (Risk Management) and Regulation 39.13(g)(4) (Spread and Portfolio Margins), which provides, in pertinent part, that a DCO "may allow reductions in initial margin requirements for related positions if the price risks with respect to such positions are significantly and reliably correlated"; (2) DCO Core Principle F (Treatment of Funds), and Regulation 39.15(b)(2); and (3) DCO Core Principle G (Default Rules and Procedures) and Regulation 39.16.

(1) *DCO Core Principle D – Risk Management*: As discussed herein, CME has developed a Risk Management Framework, which includes procedures to monitor clearing member risk management and which will be utilized with respect to the oversight of risk management by Clearing Members permitted to commingle Interest Rate Options and IRS in 4d(f) accounts. Further, CME will continue to monitor the ability of its IRS margin methodology to provide sufficient coverage for commingled

¹⁶ In such circumstances, the customer gains would be haircut on an individual customer basis. See CME Rule 8G802.B.6.vii. House account gains would be haircut on a per-firm basis. See *id.*

¹⁷ See CME Rule 8F009 (Customer Registration), available at <https://www.cmegroup.com/content/dam/cmegroup/rulebook/CME/I/8F/8F.pdf>.

customer portfolios and will adjust the model parameters or adapt the methodology used to calculate margins, as necessary and appropriate, to ensure adequate margin coverage. Interest Rate Options are eligible for commingling based on the fact that the price risks of such products are significantly and reliably correlated with IRS. The liquidity of Interest Rate Options are such that CME and its Clearing Members will have the ability to offset or mitigate the risk of these contracts, together with other commingled contracts, in a timely manner and without compromising the financial integrity of a customer account. Accordingly, CME believes the proposed commingling and portfolio margining of Interest Rate Options and IRS is consistent with the requirements set forth in DCO Core Principle D and Regulation 39.13.

(2) *DCO Core Principle F – Treatment of Funds*: CME proposes to permit the commingling of customer positions in Interest Rate Options and IRS contracts that are cleared at CME, and any money, securities, or property used to margin, guarantee, or secure such positions, in accounts subject to Section 4d(f) of the Act, as contemplated in Regulation 39.15(b)(2). CME has set forth above relevant information in response to the requirements of that Regulation, and believes the requirements are satisfied. Accordingly, CME believes the proposed commingling is consistent with the requirements of DCO Core Principle F and Regulation 39.15.

(3) *DCO Core Principle G – Default Rules and Procedures*: CME believes that its existing default management procedures and rules, as described herein, are sufficient for it to be able to take timely action to close out contracts and continue to meet its obligations in the event of a default by a Clearing Member, including situations in which Interest Rate Options are commingled with IRS in 4d(f) accounts. As such, CME believes that the proposed commingling is consistent with the requirements of DCO Core Principle G and Regulation 39.16.

CME has thus determined that the amendments set forth herein comply with the Act and regulations promulgated thereunder. No substantive opposing views regarding the proposed commingling rules have been expressed to CME.

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

Should you have any questions 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 Rule 8G831 (blackline format)
Exhibit B – Default Management Guidelines for IRS (attached under separate cover)
(Confidential Treatment Requested)

Exhibit A

CME Rulebook Chapter 8G, Interest Rate Derivative Clearing Rule 8G831

(additions underlined, deletions ~~overstruck~~)

8G831. COMMINGLING OF ELIGIBLE FUTURES, OPTIONS ON FUTURES, AND SWAPS POSITIONS

The Clearing House shall determine Base Guaranty Fund Products that may be commingled with positions in IRS Contracts in order to provide risk offsets for proprietary and customer positions on the basis that the price risks with respect to such products are significantly and reliably correlated (such products, “Commingling Eligible Futures and Options on Futures Products”). Eligible Clearing Members may elect that any of their proprietary positions in Commingling Eligible Futures and Options on Futures Products be commingled with proprietary positions in IRS Contracts and subject to the financial safeguards package for IRS Contracts. Eligible Clearing Members may elect that any of their customer’s positions in Commingling Eligible Futures and Options on Futures Products be commingled with such customer’s positions in IRS Contracts and subject to the financial safeguards package for IRS Contracts. Any such commingled positions will be subject to the risk methodology associated with IRS Contracts. Notwithstanding Rule 814, the Clearing House will not make variation settlement payments (but will require collections) associated with Commingled Futures and Options on Futures Positions during intra-day variation settlement cycles which do not include variation settlements for IRS Contracts. If the Clearing House determines at any time that any Commingled Futures and/or Options on Futures Positions are non-risk reducing, the Clearing House may either restrict such participant from commingling additional positions or require such participant to move and/or liquidate any of such Commingled Futures and/or Options on Futures Positions. At no time shall the risk of commingled futures and/or options on futures positions exceed the risk of IRS positions within a commingled portfolio by more than \$1m DV01. In the event of a default by an Eligible Clearing Member, Commingled Futures and Options on Futures Positions of such Eligible Clearing Member or its customers will be subject to the default management procedures of IRS Products.

Upon the occurrence of an IRS Termination Event, (i) Commingled Futures and Options on Futures Positions will be subject to the risk methodology associated with futures and options on futures positions and subject to the Base Guaranty Fund, (ii) proprietary Commingled Futures and Options on Futures Positions of non-defaulted IRS Clearing Members will be removed from the associated IRS accounts of such IRS Clearing Member and moved (together with all performance bond of such IRS Clearing Member) to the relevant Base Guaranty Fund Product proprietary accounts of such Clearing Member and (iii) Commingled Futures and Options on Futures Positions of customers of non-defaulted IRS Clearing Members will remain in the commingled portfolio and the associated performance bond will remain in the relevant Cleared Swaps Account of such IRS Clearing Member until transferred by the customer or Clearing Member to segregated accounts maintained in accordance with Section 4d of the CEA (such transfers shall occur as soon as reasonably practicable) and (iv) the Clearing House will make regular intraday variation settlement payments during intra-day settlement cycles.

“Commingled Futures and Options on Futures Positions” shall mean any positions in Base Guaranty Fund Products commingled with positions in IRS Contracts in accordance with this Rule 8G831. As used in Rules 8G04, 8G14, 8G25, 8G28 (except for 8G28(a), 8G600, 8G802.A, 8G802.B.2,3,7 and 8, 8G802.C, 8G802.I and 8G931, except as otherwise provided therein, the term “IRS Contracts” shall include Commingled Futures and Options on Futures Positions.

“Eligible Clearing Member” shall mean a firm that has been approved as a Clearing Member and an IRS Clearing Member.

Exhibit B

Default Management Guidelines for IRS

(attached under separate cover)

(Confidential Treatment Requested)