

SUBMISSION COVER SHEET

IMPORTANT: Check box if Confidential Treatment is requested

Registered Entity Identifier Code (optional): 23-301

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

Filing as a: DCM SEF DCO SDR

Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): 07/17/23 **Filing Description:** Request for Approval of Amended and Restated Cross-Margining Agreement and Service Level Agreement between Chicago Mercantile Exchange Inc. and Fixed Income Clearing Corporation

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 |

Official Product Name:

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:

July 17, 2023

VIA ELECTRONIC PORTAL

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

**Re: CFTC Regulation 40.5(a) Request for Approval. Amended and Restated Cross-Margining Agreement and Service Level Agreement between Chicago Mercantile Exchange Inc. and Fixed Income Clearing Corporation.
CME Submission No. 23-301**

Dear Mr. Kirkpatrick:

Pursuant to Commodity Futures Trading Commission (“CFTC” or “Commission”) Regulations 39.13(i) and 40.5(a), Chicago Mercantile Exchange Inc. (“CME” or “CME Clearing”), a registered derivatives clearing organization (“DCO”) under the Commodity Exchange Act, as amended (“CEA” or “Act”) respectfully requests that the Commission approve its proposal to enter into an Amended and Restated Cross-Margining Agreement (“Proposed XM Agreement”) between CME and Fixed Income Clearing Corporation (“FICC”) and a related CME-FICC Cross-Margining Service Level Agreement (“Service Level Agreement”) (the “Proposal”). Both Agreements are filed as Exhibit A and B, respectively, under separate cover and are subject to a request for confidential treatment. Separately, as a registered clearing agency, FICC must submit the Proposed XM Agreement and Service Level Agreement in a rule filing with the Securities and Exchange Commission (“SEC”). Thus, the Proposed XM Agreement and Service Level Agreement will not be executed and may not be implemented until approval is received from the SEC or they otherwise become effective under the Securities Exchange Act of 1934.

As further explained below, the Proposal will benefit clearing members and the overall financial markets by: (1) expanding the scope and efficiency of the margin offsets that are available to clearing members under the current cross-margining arrangement, thus reducing their trading costs and allowing for more efficient capital usage; (2) improving the efficiency and effectiveness of the existing default management framework; and (3) encouraging greater utilization of clearing, thereby facilitating systemic risk reduction. This submission shall become effective on September 1, 2023. CME intends to implement the Proposal following the receipt of all required regulatory approvals by CME and FICC and upon a date agreed between CME and FICC.

I. Background

As the Commission is aware, CME and FICC currently have a cross-margining arrangement in place which is governed by a cross-margining agreement between CME and FICC dated January 2, 2004, as amended (the “Current Agreement”).¹ Under the Current Agreement, each of CME and FICC holds and manages its

¹ The Current Agreement has been amended by Amendment No. 1 dated October 11, 2005, Amendment No. 2 dated February 5, 2007, Amendment [No. 3] dated February 28, 2011 and Amendment No. [4] dated June 9, 2014. Appendix A of the Current Agreement was most recently amended on June 9, 2014. The notice provisions of the Current Agreement for CME and FICC were amended on February 28, 2011, February 3, 2016 and March 11, 2016, respectively. The current version of the Current Agreement is available at www.dtcc.com/legal/rules-and-procedures.aspx.

own positions and collateral, and independently determines the extent to which a cross-margining participant's eligible positions will be made available for cross-margining after internal offsets (referred to as the "residual positions"). The Current Agreement contemplates such cross-margining participants to include both (i) entities that are clearing members of both FICC and CME ("Joint Clearing Members") and (ii) pairs of clearing members where one is a clearing member of CME and has an affiliate that is a clearing member of FICC ("Cross-Margining Affiliates"). The offsetting residual positions are allocated to different "offset classes" (i.e., maturity buckets) specified separately for CME and FICC positions. A margin amount is calculated for the residual positions in each offset class by using the lower of the applicable CME or FICC margin rate.² A disallowance factor limits the amount of margin offset (reduction) allowed between a given CME and FICC offset class. Based on these disallowance factors, margin offsets are determined for each offset class. The sum of these margin offsets gives the amount by which a cross-margining participant's margin requirement may be reduced at CME and at FICC, which amount is referred to as the cross-margining reduction.

CME and FICC each guarantee a cross-margining participant's performance to each other up to a specified maximum amount that relates back to the cross-margining reduction and the results of liquidating the participant's positions and ultimately its collateral. The guaranty represents a contractual commitment each clearing organization has to the other.

A default by a cross-margining participant triggers the loss sharing provisions of the Current Agreement and determines the guaranty payments, if any, that will flow between the CME and FICC. These provisions generally provide that if CME or FICC has a net loss (the "worse off party") and the other party has a net gain, no loss or a smaller loss (the "better off party"), then the better off party must pay the worse off party the smallest of: (i) the worse-off party's net loss; (ii) the better-off party's net gain; or (iii) the amount required to equalize their gains or losses.

The Current Agreement also contains a "cross-guaranty" provision which does not directly relate to cross-margining. This provision reflects the view that excess collateral of a defaulting cross-margining participant should initially remain with the clearing organizations, if needed, to cover all of their losses. Under this provision, if, after the cross-margining related guaranty payments described above are made, one of the clearing organizations has a remaining surplus and the other has a remaining loss, the surplus must be paid by the former to the latter.³

II. The Proposed XM Agreement

In general, CME and FICC are seeking to update the Current Agreement and arrangements to improve efficiency and reduce risk by: (x) enhancing the modeling and margining of correlation risk; (y) requiring more frequent exchange of position information to collateralize risk exposures; and (z) improving the default management process through joint liquidation of the combined portfolio. The primary changes contained in the Proposed XM Agreement and Service Level Agreement are as follows:

Margin calculation/better timing

The Proposed XM Agreement would revise the method for calculating the margin reduction that would apply to a cross-margining participant's eligible positions. Like the Current Agreement, the Proposed XM Agreement covers both Joint Clearing Members and Cross-Margining Affiliates.

² CME and FICC use different margin rates to establish margin requirements for their respective eligible products. Margin reductions under the Current Agreement are always computed based on the lower of the applicable margin savings percentages. This methodology results in a potentially lesser benefit to the participant but ensures a more conservative result (i.e., more collateral held at the clearing organization) for CME and FICC.

³ Each clearing organization's obligation to make such cross-guaranty payment is subject to its prior obligation to make payments under certain other loss sharing agreements to which it is a party.

Under the Proposed XM Agreement, eligible positions will be identified separately from the rest of the participant's positions at CME or FICC. CME and FICC would then calculate the difference between the margin that it would require a cross-margining participant to deposit with respect to its eligible positions in the absence of cross-margining and the amount of margin it would require such participant to deposit if the combined portfolio of the participant's CME and FICC eligible positions were held in its account, with each clearing organization using its own margin methodology. CME and FICC will each determine the percentage of margin savings that would be derived by margining these positions as a combined portfolio and compare their respective margin savings percentages. CME and FICC will then reduce the amount of margin required to be deposited by such participant at CME and FICC, respectively, by the lower of such margin savings percentages, thereby applying a degree of conservatism in their approach.

Default Management

Under the Proposed XM Agreement, CME and FICC would coordinate the liquidation of a Cross-Margining Participant by applying the following default management process. First, CME and FICC would attempt to jointly liquidate the combined portfolio, and any losses or gains arising from such liquidation would be shared by CME and FICC in proportion to each clearing organization's relative share of the cross-margin requirement in the manner described below. As a result, the default management process would be streamlined by making clear that a joint liquidation would be the preferred method used by the clearing organizations in the event of a member default. A joint liquidation is optimal because it maximizes the efficiency and effectiveness of the liquidation process by enabling each clearing organization to recognize reduced risk by offsetting risk positions together. If either CME or FICC determines that jointly liquidating the relevant positions is not feasible or advisable, such clearing organization ("X") may, upon written notice to the other clearing organization ("Y"), offer to assume the relevant positions at the last settlement price for such positions immediately prior to the time such offer is made and receive any remaining collateral relating thereto from Y. If such an assumption occurs, then no further loss (or gain) sharing would be required under the Proposed XM Agreement. Finally, as a last resort if a clearing organization determines that neither of the foregoing are feasible or advisable, then the parties will liquidate the relevant positions separately and share any gains or losses in the manner described below.

The Proposed XM Agreement also provides that if one clearing organization (the "first clearing organization") suspends a defaulting cross-margining participant but the other clearing organization (the "second clearing organization") determines not to do so, then the second clearing organization must require the defaulting participant to pay the second clearing organization the sum of its margin reductions at both clearing organizations within one hour. If such payment is made, then the second clearing organization must pay the first clearing organization the amount of such participant's margin reduction at the first clearing organization. After the second clearing organization makes such payment, the second clearing organization will not have any further loss sharing obligations to the first clearing organization under the Proposed XM Agreement. If the second clearing organization does not receive such amount from the defaulting participant within this timeframe, then the second clearing organization must also suspend the defaulting cross-margining participant.

Loss Sharing

The Proposed XM Agreement provides for two types of loss sharing. First, the Proposed XM Agreement expressly provides that from the time a cross-margining participant defaults until the time such default is resolved, a clearing organization that owes variation margin to the defaulting participant with respect to its eligible positions may, under certain circumstances, be obligated to pay some or all of such amount to the other clearing organization to the extent such clearing organization is owed variation margin by the defaulting participant with respect to such positions. After a default is resolved, the Proposed XM Agreement provides for loss sharing arrangements, which vary depending upon whether the clearing organizations engage in a joint liquidation or

pursue separate liquidations. In a joint liquidation, the clearing organizations would determine whether the sum of their individual net gains and net losses result in a combined net gain or net loss. The clearing organizations would then allocate any combined net gain or net loss *pro rata* based on each clearing organization's share of the cross-margining requirement (i.e., the ratio of (i) the margin required for the XM account at the clearing organization to (ii) the total XM margin requirement across both clearing organizations). If a clearing organization determines that it is not feasible or advisable to resolve the default pursuant to a joint liquidation or a buy-out and the clearing organizations instead proceed to liquidate the respective positions separately, then gains or losses would be shared on a "better off/worse off" basis. Specifically, if CME or FICC has a net loss (the "worse off party") and the other party has a net gain (the "better off party"), then the better off party must make a guaranty payment to the worse off party which is equal to the lesser of: (i) the worse-off party's net loss; or (ii) the better-off party's net gain. Under the foregoing scenarios, the defaulting cross-margining participant will become obligated to reimburse the guarantor clearing organization for the amount of the guaranty payment. Unlike the Current Agreement, the Proposed XM Agreement does not contain a general "cross-guaranty" provision.

Eligible Positions

Under the Current Agreement, products eligible for cross-margining are those products agreed between the parties and identified within an appendix to the Current Agreement. The only interest rate futures and options contracts that are currently eligible for cross-margining under the Current Agreement are Eurodollar contracts listed on CME and certain U.S. Treasury contracts listed on the Chicago Board of Trade Incorporated. Under the Proposed XM Agreement, eligible products will similarly be determined, and subject to amendment, by mutual agreement between the parties. However, initially, the Proposed XM Agreement will expand the list of eligible products to include additional interest rate futures cleared by CME, which are set forth in Exhibit A to the Proposed XM Agreement. Eligible products cleared at FICC would not change and would remain comprised of all U.S. Treasury securities cleared by FICC's Government Securities Division ("GSD"), as set forth in Exhibit B to the Proposed XM Agreement.

Clearing Member Agreements

Under the Current Agreement, eligible cross-margining participants are required to enter into a Proprietary Cross-Margin Account Agreement for Clearing Members—in the case of Joint Clearing Members—or Proprietary Cross-Margin Account Agreement (Pairs of Affiliated Clearing Members)—in the case of Cross-Margining Affiliates (collectively, the "Participant Agreements"). Under these Participant Agreements, the Joint Clearing Member or Cross-Margining Affiliates agree to, among other things, be bound by CME's and GSD's applicable rules and by the provisions of the Cross-Margining Agreement between FICC and CME, as any of the foregoing may be in effect from time to time. Under the Proposed XM Agreement, the Participant Agreements have been updated to make edits which are clarifying in nature and to conform the Participant Agreements to the Proposed XM Agreement. Further edits were made to ensure appropriate treatment of the parties under a default scenario. Existing participants will be required to sign new Participant Agreements.

Service Level Agreement

Under the Current Agreement, CME and FICC share position and risk information once per day. Under the Proposed XM Agreement, CME and FICC will streamline their operational processes by entering into a separate Service Level Agreement to set forth the form and manner in which position and margin information must be communicated between the parties. Among other things, the Service Level Agreement will require more frequent and timely exchange of such information, including on an intraday basis, which will help ensure that margin reductions are based on the most current information available.

CME Clearing has reviewed the derivatives clearing organization core principles (“Core Principles”) as set forth in the Commodity Exchange Act (“CEA” or “Act”) and identified that the updates reflected in the Proposed XM Agreement and the Service Level Agreement may have some bearing on the following principles:

- DCO Core Principle D – Risk Management: The Proposed XM Agreement would revise the method for calculating the margin reduction that would apply to a cross-margining participant’s eligible positions by utilizing calculations derived from CME and FICC’s approved risk models. This change represents an improvement over the current process because these models capture correlations at a more granular position level and dynamically adjust to capture changes in correlations over time. In addition, by utilizing the lesser of CME’s or FICC’s margin savings percentage as the basis for applying this reduction, this approach is designed to consistently yield prudential margin requirements in differing market environments. Further, the more timely and frequent information exchange requirements required under the Service Level Agreement would ensure that the margin requirements generated under the Proposed XM Agreement are based on the most current position information available. As a result, the Proposed XM Agreement and Service Level Agreement are consistent with Core Principle D because they serve to enhance CME’s ability to manage the risks associated with cross-margining through the use of more effective risk management tools and procedures.
- DCO Core Principle B – Financial Resources: The Proposed XM Agreement requires the parties to exchange variation margin that may be owed to a defaulting cross-margining participant under certain circumstances during the liquidation period. This provision thus enhances CME Clearing’s ability to manage its liquidity risk consistent with CFTC Regulation 39.11(e).
- DCO Core Principle G – Default Rules and Procedures: The Proposed XM Agreement promotes compliance with Core Principle G by setting forth a specific default management waterfall which prioritizes the joint liquidation of a cross-margining participant’s eligible positions. Such joint liquidation would be conducted pursuant to default management guidelines adopted by CME and FICC which would require CME and FICC to conduct joint default management drills in order to confirm the efficacy of these guidelines. Further, CME’s buy-out option embedded in the default management waterfall may serve to reduce the adverse selection risk that is inherent in the liquidation of a portfolio during stressed market conditions by eliminating the need for a clearing organization to hedge its portfolio risk by effecting open market transactions.
- DCO Core Principle R – Legal Risk: The revisions to the Proposed XM Agreement provide legal certainty as to the operation of the XM Program by reflecting the agreed operational processes between the parties in an efficient manner through the creation of the Service Level Agreement. This will provide for more operational transparency between the parties and permit them to address their changing operational needs and capabilities in a more efficient manner.

CME Clearing has requested confidential treatment with respect to Proposed XM Agreement and the Service Level Agreement, which have been submitted concurrently with this submission under separate cover. The Proposed XM Agreement includes the following as exhibits: Proprietary Cross-Margin Account Agreement for Clearing Members (Joint Clearing Member) and the Proprietary Cross-Margin Account Agreement (Pairs of Affiliated Clearing Members).

Pursuant to Section 5c(c) of the CEA and CFTC Regulation 40.5(a), CME Clearing certifies that the Proposal complies with the Act and regulations thereunder. There were no substantive opposing views to the Proposal.

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

Should you have any questions or require more information concerning the above, 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

Attachments: Exhibit A – Amended and Restated Cross-Margining Agreement (attached under separate cover and confidential treatment requested)

Exhibit B – CME-FICC Cross-Margining Service Level Agreement (attached under separate cover and confidential treatment requested)

Exhibit A and Exhibit B

(CONFIDENTIAL TREATMENT REQUESTED)

(ATTACHED UNDER SEPARATE COVER)