



Jason Silverstein
Director and Associate General Counsel
Legal Department

February 28, 2012

VIA E-MAIL

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

**RE: Portfolio Margining of IRS and Interest Rate Futures; IRS Guaranty Fund Allocation Amendments; IRS Guaranty Fund Application Amendments; IRS Clearing Member Outsourcing
CME Submission No. 12-061R**

Dear Mr. Stawick:

Chicago Mercantile Exchange Inc. ("CME"), The Board of Trade of the City of Chicago, Inc. ("CBOT") and The New York Mercantile Exchange, Inc. ("NYMEX") (collectively, the "Exchanges") pursuant to Commodity Futures Trading Commission (the "Commission Regulation 40.6(a) hereby notifies the Commission of certain new rules and rule amendments relating to our offering for cleared interest rate swaps ("IRS"). The changes will be effective March 14, 2012 pending other regulatory approvals. The original submission did not clearly identify proprietary portfolios as the only eligible portfolios for the Program at this time. The clarifications are contained in Section 1 below. Additionally a presentation of the framework of the Program is provided as Exhibit 1B. A blacklined copy of this submission letter against the original submission letter is attached as Annex A.

1. Portfolio Margining among Eligible Futures Products and IRS for Proprietary Positions; Comingling of Related Positions

CME/CBOT are offering a portfolio margining program (the "Program") for proprietary portfolios containing Interest Rate Swaps and Interest Rate Futures positions in order for eligible clearing members to receive risk offsets across our listed interest rate futures and cleared interest rate swap product suite.

To participate in the Program a Clearing Member must be both an IRS Clearing Member and a CME/CBOT Clearing Member. The listed interest rate products that will be eligible for this program will be those with price risks that are significantly and reliably correlated, initially Eurodollar and Treasury futures. Additionally, the Clearing House has the right to ask a participant to move futures positions in eligible products back to the participant's futures account if it is not risk reducing.

The 99% 5-day Historical VaR margin model with EWMA weighting that is currently used for IRS products will be extended to include the same level of coverage for commingled portfolios and the existing default management process for interest rate swaps will be extended to portfolios which have commingled positions. Any losses for commingled portfolios exceeding the margin on hand of a defaulted member will be backed CME's financial safeguards package for Interest Rate Swaps.

A presentation of the framework for the Program is attached as Exhibit 1B hereto.

New CME Rule 8G831 and related change to CME/CBOT/NYMEX Rule 802 are reflected on Exhibit 1A attached hereto.

2. CME Rule 8G07.1 - Changes to IRS Guaranty Fund Allocation

CME is implementing certain changes to the allocation of the IRS Guaranty Fund among IRS Clearing Members. Currently the IRS Guaranty Fund is calculated monthly and is proportionally allocated to each IRS Clearing Member the basis of its 90-day trailing average of its potential residual loss and 90-day trailing average of its gross notional open interest outstanding at the Clearing House. CME Clearing is proposing to change the measurement period from 90 days to 30 days in order for the IRS Guaranty Fund to more quickly react to an IRS Clearing Member's current activity and to align the measurement period with the frequency of Guaranty Fund calculations.

Additionally, Each IRS Clearing Member's contribution to the IRS Guaranty Fund is currently the greater of its proportional share of the IRS Guaranty Fund as described above and a \$50MM minimum contribution. The minimum was established to ensure that each IRS Clearing Member has an appropriate stake in proper default management regardless of the firm's position and incentivize a better default auction process. The result of the minimum requirement is that the IRS Guaranty fund is over-collateralized above the conservative estimates of our IRS Guaranty Fund methodology. The proposed amendments would size the IRS Guaranty Fund to the shortfall brought by the two largest net debtors and adjust each firm's contribution on that basis.

The amendments to CME Rule 8G07.1 are attached as Exhibit 2 hereto.

3. Rule 8G802.B - Seniorization and Subordination of IRS Guaranty Fund

In order to provide appropriate incentive for IRS Clearing Members to submit aggressive bids during an auction for a defaulted IRS Clearing Member's portfolio, CME is modifying the application of the IRS Guaranty Fund on the basis of each IRS Clearing Member's bidding during the auction process. Where a defaulted IRS Clearing Member has a portfolio of IRS denominated in multiple currencies, CME will split such portfolio by currency and separately hedge and auction the resulting split portfolios. IRS Clearing Members with open interest in a currency being auctioned is required to provide a bid for the auctioned portfolio. Each bid will be assessed for quality within the respective auction and a portion (or all) of such IRS Clearing Member's deposit to the IRS Guaranty Fund will be subject to seniorization (if such IRS Clearing Member provides the winning bid) and subordination (if such IRS Clearing Member provided an off market price). The amount subject to such seniorization/subordination for an auction will be based on a percentage determined for such IRS Clearing Member at the time of the related auction in accordance with our IRS default management procedures. Any IRS Guaranty Fund deposits that are subordinated will be allocated pro rata to IRS Losses after the CME corporate contribution and prior to any non-subordinated/seniorized deposits. Any contributions that are not seniorized or subordinated in accordance with above formula. will be allocated pro rata to IRS losses after all subordinated amounts and prior to any seniorized amounts.

The amendments to Rule 8G802.B are attached as Exhibit 3.

4. New Rule 8G04.3 – Outsourcing to third parties

In connection with the Commission's final rules for Derivatives Clearing Organization General Provisions and Core Principles relating to Core Principle G (Default Rules and Procedures) the Commission implemented Regulation 39.16 which includes a requirement that DCO's permit clearing

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members to outsource certain obligations to qualified third parties. To codify CME's practice of permitting eligible arrangements for IRS, CME is adopting new CME Rule 8G04.3.

New CME Rule 8G04.3 is reflected on Exhibit 4 attached hereto.

The text of the proposed changes is reflected on the attached Exhibits, with additions underlined and deletions ~~stricken through~~.

The Exchanges certify that these changes comply with the Commodity Exchange Act and the regulations thereunder, including the core principles of Financial Resources, Participant and Product Eligibility, Risk Management and Default Rules and Procedures by maintaining adequate resources and risk management in the event of a default of an IRS Clearing Member and appropriately allocating the IRS Guaranty Fund among IRS Clearing Members. There were no substantive opposing views.

The Exchanges certify that this submission has been concurrently posted on CME Group's website at <http://www.cmegroup.com/market-regulation/rule-filings.html>

If you require any additional information regarding this submission, please contact Sasha Rozenberg at 212-299-2106 or via e-mail at sasha.rozenberg@cmegroup.com, or contact me at 212-299-2228. Please reference our CME/CBOT/NYMEX Submission No. 12-061R in any related correspondence.

Sincerely,

/s/ Jason Silverstein
Director & Associate General Counsel

Attachments

EXHIBIT 1A

New CME Rule 8G831 COMMINGLING OF ELIGIBLE 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 on the basis that the price risks with respect to such products are significantly and reliably correlated (such products, "Commingling Eligible Futures Products"). Eligible Clearing Members may elect that any of their house positions in Commingling Eligible Futures Products be commingled with IRS Contracts for margin purposes 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. If the Clearing House determines that any Commingled 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 Positions. In the event of a default by an Eligible Clearing Member, Commingled Futures Positions will be subject to the default management procedures of IRS Products.

Upon the occurrence of an IRS Termination Event, Commingled Futures Positions of non-defaulted IRS Clearing Members will be removed from the associated IRS accounts of such IRS Clearing Member and moved to relevant Base Guaranty Fund Product accounts of such Clearing Member.

"Commingled 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 Rule 8G802.A, except as otherwise provided therein, the term "IRS Contracts" shall include Commingled Futures Positions.

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

CME/CBOT/NYMEX Rule 802.A. Default by Clearing Member or Other Participating Exchanges

The Clearing House shall establish a guaranty fund (the "Base Guaranty Fund") for products other than CDS Products, IRS Products and any positions commingled with IRS Contracts pursuant to Rule 8G831 (such products, the "Base Guaranty Fund Products" and each product, a "Base Guaranty Fund Product Class"). Each clearing member shall contribute to the Base Guaranty Fund in accordance with the requirements of Rule 816.....

EXHIBIT 1B

Portfolio Margining

CONFIDENTIAL

EXHIBIT 2

Rule 8G07.1 IRS FINANCIAL SAFEGUARDS AND GUARANTY FUND DEPOSIT

(i) The Clearing House shall establish a financial safeguards package to support IRS clearing, and each IRS Clearing Member shall make an IRS Guaranty Fund deposit with the Clearing House. An IRS Clearing Member's deposit to the IRS Guaranty Fund and assessments against it pursuant to these Rules may be used to cover losses incurred by the Clearing House if a defaulted IRS Clearing Member's assets, including amounts available pursuant to any guarantee from an Affiliate of an IRS Clearing Member, available to the Clearing House are insufficient to cover such loss, regardless of the cause of default. The Clearing House shall calculate the requirements for the IRS financial safeguards package, which shall be composed of:

(a) a funded portion, determined by the Clearing House using stress test methodology equal to the theoretical two largest IRS Clearing Member losses produced by such stress test or such other methodology determined by the IRS Risk Committee (such amount, the "IRS Guaranty Fund"), and

(b) an unfunded portion, determined by the Clearing House using stress test methodology equal to the theoretical third and fourth largest IRS Clearing Member losses produced by such stress test (and assuming for purposes of the model that already-defaulted IRS Clearing Members will fail to contribute) or such other methodology determined by the IRS Risk Committee. Upon a default, after application of the IRS Guaranty Fund, each IRS Clearing Member (excluding any insolvent or defaulted IRS Clearing Member) shall be subject to assessment of its previously-assigned proportionate share of such amount (collectively the "IRS Assessments").

(ii) Each IRS Clearing Member's minimum contribution to the IRS Guaranty Fund shall be the greater of:

(a) such IRS Clearing Member's proportionate share of the IRS Guaranty Fund based on the 30-day trailing average of its potential residual loss and the 30-day trailing average gross notional open interest outstanding at the Clearing House (or in either case, such other shorter time interval determined by the IRS Risk Committee); or

(b) \$50,000,000 for a non-Affiliated IRS Clearing Member or (y) \$25,000,000 for each Affiliated IRS Clearing Member, where one Affiliated IRS Clearing Member provides its primary clearing services for customers as a FCM with any proprietary business of such FCM only incidental to providing such clearing service for customers and the other Affiliated IRS Clearing Member only provides IRS clearing services through its proprietary account for itself and its Affiliates. An "Affiliated IRS Clearing Member" shall mean an IRS Clearing Member with an Affiliate that is also an IRS Clearing Member.

EXHIBIT 3

Rule 8G802.B- APPLICATION OF CLEARING HOUSE AND NON-DEFAULTING IRS CLEARING MEMBER CONTRIBUTIONS

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

- (i) First, the corporate contribution of CME for IRS Products (the "CME IRS Contribution"), which shall equal \$100,000,000;
- (ii) Second, the IRS Guaranty Fund (excluding the contribution of the defaulted IRS Clearing Member), which shall be applied in the following manner:
 - (a) the IRS Guaranty Fund contribution of a Category 1 Bidder (if any) will be applied first up to an amount equal to the Aggregate Subordinated Amount for such Category 1 Bidder and where there is more than one Category 1 Bidder, an amount of the IRS Guaranty Fund of each Category 1 Bidder equal to the relevant Aggregate Subordinated Amount will be applied *pro rata* until the entire IRS Loss is allocated; then, to the extent not all IRS Losses have been applied after application pursuant to this sub-section (a);
 - (b) the (remaining) IRS Guaranty Fund of all Clearing Members (excluding an amount of the IRS Guaranty Fund of each Winning Bidder equal to the Aggregate Seniorized Amounts for such Winning Bidders) will be applied *pro rata* until the entire IRS Loss is allocated; then, to the extent not all IRS Losses have been applied after application pursuant to this sub-section (b); and
 - (c) the (remaining) IRS Guaranty Fund of all Winning Bidders will be applied *pro rata*;
- (iii) Third, IRS Assessments against all IRS Clearing Members (excluding any defaulted IRS Clearing Members), which shall be assessed against each non-defaulted IRS Clearing Member *pro rata* in proportion to their required contributions to the IRS Guaranty Fund in accordance with Rule 8G07. Assessments against non-defaulted IRS Clearing Members shall be subject to a maximum of the maximum IRS Assessment assigned to such IRS Clearing Member pursuant to Rule 8G07 at the time of the default, and also subject to the limits set forth in Rule 8G802.H in the case of multiple successive defaults.

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

As used herein.

"Auction Portfolio" has the meaning given to it in the IRS Default Management Guidelines.

"Aggregate Subordinated Amount" has the meaning given to it in the IRS Default Management Guidelines.

"Aggregate Seniorized Amount" has the meaning given to it in the IRS Default Management Guidelines.

"Bid Ratio" has the meaning given to it in the IRS Default Management Guidelines.

"Category 1 Bidder" means an IRS Clearing Member designated by the Clearing House pursuant to the IRS Default Management Guidelines as having (a) not submitted a Valid Bid or (b) submitted a bid with a Bid Ratio equal to or greater than 50% in each case in respect of a Competitive Auction.

"Competitive Auction" has the meaning given to it in the IRS Default Management Guidelines.

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

"Valid Bid" has the meaning given to it in the IRS Default Management Guidelines.

"Winning Bidder" means, in respect of each Auction Portfolio, the IRS Clearing Member(s) designated as such by the Clearing House at the end of a Competitive Auction in respect of such Auction Portfolio.

EXHIBIT 4

New CME Rule 8G04.3:

An IRS Clearing Member and any applicant for IRS clearing membership shall be engaged in or demonstrate immediate capacity to engage in the conduct of the business of a IRS Clearing Member and to perform all other obligations of a IRS Clearing Member as described or referenced in these Rules or in the IRS Manual; provided that, in the event that a IRS Clearing Member does not have the capabilities to perform such responsibilities or obligations, such IRS Clearing Member may contract with a third party (including an Affiliate) to fulfill certain operational or risk requirements; provided that all agreements relating to such service shall be subject to the prior review and approval by the Clearing House staff and consultation with the IRS Risk Committee. The Clearing House may impose limitations on IRS Clearing Member utilization of service providers, including limitations on the number of IRS Clearing Members to which a service provider may provide services.

ANNEX A



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Sincerely,

/s/ Jason Silverstein
Director & Associate General Counsel

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