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Sean M. Downey
Associate Director and Assistant General Counsel
Legal Department

October 14, 2011

VIA E-MAIL

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

Re: Section 5c(c)(1), Rule 40.6(a) – Exchange Certification of CME's Change From "Collateralization Mark to Market" to "Cash Mark to Market" Performance Bond Method for Cleared OTC USD/CLP Spot, Forward and Swap Transactions

CME Submission 11-377

Dear Mr. Stawick:

Chicago Mercantile Exchange Inc. hereby notifies the Commission that effective on Monday, October 31, 2011, CME will change from a "collateralization" to "cash mark to market" performance bond method for Cleared OTC USD/CLP Spot, Forward and Swap Transactions, also known as non-deliverable forwards (NDF). This submission includes the description supporting the implementation of the new performance bond administration procedures, which are summarized as follows.

Performance Bonds & Daily Cash Mark to Market - Based upon client input and demand, CME is changing the CME Rulebook Chapter 274H Cleared OTC U.S. Dollar / Chilean Peso (USD/CLP) Spot, Forward and Swap Transactions product (Chapter 274H) performance bond (margin) regime from a "collateralization mark to market" to a "cash mark-to-market" method (there is no open interest to date). This change is consistent with the new margining system described in CME Submission 11-360, dated Thursday, September 22, 2011, where CME notified the Commission of the planned rollout of 26 new foreign exchange (FX) pairs for over-the-counter (OTC) cash settlement CME WM/Reuters spot, forward and swap transactions, and 11 new FX pairs for traditional OTC cash settlement non-deliverable forward (NDF) transactions. In that submission CME informed the Commission it would be changing the Cleared OTC USD/CLP products currently listed from "collateralization mark to market" to "cash mark to market," analogous to the 37 new products proposed. This is a change in operational procedures only; there are no CME Rulebook changes needed.

CME Clearing has deployed the SPAN system to establish performance bond or "margin" requirements for OTC USD/CLP spot, forwards and swaps. Initial performance bond requirements are established at levels that are consistent with observed levels of volatility in the particular currency pairing and generally aligned with initial margin levels applied to current CME FX futures and option contracts, where applicable, which is not the current case with the cleared OTC USD/CLP products, where there is no USD/CLP futures contract. These risk components of the clearing system are unchanged with implementation of "cash mark to market" rather than "collateralization mark to market." However, please note the administration of the new margin regime will require a daily mark-to-market (MTM) on a cash basis, similar to traded FX futures.

Variation margins may be satisfied with the posting of appropriate amounts of collateral, where CME Clearing collects and pays in cash between the counterparties each day.

CME Clearing will accept as collateral cash or any other instruments currently designated as approved collateral for posting for performance bonds. In order to calculate variation requirements, settlement prices are established for each contract and for each delivery date referencing data collected from a variety of market sources. Appendix 1 is a detailed description of the "cash mark to market" method of performance bond administration. The difference between current "collateralization mark to market" and "cash mark to market" is explained.

Pursuant to CFTC regulations, this change in the applicable performance bond regime from "collateralization mark to market" to "cash mark to market" has been interpreted by CME as having the impact of a CFTC Part 40.6 amendment though no change to CME's rulebook is required.

Business staff responsible for the proposed change and the legal department collectively reviewed the derivatives clearing organization core principles ("Core Principles") as set forth in the Commodities Exchange Act ("CEA"). During this review, the following Core Principles were identified as being relevant to this submission:

FINANCIAL RESOURCES—Demonstrate that CME (the derivative clearing organization or DCO) has adequate financial, operational, and managerial resources to discharge the responsibilities of a derivatives clearing organization.

Compliance: As stated previously, there are no rule changes associated with the switch from "collateralization mark to market" to "cash mark to market," however, there are financial impacts associated with this revised performance bond administration regime. CME Clearing has deployed the SPAN system to establish performance bond or "margin" requirements for FX spot, forwards and swaps. Initial performance bond requirements are established at levels that are consistent with observed levels of volatility in the particular currency pairing and generally aligned with initial margin levels applied to current CME FX futures and option contracts, where applicable. These components of the clearing system are unchanged. However, the administration of the new margin regime will require a daily mark-to-market (MTM) on a cash basis, similar to traded FX futures. Variation margins may be satisfied with the posting of appropriate amounts of collateral, where CME Clearing collects and pays in cash between the counterparties each day. Therefore, under the "cash mark to market" system, the risk of all open positions held by market participants is evaluated each day and real cash payments are made by CME Clearing to appropriate parties. This system, analogous to margining for futures, is consistent with the requirements of the CEA.

PARTICIPANT AND PRODUCT ELIGIBILITY—CME has established (i) appropriate admission and continuing eligibility standards (including appropriate minimum financial requirements) for members of and participants in the organization; and (ii) appropriate standards for determining eligibility of agreements, contracts, or transactions submitted to CME.

Compliance: Parties to transactions in these Cleared OTC Contracts continue to be limited, in line with Exchange rules, to "eligible contract participants" as defined in Section 1a(12) of the Commodity Exchange Act and existing methods for monitoring compliance with eligibility standards will be utilized by CME in the same fashion as for other similarly situated products.

RISK MANAGEMENT—CME has the ability to manage the risks associated with discharging the responsibilities of a derivatives clearing organization through the use of appropriate tools and procedures.

Compliance: Discussions between CME Clearing and the applicable business staff confirmed that the change from "collateralization mark to market" to "cash mark to market" does not affect CME's ability to manage the risks associated with discharging the responsibilities of a derivatives clearing organization through the use of appropriate tools, procedures and techniques used in other of the Exchange's products.

SETTLEMENT PROCEDURES—CME will have the ability to (i) complete settlements on a timely basis under varying circumstances; (ii) maintain an adequate record of the flow of funds associated with each transaction that the applicant clears; and (iii) comply with the terms and conditions of any permitted netting or offset arrangements with other clearing organizations.

Compliance: CME Clearing and the Settlements Team together manage the daily requirements to evaluate appropriate daily marks to market for all CME products including the Cleared OTC USD/CLP NDF transactions. The cash mark to market of this product is in U.S. dollars and facilitated through the Fedwire. This arrangement has long history of working smoothly.

TREATMENT OF FUNDS—CME will have standards and procedures designed to protect and ensure the safety of member and participant funds.

Compliance: There is no change to CME's standards and procedures to protect and ensure safety of member and participant funds as impacted by the change from "collateralization mark to market" to "cash mark to market."

DEFAULT RULES AND PROCEDURES—CME has rules and procedures designed to allow for efficient, fair, and safe management of events when members or participants become insolvent or otherwise default on their obligations to the derivatives clearing organization.

Compliance: The standard CME financial safeguards continue to apply under the new performance bond administration regime described herein.

SYSTEM SAFEGUARDS—CME demonstrates that it (i) has established and will maintain a program of oversight and risk analysis to ensure that the automated systems of the applicant function properly and have adequate capacity and security; and (ii) has established and will maintain emergency procedures and a plan for disaster recovery, and will periodically test backup facilities sufficient to ensure daily processing, clearing, and settlement of transactions.

Compliance: CME's standard oversight, risk analysis and emergency systems apply to all CME products, including the Cleared OTC USD/CLP NDFs and all other cleared OTC FX products.

The Exchange certifies that these rule amendments and procedures comply with the Act and the rules thereunder and that there were no substantive opposing views to this proposal.

The Exchange certifies that this submission has been concurrently posted on the Exchange's website at http://www.cmegroup.com/market-regulation/rule-filings.html.

Members/shareholders will be notified of the information contained herein in CME Group Special Executive Report, S-5982, dated Tuesday, October 18, 2011.

If you require any additional information regarding this action, please do not hesitate to contact Steve Youngren, at 312-930-4583 or via e-mail at Steve.Youngren@cmegroup.com or me. Please reference our CME Submission #11-377 in any related correspondence.

Sincerely,

/s/Sean M. Downey

Enclosure

20 South Wacker Drive, Chicago, Illinois 60606 T 312 930 8167 F 312 930 3323 sean.downey@cmegroup.com cmegroup.com

Appendix 1

CME Introducing Forwards with Cash Mark-To-Market

In accordance with customer demand CME will begin clearing privately-negotiated transactions in forwards with cash mark-to-market.

Currently, all forwards cleared by CME have a collateralized mark-to-market. Each day, for each open forward trade, mark-to-market is calculated, from original trade price to the current end-of-day settlement price. These amounts are netted together and "collateralized". In other words, if a negative number (a loss), they increase the initial margin (performance bond) requirement, thereby increasing the amount of collateral that must be posted to meet that margin requirement. If a positive number (a gain), they decrease the initial margin requirement.

With cash mark-to-market, the mark-to-market value for the previous clearing business date is subtracted from the mark-to-market amount for the current clearing date. These amounts are netted down and become part of the total banked cash flow for the currency in which they are denominated. It's a very simple change.

There is one additional feature for FX forwards, and in particular for Non-Deliverable Forwards (NDF's) – forwards where one currency of the pair is not bankable. We call this a forward where the cash mark-to-market is flipped, or inverted.

Take for example a forward on the exchange rate between the US Dollar (USD) and the Chilean Peso (CLP). The quantity is specified in USD, and the price is quoted as a specified amount of CLP per one USD. Normally, the mark-to-market amount would be denominated in CLP, also referred to as the contra currency. But with the flipped mark-to-market, the amount is converted to USD by dividing by today's end-of-day settlement price for the contract.

Calculating Mark-to-Market and change in Mark-to-Market

In the normal case, the mark-to-market amount for a forward is calculated as:

- Subtract the original trade price from the end-of-day settlement price.
- Express the trade quantity as a positive number for a buy or a negative number for a sell.
- Take the product of the price difference, the trade quantity, the contract value factor, and the discount factor.
- Round normally to the normal precision of the currency in which the mark-to-market amount is denominated. (the contra currency for an FX forward)

In other words:

$(S - T) * Q * CVF * DF$

Where:
S is the end-of-day settlement price
T is the original trade price
Q is the trade quantity
CVF is the contract value factor
DF is the discount factor.

In the inverse case, the mark-to-market amount is calculated in the exact same way, except that it includes a division by the daily settlement price:

- Subtract the original trade price from the end-of-day settlement price.
- Express the trade quantity as a positive number for a buy or a negative number for a sell.
- Take the product of the price difference, the trade quantity, the contract value factor, and the discount factor.
- Divide this result by the end-of-day settlement price.
- Round normally to the normal precision of the currency in which the mark-to-market amount is denominated. (the primary currency for an FX forward)

In other words:

[(S – T) * Q * CVF * DF] / S

In either case, the settlement variation amount to be banked is calculated by subtracting the mark-to-market amount for the previous clearing business date from the amount for the current business date.

Cash-Settled and Physically-Delivered Forwards

At maturity, forwards with cash mark-to-market can be either cash-settled or physically-delivered, exactly as for forwards with collateralized mark-to-market.

For a cash-settled forward, at contract maturity (end-of-day on the "clearing settlement date"):

- The mark-to-market amount is set to zero.
- We then calculate the settlement variation amount to be banked exactly as on any other day – by subtracting the previous day's value for mark-to-market from the current day's (zero) value.
- The mark-to-market amount is then calculated one final time – from original trade price to the final settlement price and banked as part of the final settlement of the contract.
- The initial margin requirement is also set to zero, exactly as for any other cash-settled forward or future.
- The next morning the cash moves at the bank, and any collateral deposited to meet the initial margin requirement may be withdrawn.

For a physically-delivered forward, at contract maturity (end-of-day on the clearing settlement date):

- The mark-to-market amount is set to zero.
- We then calculate the settlement variation amount to be banked exactly as on any other day – by subtracting the previous day's value for mark-to-market from the current day's (zero) value.
- The invoice amount, calculated at original trade price, is included in the total amount to be banked.
- On the value date for physical delivery, the position is removed. This causes the initial margin requirement to be set to zero, and any collateral deposited to meet it may be withdrawn.

Data formats

Exactly as before, a forward is denoted with a product type code of **FWD**, and the settlement method is denoted as either **CASH** (for cash-settled) or **DELIV** (for physically-delivered).

There are now three possible values for the "valuation method" for forwards:

- The existing value **FWD** will continue to mean that mark-to-market amounts are collateralized.
- A new value **FWDB** ("forward banked") means a forward with cash mark-to-market.
- A second new value **FWDBI** ("forward banked inverse") will be used for FX forwards with cash mark-to-market where the value is flipped from the contra currency to the primary currency.

Exactly as before, the **FinalSettlCcy** attribute denotes the currency in which the mark-to-market amount is denominated, and the **Ccy** attribute on **Amt** elements also specifies the currency.

Exactly as before, the **FMTM** amount type will denote mark-to-market. For forwards with cash mark-to-market, a new **IMTM** amount type – "incremental mark-to-market" – denotes the change in mark-to-market from the previous clearing business date – in other words, the settlement variation amount.

Exactly as before, the **DLV** amount type represents either the final mark-to-market amount to be banked (for cash settled contracts) or the invoice amount (for physically-delivered contracts.)

To simplify bookkeeping system processing, a new **BANK** amount element represents the total cash to be banked, and a new **COLAT** amount element represents the total amount to be collateralized. (For forwards with cash mark-to-market, the **COLAT** element will always have a value of zero.)

Margining in SPAN

There are no changes to how performance bond (initial margin) requirements are calculated in SPAN for portfolios including forwards with cash mark-to-market. Simply divide the true notional position by the equivalent position factor for the product, round the result up (away from zero) to the nearest integer, and feed the resulting "marginable positions" to SPAN, exactly as before.

Testing opportunities

Forwards with cash mark-to-market are now available for testing in CME's "New Release" environment.
For more information please contact CME Clearing at 312-207-2525.