

December 19, 2008

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

RE: Rules and Certification for Cleared-Only Credit Default Swaps
Pursuant to Regulations 39.4(c)(2) and 40.2
CME Submission #08-185

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Dear Mr. Stawick:

Chicago Mercantile Exchange Inc. ("CME"), pursuant to Commission Regulations 39.4(c)(2) and 40.2, makes this submission to the Commission with regard to plans of the CME clearing house ("CME Clearing"), a registered derivatives clearing organization ("DCO"), to accept for clearing certain credit default swap ("CDS") products that are not traded on a designated contract market or a registered derivatives transaction execution facility. Enclosed is a copy of Chapter 8-F of the CME Rulebook, which sets forth the rules governing clearing and settlement of all over-the-counter ("OTC") derivatives that CME Clearing designates as eligible for clearing, including but not limited to CDS products. CME certifies that the clearing of CDS products and the applicable rules comply with the Commodity Exchange Act and regulations thereunder.

Overview

CME cleared CDS products are intended to bring the safety and efficiency of cleared futures to OTC credit default swaps. CME plans to accept for clearing both index CDS products and single-name CDS products. CME Clearing will be the counterparty to every CME cleared CDS transaction accepted for clearing and will provide all clearing house services, including a mark-to-market function as further described in this submission.

A. Benefits

CME cleared CDS products standardize contract-critical dates (e.g., start dates, last trade dates, expiry dates) and other contract terms. This enables customers who hold positions to liquidate or to adjust positions simply by buying back or selling the relevant contracts. The associated benefits are considerable:

Centralized clearing. CME cleared CDS products will allow users to free up counterparty credit lines. The twice daily mark-to-market process employed by CME Clearing will enhance customer risk management.

Operational efficiencies. Centralized clearing of credit default swaps reduces operational burdens in several ways. Standardization and centralized clearing enables consolidation of collateral management and cash flows and eliminates the need for novations or tear-ups.

Ease of position adjustment. Currently, the only means to completely eliminate the risk of a CDS is to (i) enter into a tear-up agreement with the swap counterparty, or (ii) enter into a novation (*i.e.*, find another entity willing to assume its side of the swap). In either case, the tear-up or the novation must be approved by the bilateral swap counterparty. Centrally cleared CDS products, on the other hand, can be offset by a contra trade.

Reduced documentation. CME cleared CDS products do not require any documentation apart from CME Clearing rules.

B. Continued Compliance with Core Principles

The CME cleared CDS initiative described herein is compliant with DCO Core Principles as enumerated in Section 5b(c)(2) of the Act and Part 39 of Commission Regulations. In particular, Core Principle B requires a DCO to demonstrate “adequate financial, operational, and managerial resources to discharge the responsibilities of a derivatives clearing organization.” Core Principle D requires a DCO to maintain “ability to manage the risks associated with discharging the responsibilities of a derivatives clearing organization through the use of appropriate tools and procedures.”

As further explained below, CME Clearing will deploy the same or enhanced systems, procedures and processes to clear CME cleared CDS products as currently utilized for other transactions cleared by CME. CME Clearing is staffed by over 169 employees, including IT and Audits staff. In the first six months of 2008, CME Clearing processed and cleared over 1.541 billion transactions on behalf of CME and CBOT with an estimated notional value of \$663 trillion for CME products alone.

1. Financial Safeguards Package

CME Clearing’s financial safeguards package is a combination of each clearing member’s collateral on deposit to support its positions, the collateral of its customers to support their positions, CME surplus funds, security deposits and assessment powers. Excluding collateral supporting open positions, whose total is approximately \$122 billion, the total financial safeguards package is nearly \$7 billion, comprised of the following elements:

- CME surplus funds of \$100 million.
- Security deposits of approximately \$1,748,668,000.
- Assessment powers of approximately \$4,808,839,000.

CME’s financial safeguards package is measured and stress tested each month to ensure that CME Clearing can, at a minimum, cover its largest net debtor in addition to smaller defaults in a hypothetical stress-test situation. The stress tests rely upon the largest historical market moves for each product and are performed independently from asset class to asset class. Thus, for example, interest rate stress tests are independent of equity stress tests and energy stress tests. Actual changes to clearing firm contributions to the financial safeguards package are

calculated quarterly. Any changes to financial safeguard policies are reviewed and approved by the Clearing House Risk Committee.

The addition of CME cleared CDS products to the risk pool will not adversely impact the safety and soundness of CME Clearing. First, the collateral requirements for such contracts will appropriately reflect the specific risks of credit default swaps, including jump-to-default and the consequences of a liquidity event caused by the defaults. Second, in accordance with Rule 8F04 of Chapter 8-F of the CME Rulebook, clearing members that clear CME cleared CDS products will be subject to an additional \$5 million security deposit requirement. Third, the calculation of that portion of a clearing member's security deposit that is related to the risk of its CDS position will be scaled upward by a factor of three.

2. Risk Management Procedures

Margining. For cleared CDS products, CME Clearing will utilize concentration margining based on the following risk factors/stress testing scenarios:

- Credit volatility scenarios from 2007/2008.
- Stress test for loss given default of two or more of the most concentrated positions in a portfolio to address concentration risks and the risk of financial distress in single-name instruments.
- Catastrophic credit events to address systematic risk.
- Open-interest concentration risk.
- Cascading effects from single-name credit events referencing CME clearing firms or clearing-firm affiliates (e.g., AIG Clearing Corp. and its parent, AIG Inc.).

CME Clearing also will use the same methodologies for concentration monitoring and margining for CME cleared CDS products as are used for the current product base. Margining of the current product base incorporates additional margin for firms with larger concentrations of positions. A stress test is run every night on each clearing member's customer and house portfolios. The stress test hypothetically moves futures contracts by 150 percent of their current margin requirement. For example, the current margin on an S&P 500 future is 90 points so the stress test moves the future up and down by 135 points and reprices all the S&P options based on those moves. The scenario generating the largest loss for each product group is used to test whether additional concentration margins will be applied.

If the stress-test result for a given product group exceeds the clearing member's excess adjusted net capital or \$500 million and the average of its three highest pays over the previous year, the total margin requirement for that product group is increased by ten percent. If the stress-test result for a given product group exceeds two times the clearing member's excess adjusted net capital or \$1 billion and the average of its three highest pays over the previous year, the total margin requirement for that product group is increased by 25 percent.

In addition, CME Clearing will monitor concentrations as reflected in percent of open interest for a given obligor controlled by a single clearing firm or large trader, and will assess additional margin to reflect the incremental exposures deriving from these concentrations.

Stress testing. CME Clearing conducts a multitude of stress tests on its existing product base. Stress tests currently employed include the following:

- On a daily basis, all clearing member positions are subjected to significant hypothetical market moves in the stock index, interest rate, currency, energy, metals and agricultural complexes at various levels exceeding the current performance bond requirements in these products as well as at levels that equal the largest historical market moves for the instruments. Hypothetical gains and losses, incorporating full option revaluation, are calculated for each clearing firm's segregated and house (non-segregated) clearing-level portfolio.
- On a daily basis, customer account level portfolios are also subjected to significant hypothetical market moves in the stock index, interest rate, currency, energy, metals and agricultural complexes to evaluate hypothetical gains/losses relative to clearing member capital.
- On a monthly basis, all clearing member positions are subjected to hypothetical major market moves in the stock index, interest rate and currency products to evaluate the firm's access to sufficient liquidity to cover the potential cash flows.
- On a quarterly basis, all clearing member positions are subjected to hypothetical dramatic moves in the stock index, currency and interest rate products. CME Clearing coordinates market scenarios with the Options Clearing Corporation and combine and jointly review the results.
- As needed, portfolios of individual clearing members are stress-tested to evaluate the impact of changing correlations between products.
- As needed, all clearing member positions are subjected to various additional stress tests based on current market situations.

CME cleared CDS products will be subject to the above types of stress tests. CME Clearing also will perform these tests on hypothetical portfolios of its own creation, which at any given point in time should reflect risk concentrations in the credit markets in general. The inputs will be based on historically generated and internally designed price movements, as applied separately and in combination with each of the following risk factors:

- Systematic – portfolio spread movement.
- Curve – credit curve steepening or flattening.
- Credit Risk Spread – change in investment grade/high yield spreads.
- Sector – risk related to a specific sector.

- Idiosyncratic – single-name reference entity spread movement.
- Liquidity – relative size of bid/offer spreads.
- Basis – relative richness or cheapness of an index relative to its constituents.

The results will be based upon a simulation of each of these factors individually, with the analytical output reflecting the worst-case combination of these stresses. In addition, CME Clearing will run historical simulation results across entire portfolios as well as jump-to-default scenarios for CDS instruments that the market has priced at higher levels of risk.

CME Clearing will integrate the results of these analyses into its current stress-testing dynamics to ascertain the full measure of worst-case losses for all products, including standard futures products. Results from these analyses will be retained in a database, which will allow CME Clearing to track patterns of worst-case outcomes for individual and groups of risk factors, and compare them to actual performance results. In addition, the results of the stress tests will be used in determining margin/collateral requirements, clearing member capital requirements, the size and distribution of the guarantee fund, and similar policy matters. As deemed appropriate, CME Clearing risk management staff will share the results of its stress tests with clearing members and customer accounts whose portfolios have been analyzed in order to ensure that (i) they understand the possible performance outcomes associated with their portfolios, and (ii) they have appropriate risk, financial and contingency controls to effectively manage their activities in the event of worst-case scenarios.

Back testing. CME considers back testing of risk analytics to be a critical component of risk control and intends to perform a series of daily back-tests of both its margin system and of supporting analytics (e.g., stress test results). We will conduct these tests as a continuous comparison of the following information streams:

- Results from the multi-factor risk margin system.
- Results from the stress-test models.
- Actual portfolio performance.

Among other potentially useful information, CME will utilize these back tests to measure the following critical dynamics:

- Consistency of Multi-Factor Risk Margin System in producing results which are in line with associated target confidence intervals.
- Understanding the magnitude, frequency and distribution of performance observations that exceed margin target/confidence interval.
- Accuracy of stress tests in predicting worst-case portfolio outcomes.

- Ensuring that “intermediate calculations” (e.g., movements of credit curves) accurately reflect real-world pricing dynamics.
- Understanding the manner in which margin and stress calculations evolve: over time, across market conditions and at varying levels of product participation.
- Comparison of stress, margin and performance data to dynamics within and across CME Clearing’s existing mix of products.

We will maintain the results of the back tests in a historical database, which will allow for further evaluation of key trends and dynamics on an ex-post basis. The back-test results will provide the primary means for measuring the accuracy and efficacy of margin systems and support analytics and, thus, will provide a critical pathway towards further enhancing the analytical process. CME Clearing will use this information, as appropriate, in determining such matters as margin levels, capital requirements and guarantee-fund policies.

Marking to Market; Settlement Prices. Settlement prices shall be determined each business day for each eligible product based upon pricing data from multiple origins. Sources of pricing data will include: (1) prices of OTC transactions submitted to CME Clearing for clearing; (2) prices of transactions executed on the trading platform of CMDX LLC; and (3) indicative prices contributed by members of the OTC Financial Data Exchange.¹ The pricing data will be processed using standard validation, aggregation and valuation analytics. Updated settlement prices will be made available to clearing members on their open positions on a regular basis (typically twice a day, or more frequently in case of sudden market moves).

Monitoring. CME Clearing will extend its monitoring procedures to CME cleared CDS products. Monitoring of both clearing firms and customer accounts is currently conducted around the clock. Risk staff monitors significant trading activity at any clearing firm 24 hours a day. Unusual trading patterns or volumes are investigated immediately. Customer account reporting allows CME Clearing to view the positions held by individual accounts. The positions of each account are analyzed many times throughout the day in order to monitor any accounts that may have significant losses due to market moves. In addition, significant changes in positions from day to day are analyzed and reported to CME Clearing senior management.

CME Clearing will also include stress testing of the different CDS margin factors to capture moves beyond the one-day 99% standard on the macro and sector moves and the five-day 99% standard for the idiosyncratic shocks. This will be included in framing the financial safeguards package, adding concentration types of margining, and routine stress testing. In addition, as mentioned above, the CDS margin factor parameters will be reviewed on a daily basis as a back-testing procedure to ensure the parameters are providing the desired coverage. CME Clearing will also review on a daily basis the margin collected on CDS portfolios and compare those amounts to next-day market moves so that actual portfolio effects can be determined and gauged against the margin coverage. The concentration of CDS positions will also be

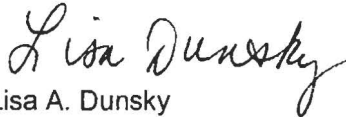
¹ The OTC Financial Data Exchange (“FDE”) is a consortium of major CDS buy-side firms. FDE members share CDS price-indicative information inferred from bids and offers provided by major sell-side participants.

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evaluated beyond the margin factors and compared against overall open interest and liquidity in the CDS market.

Should you require any additional information regarding this matter, please contact me at (312) 338-2483 or via e-mail at Lisa.Dunsky@cmegroup.com. Please reference our CME Submission #08-185 on any future correspondence regarding this submission.

Sincerely,



Lisa A. Dunsky
Director & Associate General Counsel

Cc: Mr. Ananda K. Radhakrishnan (w/ encl.)
Mr. John Lawton (w/ encl.)

Chapter 8-F Over-the-Counter Derivative Clearing

8F01. SCOPE OF CHAPTER¹

This chapter sets forth the rules governing clearing and settlement of all products, instruments, and contracts in Over-The-Counter Derivatives, including, but not limited to, swaps and forward rate agreements, that the Clearing House has designated as eligible for clearing. OTC Clearing Members are also subject to all applicable Rules in the CME and/or CBOT Rulebooks that apply to CME or CBOT Clearing Members as applicable, unless an exemption from such rule has been granted by staff or the Clearing House Risk Committee.²

8F02. DEFINITIONS³

OTC CLEARING MEMBER

An OTC Clearing Member is an entity that has been approved by CME to clear OTC Derivatives. An OTC Clearing Member who is not also a CME or CBOT Clearing Member may not clear CME or CBOT transactions, as applicable, other than OTC Derivatives.

CME and CBOT Clearing Members shall be afforded full rights and privileges to trade and clear OTC Derivatives that are listed for clearing by CME or CBOT, as applicable. This chapter shall be applicable to CME and CBOT Clearing Members and "OTC Clearing Member" shall be deemed to include CME and CBOT Clearing Members in respect to transactions in OTC Derivatives.

OVER-THE-COUNTER ("OTC") DERIVATIVES

Agreements, contracts, or transactions excluded from the Commodity Exchange Act by section 2(c), 2(d), 2(f), or 2(g) of the CEA, or by U.S.C. §§27 to 27f, or exempted under section 2(h) or 4(c) of the CEA, or other over-the-counter derivative instruments (as defined in the Federal Deposit Insurance Corporation Improvement Act of 1991, 12 U.S.C. §4421(2)). OTC Derivatives shall not include FXMS Products.

CLOSE-OUT AMOUNT

The amount of losses and costs of the CME that are or would be incurred by the CME, net of any gains incurred in replacing, or in providing the CME the economic equivalent of the material terms of the terminated OTC Derivatives, net of any gains incurred (if such net amount is positive), including (a) the payments and deliveries that would, absent termination, have been required after the termination date, (b) any option rights in respect of the terminated transactions, (c) all unpaid amounts due to the CME under the terminated transaction less all unpaid amounts due to the Bankrupt Member under the terminated transactions and (d) all related fees, costs and expenses incurred by the CME.

8F03. CLASSIFICATION OF POSITIONS⁴

OTC Derivatives submitted for clearing by an OTC Clearing Member for its proprietary account shall be assigned to and held in a proprietary account of such Clearing Member. All collateral deposited as performance bond to support positions in the proprietary account of an OTC Clearing Member and all variation margin payments made from such account shall be deemed the property of the OTC Clearing Member and shall be subject to the Clearing House's lien and security rights as described in Rule 8F08. OTC Derivatives submitted for clearing for the account of a Clearing Member's customer shall be assigned and held in a Regulation §30.7 account of such Clearing Member. All collateral deposited as performance bond to support positions in such Regulation §30.7 account and all positions, collateral or cash in such account shall be segregated from the Clearing Member's proprietary account.

Notwithstanding the foregoing, if the CFTC issues an order permitting OTC Clearing Members to commingle customer funds used to margin particular OTC Derivatives that are cleared by

¹ Entire chapter was revised April 2008.

² Revised July 2008.

³ Revised July 2008, August 2008.

⁴ Revised July 2008.

⁵ Revised November 2008.

CME with other funds held in CEA Section 4d(a)(2) customer segregated accounts, such positions may be held in the customer accounts of an OTC Clearing Member and, if so held, all collateral deposited as performance bond to support such positions and all variation margin payments made from such accounts shall be comingled with similar property of regulated customers.

8F04. OTC CLEARING MEMBER OBLIGATIONS AND QUALIFICATIONS¹

OTC Clearing Members are subject to all relevant CME and/or CBOT Rules and the Clearing House Manual unless an exemption has been granted by staff or the Clearing House Risk Committee. OTC Clearing Members must execute all agreements and documents required by the Clearing House.

The qualifications and requirements to become an OTC Clearing Member are set forth below. A CME or CBOT Clearing Member is not required to fulfill these requirements.

1. An OTC Clearing Member must be in "good standing" under each applicable regulatory regime to which it is subject at the time it applies for OTC clearing membership and it must maintain its good standing status while it is an OTC Clearing Member.
2. An OTC Clearing Member must be in compliance with all applicable regulatory capital requirements, however, an OTC Clearing Member must maintain a minimum of \$50 million in capital if it only clears agricultural OTC Derivatives and \$300 million in capital if it clears financial (i.e., equity, interest rate, etc.) OTC Derivatives. Staff may grant an exemption to the minimum capital requirement for an OTC Clearing Member that is affiliated with a CME or CBOT Clearing Member. An OTC Clearing Member that is an affiliate of a CME or CBOT Clearing Member must be guaranteed by the CME or CBOT Clearing Member with which it is affiliated unless an exemption is granted by Exchange staff.
3. An OTC Clearing Member applicant shall be engaged in or demonstrate immediate capacity to engage in the conduct of the business of an OTC Clearing Member.
4. An OTC Clearing Member shall maintain a membership-equivalent deposit with CME of at least \$5 million in cash or collateral, which shall be valued in the sole discretion of the Clearing House, to assure performance of all obligations arising out of OTC Derivatives submitted by it to the Clearing House.
5. An OTC Clearing Member shall submit to CME annual audited financial statements as well as all unaudited financial statements provided to its primary regulator within five days after such statements are provided to its regulator. All financial statements shall be in the English language.
6. The books and records of an OTC Clearing Member regarding OTC Derivatives cleared by the Clearing House and any CME or CBOT activities in connection therewith shall be made promptly available for inspection upon request by CME and such books and records shall be subject to reasonable standards of confidentiality.

8F05. SUBSTITUTION²

An OTC Derivative that is executed and submitted to the Clearing House in accordance with the rules governing such transaction shall be accepted by the Clearing House. The Clearing House shall substitute itself as the counterparty to each party to the original transaction. The OTC Clearing Member shall be responsible to the Clearing House for performance of the contract whether executed by that Clearing Member or by an authorized customer of that clearing member. After that substitution, there shall be two equal and offsetting over-the-counter transactions as follows: one between the buyer and the Clearing House, as seller; and an equal and offsetting transaction between the Clearing House and the seller.

8F06. CLEARING MEMBER DEFAULT

If an OTC Clearing Member fails promptly to discharge any obligation to the Clearing House, it shall be in default and the Clearing House may take all actions permitted by these Rules in the event of a default. All of the assets and collateral of an OTC Clearing Member that are

¹ Revised July 2008.

² Revised November 2008.

available to CME including, but not limited to, its security deposit and performance bond shall be applied by the Clearing House to discharge the obligation. The Clearing House may engage in any commercially reasonable transaction to eliminate or reduce the risk created by the default and all obligations, costs and expenses incurred thereby shall be an obligation of the defaulting OTC Clearing Member to the Clearing House.

8F07. SECURITY DEPOSIT

An OTC Clearing Members' security deposits may be used to cover losses incurred by the Clearing House if a defaulting OTC Clearing Member's assets, including amounts available pursuant to any guarantee from an affiliated Clearing Member, available to the Clearing House are insufficient to cover such loss, regardless of the cause of default.

The detailed security deposit rules applicable to Clearing Members are set forth in Rule 816.

8F08. LIEN ON COLLATERAL¹

Each OTC Clearing Member hereby grants to CME a first priority and unencumbered lien against any cash, securities or other collateral deposited with the Clearing House by the OTC Clearing Member which is the property of the OTC Clearing Member. OTC Clearing Members shall execute any documents required by CME to create and enforce such lien.

8F09. CUSTOMER REGISTRATION

All OTC Derivatives including, but not limited to, give-ups or transfers that are cleared at CME shall be identified with an account number which identifies the originator of that transaction, specifying whether the transaction was executed as a proprietary transaction of the OTC Clearing Member or arises from a transaction by a customer. OTC Clearing Members shall register, on CME approved forms, all of the "ultimate" (or end) customer authorized to execute OTC Derivatives.

8F10. RISK MANAGEMENT²

OTC Clearing Members will be subject to risk management and monitoring practices by CME relating to transactions submitted to the Clearing House. OTC Clearing Members shall promptly provide all information requested by Clearing House staff, including, without limitation, information respecting risk, settlement, liquidity, and operational issues. OTC Clearing Members shall permit on-site risk reviews in accordance with CME Rules and subject to reasonable standards of confidentiality. OTC Clearing Members will also be subject to on-going oversight by the Clearing House Risk Committee regarding their activities related to the CME Clearing House. All such inquiries shall be conducted in a manner consistent with oversight of CME Clearing Members and in accordance with reasonable standards of confidentiality.

8F11. FINANCIAL REQUIREMENTS

- A. Subject to exceptions granted by CME staff regarding CME imposed financial requirements, OTC Clearing Members must comply with the following:
1. Maintenance of minimum capital requirements;
 2. Notification requirements to the Audit Department when a clearing member:
 - (i) Fails to maintain minimum capital requirements;
 - (ii) Fails to maintain current books and records; or
 - (iii) Changes its fiscal year.
- B. CME staff may prescribe additional accounting, reporting, and other financial and/or operational requirements and OTC Clearing Members must comply with such requirements. All OTC Clearing Members must provide immediate notice to the Audit Department of a failure to comply with the additional accounting, reporting, financial, and/or operational requirements.
- C. CME staff may grant exceptions to the financial requirements of Rule 970 if it is

¹ Revised July 2008.

² Revised July 2008.

determined that such exceptions will not jeopardize the financial integrity of CME.

8F12. SETTLEMENT

An OTC Clearing Member must demonstrate, at all times, the operational capabilities and infrastructure necessary to meet all of the delivery requirements applicable to the OTC Derivatives cleared by such OTC Clearing Member.

8F13. INSOLVENCY AND LIQUIDATION¹

In the event of a bankruptcy or insolvency of an OTC Clearing Member or any other clearing member carrying OTC Derivatives in its proprietary or customer accounts, the default Rules and risk management procedures of CME shall apply, including, but not limited to, the provisions in Rule 975. Upon the bankruptcy or insolvency of such a clearing member, the Clearing House will terminate, or offset, any open OTC Derivatives of the bankrupt or insolvent Clearing Member and of its customers, however, the Clearing House shall have discretion to transfer such customer positions to one or more other Clearing Members. The Clearing House may mitigate or eliminate the risks incurred by it as a result of offsetting or terminating such open OTC Derivatives by any one or more of the following means: 1) replace all or a portion of the OTC Derivatives of the defaulting clearing member by entering into a transaction with a solvent clearing member(s); 2) replace all or a portion of the OTC Derivatives of the defaulting clearing member by entering into OTC Derivatives for its own account in the open market; and/or 3) enter into OTC Derivatives (or exchange-traded contracts) to hedge the economic risks imposed on it as a result of offsetting or terminating such OTC Derivatives by any commercially reasonable means. The Clearing House may also replace any OTC Derivatives it enters into to replace or hedge economic risks from any terminated transaction by substituting a transaction with a solvent clearing member(s) that offsets the original terminated transaction.

Any Close-out Amount incurred by the Clearing House in liquidating, transferring and establishing, adjusting and/or replacing positions resulting from the clearing member's default will be deducted from the defaulting clearing member's collateral held by CME. In the event the collateral of the defaulting clearing member is not sufficient to satisfy the Close-Out Amount, the unsatisfied costs will be a claim by the Clearing House against the defaulting clearing member.

8F14. MITIGATION OF LOSSES

In the event of a failure of an OTC Clearing Member promptly to discharge any obligation to the Clearing House involving OTC Derivatives, all OTC Clearing Members shall work cooperatively with their counterparties and CME to mitigate any losses that may occur as a result of such failure.

¹ Revised August 2008, November 2008.