

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-66250; File No. SR-CME-2012-01)

January 26, 2012

Self-Regulatory Organizations; Chicago Mercantile Exchange, Inc.; Notice of Filing of Proposed Rule Change to Amend Rules Relating to Credit Default Swap Guaranty Fund

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 23, 2012, Chicago Mercantile Exchange Inc. (“CME”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change described in Items I, II and III below, which items have been prepared primarily by CME. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

I. Self-Regulatory Organization’s Statement of Terms of Substance of the Proposed Rule Change

The text of the proposed rule change is below. Underlined text indicates additions; bracketed text indicates deletions.

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CHICAGO MERCANTILE EXCHANGE INC. RULEBOOK

Rule 100 – Rule 8H06 – No Change.

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Rule 8H07. CDS FINANCIAL SAFEGUARDS AND GUARANTY FUND DEPOSIT

Rule 8H07.1(i) – No Change

Rule 8H07.1(ii). (ii) Each CDS Clearing Member’s required contribution to the CDS Guaranty

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<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Fund shall be the greater of: (a) such CDS Clearing Member's proportionate share of the largest two losses described in 8H07.1(i)(a) above, each CDS Clearing Member's proportionate share being based on the 90-day trailing average of its [aggregate performance requirements] potential residual loss ("PRL") and the 90-day trailing average gross notional open interest outstanding at the Clearing House (or, in either case, such other shorter time interval determined by the CDS Risk Committee); and (b) \$50,000,000.

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Rule 8H07.2 – End – No Change.

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## CME CDS MANUAL OF OPERATIONS

CHAPTERS 1 – 9 – No Change.

### CHAPTER 10 – CDS GUARANTY FUND CALCULATION

#### **Separate CDS Guaranty Fund**

CME Clearing shall establish an additional CDS Guaranty Fund as described in Rule 8H07.

#### **Guaranty Fund Calculation**

Each CDS Clearing Member's Guaranty Fund contribution to the Financial Safeguards Package will be equal to the greater of:

- (1) 50MM; and
- (2) An amount using stress test methodology equal to such Clearing Member's proportionate share of the overall CDS Guaranty Fund based on a 90 day trailing average of such Clearing Member's [performance bond] PRL performance bond requirement (95% weight) and its average CDS gross notional open interest at the CME (5% weight), as further set forth in Rule 8H07.

Once the overall financial safeguards pool size has been determined using the stress testing

described below, the guaranty fund calculation is calculated as per the example below:

	<b>Time Period X</b>
<b>Determine overall financial safeguards pool size based on net debtor stress testing results</b>	
<b>Aggregate</b>	
1st Largest Net Debtor stress test	\$500,000,000
2 <sup>nd</sup> Largest Net Debtor stress test	\$400,000,000
Required Guaranty Fund Size (Sum of 2 Largest Net Debtor stress tests)	\$900,000,000
<b>Hypothetical CDS Clearing Member's Guaranty Fund Contribution</b>	
[performance bond] <u>PRL</u> Component -- 95% weight	
Total average aggregate CDS [performance bond] <u>PRL</u> over trailing 90 days at CME	\$10,000,000,000
Clearing member XYZ's average 90-day[, performance bond requirement] <u>PRL</u>	\$800,000,000
Clearing member XYZ's % of aggregate	8%
Clearing member XYZ's calculated contribution to the CDS guaranty fund (\$900M Target x 8%)	<b>\$72,000,000</b>
Clearing member XYZ's weighted (95%) [performance bond] <u>PRL</u> contribution to the CDS guaranty fund	\$68,400,000
<b>Open Interest (Gross Notional) Component -- 5% weight</b>	
Total average aggregate CDS gross notional over trailing 90 days at CME	\$100,000,000,000
Clearing member XYZ's average 90-day CDS gross notional	7,000,000,000
Clearing member XYZ's open interest % of aggregate	7%
Clearing member XYZ's open interest component of the CDS guaranty fund (\$900M Target x 7%)	<b>\$63,000,000</b>
Clearing member XYZ's weighted (5%) open interest component of the CDS guaranty fund	<b>\$3,150,000</b>
Clearing member XYZ's [performance bond] <u>PRL</u> component of the CDS guaranty fund	\$68,400,000
Clearing member XYZ's gross notional component of the CDS guaranty fund	\$3,150,000
<b>Total clearing member XYZ's calculated guaranty fund contribution</b>	<b>\$71,550,000</b>

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II. Self-Regulatory Organization's Statement of Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, CME included statements concerning the purpose and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. CME has prepared summaries, set forth in sections A, B, and C below, of the most significant aspects of such statements.

A. Self-Regulatory Organization's Statement of Purpose of, and Statutory Basis for, the Proposed Rule Change

CME offers clearing services for certain credit default swap index products. Current CME Rule 8H07 provides that each CDS Clearing Member's allocation to the CDS Guaranty Fund will be the greater of (i) \$50,000,000 and (ii) its proportionate share of the 90-day trailing average of its aggregate performance bond requirements and average gross notional open interest outstanding at the Clearing House. The rule change that is the subject of this filing would replace the "aggregate performance bond requirement" standard with a new standard that CME believes better allocates tail risk. CME is also proposing to make conforming changes to its CDS Manual of Operations.

CME believes the current "aggregate performance bond requirement" standard set forth in Rule 8H07 is designed to provide for margin requirements that adequately cover day-to-day P/L moves, however, CME believes changes could be made to provide for a more accurate allocation of potential tail risk. Therefore, in order to more accurately align the allocation of the CDS Guaranty Fund to each CDS Clearing Member, consistent with the CDS Guaranty Fund's purpose of covering tail risk events, CME proposes certain rule changes so that the allocation will be made on the basis of each CDS Clearing Member's potential residual loss ("PRL"). PRL is a stress test of the tail risk CDS Clearing Member portfolios bring to the market.

CME notes that it will also submit the proposed rule changes that are the subject of this filing to its primary regulator, the Commodity Futures Trading Commission (“CFTC”). The text of the CME proposed rule amendments is noted in Section I above, with additions underlined and deletions in brackets.

CME believes the proposed rule changes are consistent with the requirements of the Exchange Act including Section 17A of the Exchange Act. Currently, the only swaps CME clears are CFTC-regulated swaps and therefore the proposed rule changes will only directly affect CME’s swaps clearing activities pursuant to its registration as a derivatives clearing organization under the Commodity Exchange Act (“CEA”).<sup>3</sup> CME notes that the policies of the CEA with respect to clearing are comparable to a number of the policies underlying the Exchange Act, such as promoting market transparency for over-the-counter derivatives markets, promoting the prompt and accurate clearance of transactions and protecting investors and the public interest. CME believes the proposed rule changes accomplish these objectives by more accurately aligning the allocation of its CDS Guaranty Fund to each CDS Clearing Member.

**B. Self-Regulatory Organization’s Statement on Burden on Competition**

CME does not believe that the proposed rule change will have any impact, or impose any burden, on competition.

**C. Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received from Members, Participants, or Others**

CME has not solicited, and does not intend to solicit, comments regarding this proposed rule change. CME has not received any unsolicited written comments from interested parties.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

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<sup>3</sup> The staff notes that the PRL allocation will apply to any security-based swaps CME may clear in the future.

Within 45 days of the date of publication of this notice in the Federal Register or within such longer period up to 90 days (i) as the Commission may designate if it finds such longer period to be appropriate and publishes its reasons for so finding or (ii) as to which the self-regulatory organization consents, the Commission will:

- (A) by order approve or disapprove the proposed rule change or
- (B) institute proceedings to determine whether the proposed rule change should be disapproved.

#### IV. Solicitation of Comments

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

- Electronic comments may be submitted by using the Commission's Internet comment form (<http://www.sec.gov/rules/sro.shtml>), or send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-CME-2012-01 on the subject line.
- Paper comments should be sent in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, D.C., 20549-1090.

All submissions should refer to File Number SR-CME-2012-01. This file number should be included on the subject line if e-mail is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission's Internet website (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed

rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for website viewing and printing in the Commission's Public Reference Room, 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filing also will be available for inspection and copying at the principal office of CME. All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

All submissions should refer to File Number SR-CME-2012-01 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

For the Commission by the Division of Trading and Markets, pursuant to delegated authority.<sup>4</sup>

Kevin M. O’Neill  
Deputy Secretary

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<sup>4</sup> 17 CFR 200.30-3(a)(12).