

SECURITIES AND EXCHANGE COMMISSION
(Release No. 34-66354; File No. SR-CME-2012-03)

February 8, 2012

Self-Regulatory Organizations; Chicago Mercantile Exchange, Inc.; Notice of Filing and Order Granting Accelerated Approval of Proposed Rule Change to Amend Certain Aspects of the Performance Bond Regime Applicable to Cleared Only OTC FX Swaps

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”),¹ and Rule 19b-4 thereunder,² notice is hereby given that on January 30, 2012, the Chicago Mercantile Exchange Inc. (“CME”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change described in Items I and II below, which items have been prepared primarily by CME. The Commission is publishing this Notice and Order to solicit comments on the proposed rule change from interested persons and to approve the proposed rule change on an accelerated basis.

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

CME proposes to make certain changes that are related to its current cleared-only OTC foreign currency (“FX”) product offering. The proposed rule changes³ would add Price Alignment Interest (“PAI”) functionality to current “cash mark-to-market” performance bond regime that applies to CME’s cleared-only OTC FX offering.

A description of the revised performance bond regime with the addition of PAI is included below:

¹ 15 U.S.C. 78s(b)(1).

² 17 CFR 240.19b-4.

³ The text of the proposed changes does not appear in CME’s rulebook but is available on CME’s website at http://www.cmegroup.com/rulebook/files/s_6105_otc_fx_pai_cash_mk_to_mkt_ser_020112_revised.pdf.

CME Forwards with Cash Mark-To-Market

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

Until October 18, 2011, all forwards cleared by CME had 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 implemented on October 18, 2011, 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 is a very simple change for this cash mark-to-market as opposed to collateralized mark-to-market.

There is an 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.

PAI is now a second additional feature for FX forwards and it applies to both (1) non-deliverable forwards (NDF’s) – cash-settlement forwards where one currency of the pair is not bankable and (2) cash-settlement WM/Reuters OTC FX forwards.

CME Clearing is introducing PAI to ensure settlement variation amounts for cleared OTC FX forwards are treated consistently with those of CME’s cleared interest-rate swaps and credit-default swaps. PAI is consistent and appropriate for all of these cleared products with daily mark-to-market amounts settled in cash.

If the forward has positive net present value, the position holder pays price alignment interest, and conversely if the forward has negative net present value, the position holder receives

price alignment interest. The amount is calculated on the net realized cash flow, from the banking business day on which that amount was realized, to the next banking business day, and is annualized on an actual/360 day basis.

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.

Production Ready

Forwards with cash mark-to-market and the PAI enhancement are now available in CME’s “Production” environment. For more information please contact CME Clearing at 312-207-2525.

The text of the proposed changes is also available at the CME’s Web site at <http://www.cmegroup.com>, at the principal office of CME, and at the Commission’s Public Reference Room.

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 III 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 currently offers clearing for certain OTC FX cleared-only products. In a previous filing, CME adopted a "cash mark-to-market" performance bond regime for its cleared-only OTC FX products. These changes were applicable to all then currently listed and future product rollouts (which now include 12 cleared, cash-settlement OTC FX non-deliverable forwards ("NDFs") and 26 cleared, cash-settlement CME WM/Reuters OTC Spot, Forward and Swaps).⁴ With this filing, CME proposes to enhance this current "cash mark-to-market" performance bond regime by adding PAI functionality, which will bring CME's centrally cleared OTC FX products in line with typical bilaterally held OTC FX transactions.

CME uses its SPAN system to establish performance bond or "margin" requirements for CME's OTC FX cleared-only products. 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. Variation margins may be satisfied with the posting of appropriate amounts of collateral, where CME collects and pays in cash between the counterparties each day. CME accepts 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. None of these risk components of the clearing system

⁴ See Securities Exchange Act Release No. 34-65636 (October 26, 2011), 76 FR 67514 (November 1, 2011) [SR-CME-2011-14].

would be changed with the proposed implementation of PAI to the “cash mark-to-market” performance bond regime.

The addition of PAI, which is appropriate for cleared-only derivatives products with daily mark-to-market amounts settled in cash like OTC FX, would simply enhance the current performance bond administration operational procedures. Under PAI, if the contract has positive net present value, the position holder pays price alignment interest and, conversely, if the contract has negative net present value, the position holder receives price alignment interest. The amount is calculated on the net realized cash flow, from the banking business day on which that amount was realized, to the next business day, and is annualized on an actual/360 basis. Therefore, when market participants are required to post a cash mark-to-market amount for a cleared OTC FX forward position, that market participant will be reimbursed the interest equivalent on those newly posted funds. Similarly, those market participants receiving the cash mark-to-market amount for a cleared OTC FX forward position are charged the interest equivalent on those newly credited funds to their account. This PAI performance bond mechanism adjustment makes the CME cleared OTC FX market more aligned with the underlying OTC FX forward market.

Pursuant to Commodity Futures Trading Commission (“CFTC”) regulations, the changes in the applicable performance bond regime have been interpreted by CME as being subject to CFTC Regulation 40.6(d), requiring a self certification filing to the CFTC, although no change to text of the CME rulebook is required. As such, the changes that are the subject of this filing and that are necessary to add the PAI functionality to CME’s “cash mark to market” performance bond regime are changes to CME operational procedures only. CME notes that it has already certified the proposed changes that are the subject of this filing to its primary regulator, the

CFTC. The text of the proposed changes is noted above.

CME believes the proposed changes are consistent with the requirements of the Exchange Act including Section 17A of the Exchange Act because they involve clearing of swaps and thus relate solely to the CME's swaps clearing activities pursuant to its registration as a derivatives clearing organization under the Commodity Exchange Act ("CEA") and do not significantly affect any securities clearing operations of the clearing agency or any related rights or obligations of the clearing agency or persons using such service. CME further 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. The proposed rule changes accomplish those objectives by offering investors clearing for a range of FX OTC swap products.

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. 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. Please include File No. SR-CME-2012-03 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-2012-03. 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-2012-03 and should be submitted on or before [insert date 21 days from publication in the Federal Register].

IV. Commission's Findings and Order Granting Accelerated Approval of Proposed Rule Change

In its filing, CME requested that the Commission approve this request on an accelerated basis, for good cause shown. CME has articulated three reasons for granting this request on an accelerated basis. One, the products covered by this filing, and CME's operations as a derivatives clearing organization for such products, are regulated by the CFTC under the CEA. Two, the proposed rule changes relate solely to FX swap products and therefore relate solely to its swaps clearing activities and do not significantly relate to CME's functions as a clearing agency for security-based swaps. Three, not approving this request on an accelerated basis will have a significant impact on the swap clearing business of CME as a designated clearing organization.

Section 19(b) of the Act⁵ directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization. The Commission finds that the proposed rule changes is consistent with the requirements of the Act, in particular the requirements of Section 17A of the Act,⁶ and the rules and regulations thereunder applicable to CME. Specifically, the Commission finds that the proposed rule change is consistent with Section 17A(b)(3)(F) of the Act which requires, among other things among other things, that the rules of a clearing agency be designed to promote the prompt and accurate clearance and settlement of derivative agreements, contracts, and transactions because it should allow CME to enhance its services in clearing foreign currency contracts, thereby promoting the

⁵ 15 U.S.C. 78s(b).

⁶ 15 U.S.C. 78q-1. In approving this proposed rule change, the Commission has considered the proposed rule's impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

prompt and accurate clearance and settlement of derivative agreements, contracts, and transactions.⁷

The Commission finds good cause for accelerating approval because: (i) the proposed rule change does not significantly affect any securities clearing operations of the clearing agency (whether in existence or contemplated by its rules) or any related rights or obligations of the clearing agency or persons using such service; (ii) CME has indicated that not providing accelerated approval would have a significant impact on the foreign currency contracts clearing business of CME as a designated clearing organization; and (iii) the activity relating to the non-security clearing operations of the clearing agency for which the clearing agency is seeking approval is subject to regulation by another regulator.

⁷ 15 U.S.C. 78q-1(b)(3)(F).

V. Conclusion

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change (SR-CME-2012-03) is approved on an accelerated basis.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.⁸

Kevin M. O'Neill
Deputy Secretary

⁸ 17 CFR 200.30-3(a)(12).