

SECURITIES AND EXCHANGE COMMISSION  
(Release No. 34-74055; File No. SR-CME-2015-001)

January 14, 2015

Self-Regulatory Organizations; Chicago Mercantile Exchange Inc.; Notice of Filing and Immediate Effectiveness of Proposed Rule Change Related to Clearing of Certain iTraxx Europe Index Untranchred CDS Contracts on Indices Administered by Markit

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act” or “Exchange Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on January 5, 2015, Chicago Mercantile Exchange Inc. (“CME”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II and III below, which Items have been prepared primarily by CME. CME filed the proposal pursuant to Section 19(b)(3)(A) of the Act,<sup>3</sup> and Rule 19b-4(f)(4)(ii)<sup>4</sup> thereunder, so that the proposal was effective upon filing with the Commission. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

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

The purpose of the proposed changes to CME’s clearing rules (the “CDS Product Rules”) is to enable CME to offer clearing of certain iTraxx Europe index untranchred CDS contracts on indices administered by Markit (“iTraxx Contracts”). All capitalized terms not defined herein shall have the meaning given to them in the CDS Product Rules.

CME is submitting the proposed amendments to the iTraxx Chapters (as defined in Item II.A. below) to become effective immediately, subject to receiving all regulatory approvals.

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

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

<sup>3</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>4</sup> 17 CFR 240.19b-4(f)(4)(ii).

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

1. Purpose

CME is registered as a Derivatives Clearing Organization (“DCO”) with the Commodity Futures Trading Commission (“CFTC”) and offers clearing services for many different futures and swaps products, including certain CDS index products. Currently, CME offers clearing of (i) the Markit CDX North American Investment Grade Index Series 8 and forward and (ii) the Markit CDX North American High Yield Index Series 13 and forward ((i) and (ii) collectively, the “CDX Contracts”).

The primary purpose and effect of the proposed changes to the CDS Product Rules that are described in this filing is to enable CME to offer clearing of iTraxx Contracts under CME's authority to act as a DCO. iTraxx Contracts have similar terms to CDX Contracts currently cleared by CME. Accordingly, the proposed rules largely mirror the CME rules for CDX Contracts, with certain modifications that reflect the differing underlying reference entities, different standard currencies and other logistical differences in how the markets and documentation for iTraxx Contracts operate. The iTraxx Contracts reference the iTraxx Europe index, the current series of which consists of 125 European corporate reference entities. The

credit protection offered by iTraxx Contracts and any Restructuring European Single Name CDS Contract consistent with market convention and widely used standard terms documentation, can be triggered by credit events including failure to pay, bankruptcy, restructuring and, in respect of transactions that will reference the 2014 ISDA Definitions (such transactions, “2014 Definitions Transactions”) governmental intervention. iTraxx Contracts will be denominated in Euro.

CME notes that, upon the occurrence of a restructuring credit event with respect to a reference entity that is a component of an iTraxx Contract, such reference entity will be “spun out” and maintained as a separate single-name CDS contract (a “Restructuring European Single Name CDS Contract”) until settlement. If neither of the counterparties elects to trigger settlement, the positions in the Restructuring European Single Name CDS Contract will be maintained at CME until maturity of the index or the occurrence of a subsequent credit event for the same reference entity. However, CME will not permit market participants to increase, close out or otherwise affect the size of a position in a Restructuring European Single Name CDS Contract (other than due to the occurrence of a credit event, default management process, close out of a defaulting customer’s positions, or withdrawal from clearing membership in accordance with CME rules)<sup>5</sup> and CME has included language in its proposed rule change to this effect. CME notes that it may impose an increase or decrease in the position of a Restructuring European Single Name CDS Contract through its default management process under applicable CME rules.<sup>6</sup>

To the extent that a Restructuring European Single Name CDS Contract is created, CME will either (i) obtain any relief needed to permit a clearing member to maintain customer money,

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<sup>5</sup> Currently, those rules are CME Rules 230, 8H10, 8H14, 8H26, 8H27, 8H802, 8H913, and 8H975.

<sup>6</sup> Currently, those rules are CME Rules 230, 8H10, 8H14, 8H26, 8H27, 8H802, and 8H975.

securities, and property received by the clearing member to margin, guarantee, or secure customer positions in cleared CDS Contracts, which include both swaps and security-based swaps, in a segregated account established and maintained in accordance with Section 4d(f) of the Commodity Exchange Act (“CEA”) and the rules thereunder for the purpose of clearing such positions under a programme to comingle and portfolio margin CDS, or (ii) will hold customer positions in Restructuring European Single Name CDS Contracts and any margin in connection with such Restructuring European Single Name CDS Contracts in segregated accounts or take any other action required in order to comply with the provisions of the Exchange Act or any order or relief thereunder.

(i) Description of Proposed CME Rule Changes

CME is proposing to amend its CDS Product Rules by amending Chapter 801 and adding new Chapters 800: Part B, 804: Part B, 805: Part C, 806: Part B and Appendix 805: Part B (collectively, the “iTraxx Chapters”). CME is also proposing to add new Chapters 805: Part B, 806: Part A and Appendix 805: Part A (together, the “2014 iTraxx Chapters”).

CME also proposes to make corresponding changes to its CDS Manual of Operations to provide for the clearance of iTraxx Contracts. Specifically, amendments have been made where CDX Contracts are described as the only CDS Contracts which CME clears and a deletion has been made to reflect that Restructuring will be a credit event for iTraxx Contracts. Also, a reference which relates to outdated aspects of the CDS risk model is proposed to be deleted.

CME will update its list of products eligible for clearing, which is available on its website at <http://www.cmegroup.com/trading/cds/cleared-cds-product-specs.xls>, to incorporate the additional cleared products. Upon Commission approval, CME intends to provide for the clearance of the following European Indices: Markit iTraxx Europe Main 3Y: Series 17 and all

subsequent Series, up to and including the current on-the-run Series, Markit iTraxx Europe Main 5Y: Series 17 and all subsequent Series, up to and including the current on-the-run Series, Markit iTraxx Europe Main 7Y: Series 17 and all subsequent Series, up to and including the current on-the-run Series, Markit iTraxx Europe Main 10Y: Series 17 and all subsequent Series, up to and including the current on-the-run Series, and Markit iTraxx Europe Crossover 5Y: Series 17 and all subsequent Series, up to and including the current on-the-run Series.

Certain iTraxx Contracts which CME proposes to clear will, following the implementation date of the 2014 ISDA Definitions, be bifurcated such that certain component transactions will continue to reference the 2003 Credit Derivatives Definitions published by ISDA, as supplemented in 2009 (the “2003 ISDA Definitions”) (such transactions, “2003 Definitions Transactions”), and certain other component transactions will be 2014 Definitions Transactions. Consistent with CME’s treatment of CDS products with different product terms, CME will position iTraxx Component Transactions that do not incorporate the same set of credit derivatives definitions as separate cleared CDS Contracts upon the occurrence of a restructuring credit event in respect of such iTraxx Component Transactions. As a result of the above mentioned bifurcation, CME proposes to split Chapters 800, 804 and 805 of its current rules into separate sub-parts and to introduce a new Chapter 806 and a new Appendix to Chapter 805 (each of which will also be split into sub-parts) to allow for the separate treatment of iTraxx Component Transactions depending on whether such transactions are 2014 Definitions Transactions or 2003 Definitions Transactions.

The computation of the spread risk, interest rate risk, and liquidity and concentration risk components in CME’s risk model framework is described in CME’s proposed rule change to

revise its risk model for CDS (the “CDS Risk Model”)<sup>7</sup> and will be agnostic to whether the 2003 ISDA Definitions or the 2014 ISDA Definitions are applicable, therefore allowing risk offsets across iTraxx Component Transactions that refer to the same reference entity but that do not incorporate the same set of credit derivatives definitions. No risk offsets will be provided for computation of idiosyncratic risk requirements for iTraxx Component Transactions which refer to the same reference entity but that do not incorporate the same set of credit derivatives definitions. The applicability of the post credit event risk requirement will be based on whether a credit event occurs by reference to the relevant credit derivatives definitions (2003 ISDA Definitions or the 2014 ISDA Definitions) and the relevant transaction type that is applicable to an iTraxx Component Transaction. The post credit event risk requirement will be computed on a net notional basis for a particular reference entity within an iTraxx index where a Credit Event has been determined under the relevant credit derivatives definitions.

(a) Chapter 800 (Credit Default Swaps: Part B)

CME proposes to add a sub-part to Chapter 800 entitled “Credit Default Swaps: Part B.” Chapter 800: Part B provides the meanings of capitalized terms that are used but not defined within the proposed rules and the location of the meanings of any terms used in the proposed rules but not defined within Chapter 800: Part B. In addition, CME has included CME Rule 80002.B (Interpretation), which provides for the interpretation of certain contractual terms used within the proposed rules, and CME Rule 80003.B (Notices and Clearing House System Failures), which provides for how notices are to be provided by, or to, CME and also for the extension of applicable deadlines for the delivery of notices if CME, or any of its clearing members, is unable to deliver or receive notices due to a failure of the relevant CME internal

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<sup>7</sup> See Securities Exchange Act Release No. 34-73849 (Dec. 16, 2014), 79 FR 76428 (Dec. 22, 2014) (SR-CME-2014-51).

system. CME notes that CME Rule 80002.B and CME Rule 80003.B (each as described in the aforementioned sentence) are substantially similar to CME Rule 80002 and CME Rule 80003, respectively, that are provided in the currently published Chapter 800.

(b) Chapter 801 (CDS Contracts)

CME proposes to amend Chapter 801 (CDS Contracts) to include in CME Rule 80103.C (Eligible CDS) an additional provision which describes when an iTraxx Contract will be eligible for clearing and other conforming, clarification changes and drafting improvements.

(c) Chapter 804 (CME CDS Risk Committee: Part B)

CME proposes to add a sub-part to Chapter 804 entitled “CME CDS Risk Committee: Part B” to apply only in connection with 2003 Definitions Transactions. Chapter 804: Part B will not contain any iTraxx specific provisions, but will be created in anticipation of the currently published Chapter 804 being updated to operate in conjunction with the 2014 ISDA Definitions. Chapter 804: Part B is substantially similar to the currently published Chapter 804 with the exception that Chapter 804: Part B grants an additional authority to the CDS RC to determine matters of contractual interpretation relevant to market standard documentation incorporated into the terms of a CDS Contract. In addition, modifications have been made in order to ensure alignment of the CDS Product Rules with the current market practices (as proposed by ISDA) to clarify the circumstances under which the CDS RC may make such determinations to avoid determinations that are inconsistent with DC determinations, and other conforming, clarification changes and drafting improvements.

(d) Chapter 805 (CME CDS Physical Settlement: Part B), Chapter 805 (CME CDS Physical Settlement: Part C) and CDS Participant Provisions Appendix

CME proposes to add two sub-parts to Chapter 805 entitled “CME CDS Physical Settlement: Part B” and “CME CDS Physical Settlement: Part C.” CME notes that it is anticipated that the currently published Chapter 805 will be amended and referred to as “Part A” as part of CME’s amendments to its CDS Product Rules to incorporate the 2014 ISDA Definitions, but that such amendments will not take into account the required iTraxx specific changes that would need to be made to Chapter 805 in order for CME to clear iTraxx Contracts. Chapter 805: Part B will apply only in connection with 2014 Definitions Transactions and Chapter 805: Part C will apply only in connection with 2003 Definitions Transactions. In general, both Chapter 805: Part B and Chapter 805: Part C provide for the physical settlement process that will apply as the fallback settlement method with respect to iTraxx Contracts and Restructuring European Single Name CDS Contracts in circumstances where auction settlement does not apply. The substance of the new provisions is based on the fallback physical settlement provisions that apply for CDX Contracts, with some additional features addressing the product terms particular to iTraxx Contracts and some further clarification and detail in light of the increased likelihood of physical settlement being applicable to iTraxx Contracts and Restructuring European Single Name CDS Contracts. These additional features are described in further detail below.

CME Rules 80502.B.A and 80502.C.A (Matched Pair Notice) provide additional detail in relation to the matching process. The additions do not substantively alter the CDS Product Rules but rather, seek to provide greater clarity with respect to the current matching process and how such process will work in respect of iTraxx Contracts.

CME Rules 80502.B.C and 80502.C.D (Notices) have been updated to provide additional detail around the notice procedures in light of the more complex notice requirements following a



restructuring credit event with respect to an iTraxx Component Transaction or a Restructuring European Single Name CDS Contract. As a result of the more complex notice requirements, CME proposes to insert in CME Rule 80502.B.D and 80502.C.E (Disputes as to Notices) a more comprehensive dispute process in relation to the effective delivery of notices to preserve more accurately the economic effect of the delivery of certain notices.

CME Rule 80503.B and 80503.C (Physical Settlement of Non DVP Obligations) provide greater clarity with respect to the timing of the delivery of Non DVP Obligations and payment of the related portion of the Physical Settlement Amount. In addition, the allocation of any expenses incurred in connection with physical settlement is now expressly contemplated.

CME Rule 80507.B and 80507.C (Clearing House Guarantee of Matched Pair CDS Contracts) and CME Rule 80508.B and 80508.C (Failure to Perform Under Matched Pair CDS Contracts) have been updated to align the matching process with the general physical settlement provisions of CME as set out in Chapter 7 (Delivery Facilities and Procedures).

CME also proposes to add an Appendix to Chapter 805 which will be split into two sub-parts. Appendix: Part A will apply only in connection with 2014 Definitions Transactions and Appendix: Part B will apply only in connection with 2003 Definitions Transactions. The Appendix primarily sets out provisions dealing with physical settlement and the delivery of notices between clearing members and their customers. The provisions are intended to facilitate the delivery of notices and physical settlement. The Appendix is intended to apply to all CDS contracts; however, the provisions are for the convenience of the clearing members and their customers and will not bind CME. The Appendix includes provisions addressing (i) the timing of the delivery of physical notices in a chain of transactions between the clearing house, the clearing members and their customers, (ii) when notices, requests or instructions between a

clearing member and its customer are effective, (iii) the delivery of deliverable obligations between a clearing member and its customer, (iv) circumstances where a fallback to cash settlement will be deemed to apply, (v) buy-in of bonds not delivered and the circumstances around the effective delivery of a buy-in notice, and (vi) alternative procedures relating to loans not delivered and the circumstances around the effective delivery of an alternative loan buyer notice. The Appendix will only be relevant to CME CDS Physical Settlement, and not when auction settlement applies and is therefore unlikely to be applicable to settlement in most cases.

- (e) Chapter 806 (iTraxx Europe Index Untranchéd CDS Contracts: Part A) and Chapter 806 (iTraxx Europe Index Untranchéd CDS Contracts: Part B)

CME proposes to add Chapter 806 which will be split into two sub-parts entitled “iTraxx Europe Index Untranchéd CDS Contracts: Part A” and Chapter 806 “iTraxx Europe Index Untranchéd CDS Contracts: Part B.” Chapter 806: Part A will apply only in connection with 2014 Definitions Transactions and Chapter 806: Part B will apply only in connection with 2003 Definitions Transactions.

CME Rules 80601.A and 80601.B (Scope of Chapter) set forth the applicable standard terms relevant for iTraxx Component Transactions and where the terms and conditions for Restructuring European Single Name CDS Contracts are set out. Further, it is clarified that unless a restructuring credit event occurs, no iTraxx Component Transaction will be fungible with a European single name CDS contract.

CME Rules 80602.A and 80602.B (Contract Terms) reflect or incorporate the basic contract specifications for iTraxx Contracts and Restructuring European Single Name CDS Contracts and are substantially similar to CME Rule 80202 (Contract Terms) for CDX Contracts.

Similarly CME Rules 80603.A and 80603.B (Contract Modifications) are substantially similar to CME Rule 80203 (Contract Modifications) for CDX Contracts, except for conforming changes.

In addition, CME Rule 80604.A and 80604.B (Restructuring) have been added to reflect the fact that restructuring is a credit event for iTraxx Contracts and Restructuring European Single Name CDS Contracts, that governmental intervention is a credit event for certain 2014 Definitions Transactions, and that Restructuring European Single Name CDS Contracts may be created. In addition, CME has inserted (i) a notice delivery procedure to address the delivery of restructuring credit event notices and notices to exercise movement options, (ii) a process to separate any matched restructuring pairs following an announcement that a restructuring credit event did not in fact occur, (iii) provisions relating to the identification of the reference obligation for a Restructuring European Single Name CDS Contract, (iv) a comprehensive dispute process in relation to the effective delivery of restructuring credit event notices and notices to exercise movement options that are delivered directly (not via DTCC), and (v) a procedure for CME to communicate certain information received from DTCC, or from its clearing members, as applicable, to the relevant clearing members via reports.

(ii) CDS Risk Model

CME has submitted to the Commission, pursuant to Section 19(b)(3)(A) of the Exchange Act<sup>8</sup> and Rule 19b-4(f)(4)(ii)<sup>9</sup> thereunder, the proposed CDS Risk Model, for the purposes of enabling CME to offer clearing of additional CDS instruments, including iTraxx Contracts, within the CDS Risk Model.<sup>10</sup>

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<sup>8</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>9</sup> 17 CFR 240.19b-4(f)(4)(ii).

<sup>10</sup> See supra note 7.

## 2. Statutory Basis

CME has identified iTraxx Contracts as products that have become increasingly important for market participants to manage risk with respect to European corporate and financial entities' credit risk. CME believes the proposed changes to its CDS Product Rules are consistent with the requirements of the Exchange Act including Section 17A of the Exchange Act.<sup>11</sup> The proposed changes which will facilitate CME's clearance of iTraxx Contracts would expand CME's CDS index product offering and would therefore provide investors with an expanded range of derivatives products for clearing. CME notes that the facilitation of clearance of iTraxx Contracts is of particular importance as the CFTC has determined that iTraxx Contracts that are subject to a 5Y or 10Y tenor are subject to mandatory clearing under Section 2(h) of the CEA.<sup>12</sup> As such, the proposed changes are designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivatives agreements, contracts, and transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and, in general, to protect investors and the public interest consistent with Section 17A(b)(3)(F) of the Exchange Act.<sup>13</sup>

### B. Self-Regulatory Organization's Statement on Burden on Competition

CME does not believe that the proposed rule change would have any impact, or impose any burden, on competition. On the contrary, the clearance of iTraxx Contracts will promote competition since some of CME's competitors, including ICE Clear Credit LLC, ICE Clear Europe Limited and LCH.Clearnet S.A., already offer clearing of iTraxx Contracts. CME will

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<sup>11</sup> 15 U.S.C. 78q-1.

<sup>12</sup> 7 U.S.C. 2(h).

<sup>13</sup> 15 U.S.C. 78q-1(b)(3)(F).

therefore be able to provide market participants with an expanded choice for clearing iTraxx Contracts.

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

The foregoing rule change has become effective upon filing pursuant to Section 19(b)(3)(A)<sup>14</sup> of the Act and Rule 19b-4(f)(4)(ii)<sup>15</sup> thereunder.

CME asserts that this proposal constitutes a change in an existing service of CME that (a) primarily affects the clearing operations of CME with respect to products that are not securities, including futures that are not security futures, and swaps that are not security-based swaps or mixed swaps, and forwards that are not security forwards; and (b) does not significantly affect any securities clearing operations of CME or any rights or obligations of CME with respect to securities clearing or persons using such securities-clearing service, which renders the proposed change effective upon filing. CME believes that the proposal does not significantly affect any securities clearing operations of CME because CME recently filed a proposed rule change that clarified that CME has decided not to clear security-based swaps, except in a very limited set of circumstances.<sup>16</sup> The rule filing reflecting CME's decision not to clear security-based swaps

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<sup>14</sup> 15 U.S.C. 78s(b)(3)(A).

<sup>15</sup> 17 CFR 240.19b-4(f)(4)(ii).

<sup>16</sup> See Securities Exchange Act Release No. 34-73615 (Nov. 17, 2014), 79 FR 69545 (Nov. 21, 2014) (SR-CME-2014-49). The only exception is with regards to Restructuring European Single Name CDS Contracts created following the occurrence of a Restructuring Credit Event in respect of an iTraxx Component Transaction. The clearing of Restructuring European Single Name CDS Contracts will be a necessary byproduct after such time that CME begins clearing iTraxx Contracts.

removed any ambiguity concerning CME's ability or intent to perform the functions of a clearing agency with respect to security-based swaps. Therefore, this proposal will not have an effect on any securities clearing operations of CME.

At any time within 60 days of the filing of the proposed change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

#### 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:

- Use 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-2015-001 on the subject line.

##### Paper Comments:

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE, Washington, DC, 20549-1090.

All submissions should refer to File Number SR-CME-2015-001. 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 and on CME's website at <http://www.cmegroup.com/market-regulation/rule-filings.html>.

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-2015-001 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>17</sup>

Brent J. Fields  
Secretary

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