

## Chapter 8-F Over-the-Counter Derivative Clearing

### 8F01. SCOPE OF CHAPTER<sup>1</sup>

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.<sup>2</sup>

### 8F02. DEFINITIONS<sup>3</sup>

#### 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 POSITIONS<sup>4</sup>

All OTC Derivatives accepted for clearing by the Clearing House shall be deemed to be positions of the submitting OTC Clearing Member. Each position 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. Customers of OTC Clearing Members shall have no rights to positions, collateral or cash in the proprietary accounts of an OTC Clearing Member. Notwithstanding the foregoing, if the CFTC has issued an order permitting OTC Clearing Members to commingle customer funds used to margin particular OTC Derivatives that are cleared by CME with other funds held in 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

<sup>1</sup> Entire chapter was revised April 2008.

<sup>2</sup> Revised July 2008.

<sup>3</sup> Revised July 2008, August 2008.

<sup>4</sup> Revised July 2008.

made from such accounts shall belong to such customers.

#### **8F04. OTC CLEARING MEMBER OBLIGATIONS AND QUALIFICATIONS<sup>1</sup>**

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. SUBSTITUTION**

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 OTC Clearing Member party to the original transaction. The OTC Clearing Member shall be deemed the party to the transaction 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 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

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<sup>1</sup> Revised July 2008.

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 COLLATERAL<sup>1</sup>**

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 MANAGEMENT<sup>2</sup>**

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 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

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<sup>2</sup> Revised July 2008.

infrastructure necessary to meet all of the delivery requirements applicable to the OTC Derivatives cleared by such OTC Clearing Member.

#### **8F13. INSOLVENCY AND LIQUIDATION<sup>1</sup>**

In the event of a bankruptcy or insolvency of an OTC Clearing Member or any other clearing member carrying OTC Derivatives, 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. 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.

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<sup>1</sup> Revised August 2008.