

# Direct Funding Participant

Individual Segregation model in U.S. Market

# Direct Funding Participant Model

## Overview

The primary goal of the Direct Funding Participant (“DFP”) model is to provide an individual segregation offering in the U.S. and operational efficiencies

- The structure allows for firms or individuals to segregate and protect their collateral
- The DFP account will be separate and distinct from any of the Guarantor’s accounts
- Any potential DFP must:
  - Obtain a FCM guarantee
  - For exchange traded derivatives, be approved for the exchange membership(s) that is relevant to those exchanges;
  - Meet CME DFP requirements;
  - Establish a relationship with a CME approved settlement bank
- DFPs may only participate in the asset classes they have attained required memberships for and asset classes (i.e. Futures, IRS) in which their Guarantors are Clearing Members
- DFPs default does not result in utilization of the waterfall unless the DFP Guarantor also defaults

# Direct Funding Participant: Protections & Benefits

The primary goal of the Direct Funding Participant (“DFP”) model is to provide an individual segregation offering in the U.S. and operational efficiencies

## Protections

- Individual segregation eliminates fellow customer risk
- No risk of mutualized investment loss on posted collateral
- No DFP contribution to the mutualized portion of the waterfall

## Benefits

- Greater custodial flexibility
- Direct return of interest earned on posted collateral
- Faster payment due to direct settlement

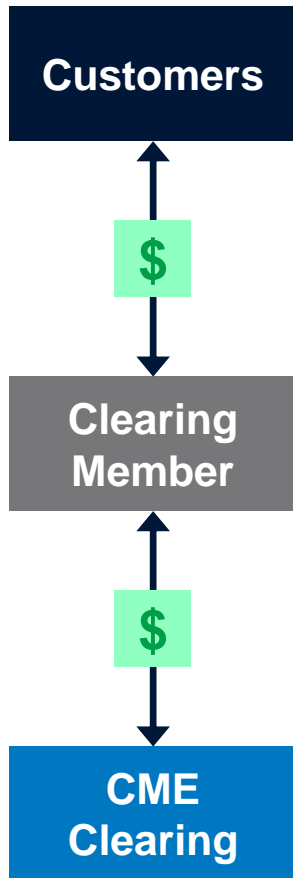
The structure may provide capital relief to the DFP Guarantor by removing client cash IM from the balance sheet and reducing CFTC capital requirements from 8% to 4% for DFP IM requirements

# Comparison of DFP vs. Clearing Member Requirements

	Direct Funding Participant	Exchange Traded Clearing Member	IRS Clearing Member
<b>Minimum Capital</b>	<ul style="list-style-type: none"> <li>None</li> </ul>	<ul style="list-style-type: none"> <li>\$5,000,000</li> </ul>	<ul style="list-style-type: none"> <li>\$50,000,000</li> </ul>
<b>Membership ownership</b>	<ul style="list-style-type: none"> <li>CME: 1 membership to trade CME products</li> <li>CBOT: 1 membership to trade CBOT products</li> <li>2 NYMEX</li> <li>2 COMEX</li> </ul>	<ul style="list-style-type: none"> <li>Must own Exchange Memberships (Exchange Traded, OTC option)</li> </ul>	
<b>Risk management capabilities</b>	<ul style="list-style-type: none"> <li>Maintain appropriate staffed and skilled risk department</li> <li>Ability and expertise in monitoring P&amp;L swings and margin changes</li> <li>Appropriate product expertise</li> </ul>	<ul style="list-style-type: none"> <li>Maintain appropriate staffed and skilled risk management department</li> <li>Ability and expertise in monitoring P&amp;L swings and margin changes</li> <li>Exhibit appropriate product expertise</li> <li>Credit approval process for approving new clients and establishing limits</li> <li>Ability to liquidate any and all positions the firm clears</li> </ul>	
<b>Operational requirements</b>	<ul style="list-style-type: none"> <li>Maintain appropriate staffed and skilled operations functions</li> <li>Ability to meet required margin calls</li> </ul>	<ul style="list-style-type: none"> <li>Maintain appropriate staffed and skilled operations functions</li> <li>Submit required financial statements and audited statements</li> <li>Offer the necessary back office services to clients</li> <li>Ability to meet required margin calls</li> </ul>	<ul style="list-style-type: none"> <li>Maintain appropriate staffed and skilled operations functions</li> <li>Submit required financial statements and audited statements</li> <li>Offer the necessary back office services to clients</li> <li>Perform trade and position processing services for CME-cleared OTC Products</li> <li>Ability to meet required margin calls</li> </ul>
<b>Default Management</b>	<ul style="list-style-type: none"> <li>Not required</li> </ul>	<ul style="list-style-type: none"> <li>Not required</li> </ul>	<ul style="list-style-type: none"> <li>Ability to participate and construct a bid during the default management process</li> </ul>
<b>DFP Legal Agreements</b>	<ul style="list-style-type: none"> <li>Reimbursement Agreement (DFP to DFP Guarantor)</li> </ul>	N/A	

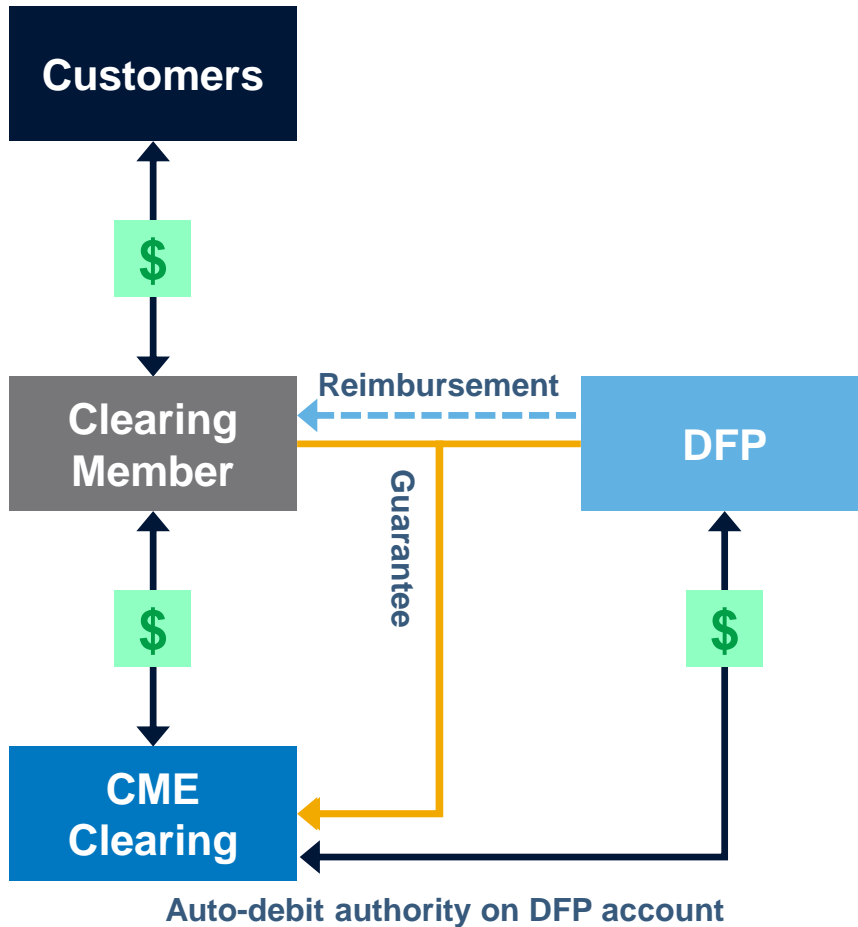
Note: DFPs are only required to purchase memberships for the DCMs on which they wish to trade

# Traditional Clearing Relationship



- Customers access CME Clearing services through CME Clearing Members
- Clearing Members have legal agreement with customers to guarantee customer performance to CME
- All IM and VM flows go through Clearing Members to CME
- Customer funds must be held in segregated accounts
  - Futures: Customer Segregated 4d account
  - Swaps: Cleared Swaps Customer 4d(f) account (LSOC)

# DFP Clearing Structure Overview



## DFP Guarantor

- May only guarantee DFP trades in asset classes for which it maintains a clearing membership
- Assumes responsibility for DFP obligations to CME Clearing and accountable for any shortfalls
- In the event of a DFP default, may serve as CME's liquidation agent for the DFP portfolio

## DFP & DFP Guarantor: Capital Requirement

- DFP: Must post the greater of (1) the margin top-up required due to the move to a two-day liquidation period or (2) 104% of margin that would be required without application of two-day
- Guarantor: Must hold 4% capital against the DFP's performance bond requirement

## Direct Funding Participant

- DFP is a special Clearing Membership type that receives full guarantee of another non-DFP Clearing Member firm
- Must meet DFP requirements under CME rules and/or imposed by DFP Guarantor
- DFP pays and collects IM and VM with CME directly (FCM removed from payment flows)
- Must use CME approved settlement banks
- In the event of the DFP Guarantor's default, DFP performance bond is not subject to the risk of pro-rata distribution

# Risk Managing DFPs

DFP Guarantors will be provided the tools and reporting to fully risk manage their DFPs

Reporting/ Tool	Frequency/ Ability	What report/tool provides	Customer	DFP
<b>Drop Copy services</b>	<ul style="list-style-type: none"> <li>Real-time</li> </ul>	<ul style="list-style-type: none"> <li>Messages routed in real time that provide CMFs trade order entry acknowledgements and trade executions of those they provide clearing services</li> <li>Specific identifiers will notify Guarantors which messages are a DFP's</li> </ul>	Yes	Yes
<b>Other trade reporting</b>	<ul style="list-style-type: none"> <li>Real-time</li> </ul>	<ul style="list-style-type: none"> <li>CME will provide real-time notifications of DFP give-up and block trading activity through normal clearing messaging infrastructure</li> </ul>	Yes	Yes
<b>Initial Margin report</b>	<ul style="list-style-type: none"> <li>ITD, EOD</li> </ul>	<ul style="list-style-type: none"> <li>Breakdown of margin requirements by currency and product</li> </ul>	Yes	Yes
<b>Initial Margin Requirements</b>	<ul style="list-style-type: none"> <li>ITD, EOD</li> </ul>	<ul style="list-style-type: none"> <li>Ability to require additional margin to be held at CME</li> </ul>	Yes	Yes
<b>Variation Margin report</b>	<ul style="list-style-type: none"> <li>ITD, EOD</li> </ul>	<ul style="list-style-type: none"> <li>Breakdown of variation by product type and currency</li> </ul>	Yes	Yes
<b>Guaranty Fund reports</b>	<ul style="list-style-type: none"> <li>Monthly</li> </ul>	<ul style="list-style-type: none"> <li>Reports Guaranty Fund requirement for the given period and change from prior period</li> <li>Will provide DFP specific reporting</li> </ul>	Yes	Yes
<b>Trade Registers</b>	<ul style="list-style-type: none"> <li>ITD, EOD</li> </ul>	<ul style="list-style-type: none"> <li>Verify trading activity and positions of accounts</li> </ul>	Yes	Yes
<b>Asset Inventory Trial Balance</b>	<ul style="list-style-type: none"> <li>ITD, EOD</li> </ul>	<ul style="list-style-type: none"> <li>Provides detailed breakdown of collateral deposited at CME</li> </ul>	Yes	Yes
<b>Collateral management</b>	<ul style="list-style-type: none"> <li>Real-time</li> </ul>	<ul style="list-style-type: none"> <li>Ability to control what collateral can be deposited to fulfill initial margin obligations</li> </ul>	Yes	Yes
<b>Globex Credit Controls</b>	<ul style="list-style-type: none"> <li>Real-time</li> </ul>	<ul style="list-style-type: none"> <li>Set and monitor margin based and position based limits for trades executed through Globex</li> </ul>	Yes	Yes
<b>OTC Credit Controls</b>	<ul style="list-style-type: none"> <li>Real-time</li> </ul>	<ul style="list-style-type: none"> <li>Set and monitor risk based limits</li> </ul>	Yes	Yes

Reports provided per clearing service, as applicable

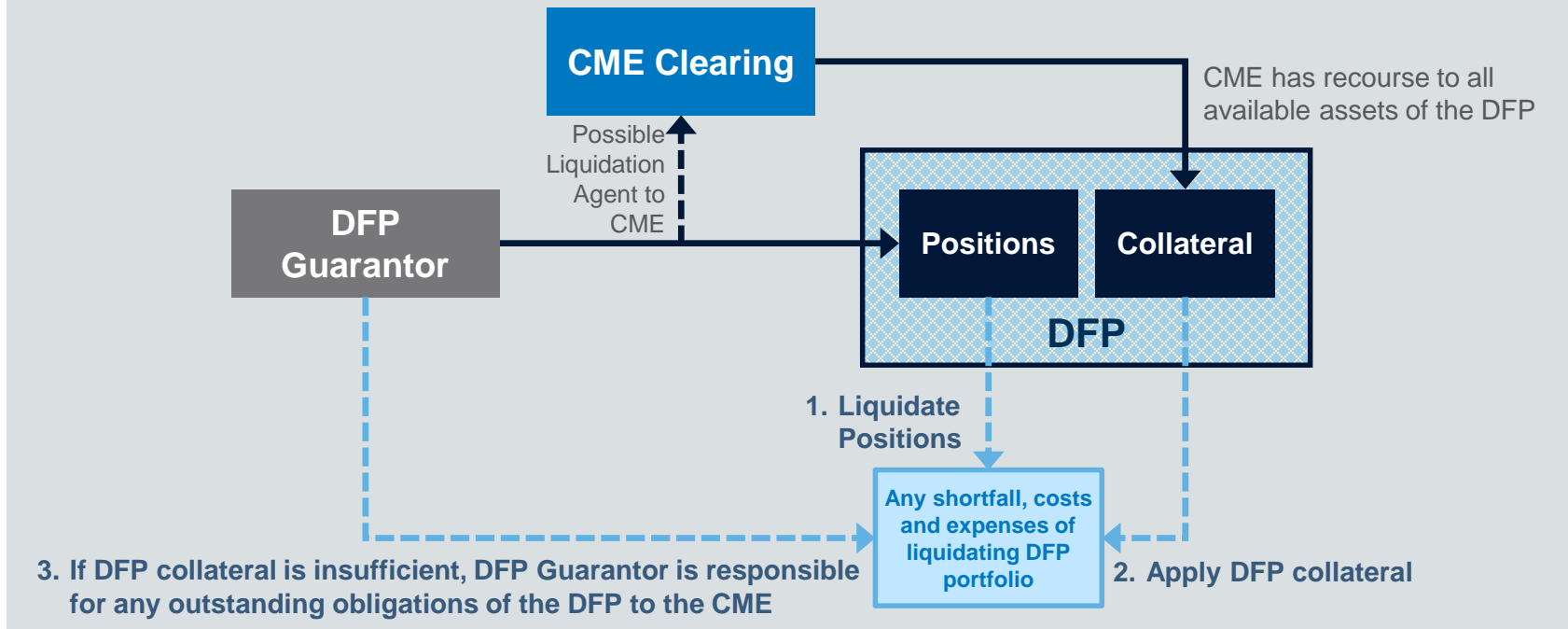
# DFP Default Scenario

If a DFP defaults, CME has 2 options after ensuring the DFP shortfall is met

1. Confirm that failure is operational in nature and bring fully margined DFP into relevant FCM customer pool subject to CME approval

2. Allow DFP's positions/collateral to be liquidated

## Scenario: DFP Defaults, DFP positions/collateral liquidated



- DFP default does not result in utilization of the waterfall unless the DFP Guarantor also defaults



# DFP Guarantor Exit Scenario

## Default or Suspension of the Guarantor

- If the DFP Guarantor defaults or is suspended the DFP may express one of the following preferences:
  1. Find a replacement DFP Guarantor;
  2. Change its clearing membership status in the Clearing House to that of a Clearing Member that is not a DFP, which status would be provisional pending subsequent approval by the Clearing House;
  3. Transfer its open positions to one or more Clearing Members in the customer origin; or
  4. Liquidate its open positions guaranteed by its DFP Guarantor
- The DFP has 24 hours to declare its intention to CME; if it is options 1, 2, or 3 they will need to have completed the arrangements by last settlement cycle of the first business day following the declaration

## Withdrawal of the Guarantor

- A DFP Guarantor may request to withdraw from its status as a DFP Guarantor for one or more of its DFPs
- The withdrawal is effective upon the earlier of:
- The withdrawal is effective upon the earlier of:
  - (i) 30 business days after the date on which the notice of intent was submitted;
  - (ii) the date of Clearing House staff approval; or
  - (iii) the 1st Business Day following the date of the clearing cycle in which each DFP of the withdrawing Guarantor either (a) has liquidated or transferred all of its open positions, (b) finds a replacement guarantor that has funded any necessary contributions, or (c) changes its clearing membership status to that of a clearing member that is not a DFP.

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