

**SUBMISSION COVER SHEET**

**IMPORTANT:** Check box if Confidential Treatment is requested

Registered Entity Identifier Code (optional): 16-301RRR (1 of 5)

Organization: Chicago Mercantile Exchange Inc. ("CME")

Filing as a:  DCM  SEF  DCO  SDR

Please note - only ONE choice allowed.

**Filing Date (mm/dd/yy): 08/25/17 Filing Description: Implementation of New CME, CBOT, NYMEX, and COMEX Rules 830.C., 900.C., 902.B., 912.A., and 912.B.; Amendments to CME, CBOT, NYMEX, and COMEX Rule 820 and CME Rule 8G831; and Implementation of New CME Rule 8G912 to Create Direct Funding Participant Clearing Membership.**

**SPECIFY FILING TYPE**

Please note only ONE choice allowed per Submission.

**Organization Rules and Rule Amendments**

- Certification § 40.6(a)
- Approval § 40.5(a)
- Notification § 40.6(d)
- Advance Notice of SIDCO Rule Change § 40.10(a)
- SIDCO Emergency Rule Change § 40.10(h)

**Rule Numbers:** 820; 830.C., 900.C, 902.B, 912, 8G831 and 8G912

**New Product**

**Please note only ONE product per Submission.**

- Certification § 40.2(a)
- Certification Security Futures § 41.23(a)
- Certification Swap Class § 40.2(d)
- Approval § 40.3(a)
- Approval Security Futures § 41.23(b)
- Novel Derivative Product Notification § 40.12(a)
- Swap Submission § 39.5

**Official Product Name:**

**Product Terms and Conditions (product related Rules and Rule Amendments)**

- Certification § 40.6(a)
- Certification Made Available to Trade Determination § 40.6(a)
- Certification Security Futures § 41.24(a)
- Delisting (No Open Interest) § 40.6(a)
- Approval § 40.5(a)
- Approval Made Available to Trade Determination § 40.5(a)
- Approval Security Futures § 41.24(c)
- Approval Amendments to enumerated agricultural products § 40.4(a), § 40.5(a)
- "Non-Material Agricultural Rule Change" § 40.4(b)(5)
- Notification § 40.6(d)

**Official Name(s) of Product(s) Affected:**

**Rule Numbers:**

**VIA ELECTRONIC PORTAL**

Mr. Christopher J. Kirkpatrick  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

**RE: CFTC Regulation 40.10(a) Advance Notice. Implementation of New CME, CBOT, NYMEX, and COMEX Rules 830.C., 900.C., 902.B., 912.A., and 912.B.; Amendments to CME, CBOT, NYMEX and COMEX Rule 820 and CME Rule 8G831; and Implementation of New CME Rule 8G912 to Create Direct Funding Participant Clearing Membership. CME Submission No. 16-301RRR (1 of 5)**

Dear Mr. Kirkpatrick:

By this submission, Chicago Mercantile Exchange Inc. (“CME”), The Board of Trade of the City of Chicago, Inc. (“CBOT”), New York Mercantile Exchange, Inc. (“NYMEX”), and Commodity Exchange, Inc. (“COMEX”) (each an “Exchange” and collectively, the “Exchanges”) hereby amend Submission No. 16-301RR, dated April 19, 2017, in response to the June 8, 2017 request for further information from the Division of Clearing and Risk of the Commodity Futures Trading Commission (“CFTC” or “Commission”) pursuant to Regulation 40.10(c).

Please note that Submission No. 16-301RRR provides additional information requested by the Commission and proposes further modifications to the Exchanges’ rulebooks. Key amendments include:

- Providing CFTC-requested information regarding financial resource sizing under the DFP program;
- Making certain clarifying amendments suggested by the Futures Industry Association (“FIA”) and addressing FIA comments in cover letter;
- Clarifying Exchange membership requirements for DFPs;
- Updating the form of Reimbursement Agreement; and
- Adding rule text describing types of permissible service arrangements between DFP Guarantors and DFPs.

All changes to the rule text as against Submission No. 16-301RR are reflected in Exhibit 1.

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The Exchanges hereby provide advance notice to the Commission, pursuant to CFTC Regulation 40.10, of proposed changes to the CME/CBOT/NYMEX/COMEX Rulebooks to: (i) add new Rule 900.C, which will provide for a new category of clearing membership, a Direct Funding Participant (“DFP”) clearing member, (ii) add new Rule 902.B., which will prescribe the membership requirements for a DFP, (iii) amend CME Rule 8G831 to address the application of portfolio margining between eligible futures and swaps positions in a DFP’s portfolio, (iv) amend Rule 912 to address the approval of an applicant for DFP clearing membership, (v) amend Rule 830.C. to exclude DFPs from cross margining, (vi) add new CME Rule 8G912

to conform to the existing and concurrently proposed provisions of Rule 912 and (vii) amend Rule 820 to address the potential for a second lien on behalf of DFP Guarantors (cumulatively, the “Proposed Rules”).<sup>1</sup>

We intend these changes to become effective on the earlier of October 25, 2017 or the receipt of regulatory approval.

The Proposed Rules will create a new type of direct clearing membership at the Exchanges, which will enable a firm to clear trades solely for its own account; provided that, the obligations to the Clearing House arising from the firm’s DFP activity are guaranteed by at least one other clearing member that is registered with the CFTC as a futures commission merchant (“FCM”), called a “DFP Guarantor” in the context of the DFP program, and entitled to directly clear the relevant products at the Exchanges. DFPs will directly deliver their performance bond collateral to the Clearing House, thereby providing three key benefits. First, the DFP’s collateral is not exposed to the risk of pro rata loss allocation that it might otherwise face if the DFP instead were a customer of an FCM. All discussions in this document with respect to pro rata loss allocation and insolvency relate exclusively to the commodity broker liquidation provisions of the Bankruptcy Code and Part 190 of the CFTC Rules. This document does not address customer property or an insolvency proceeding under the Securities Investor Protection Act of 1970. Second, since the DFP’s performance bond would not pass through the DFP Guarantor, the DFP Guarantor would not face the potential increase to its regulatory leverage capital requirements that it otherwise might have faced if it had directly received cash performance bond from its cleared derivatives customer in its capacity as an FCM (assuming the applicability of U.S. GAAP). Third, direct settlements between the DFP and the Clearing House have the benefits of (i) removing a link in the settlement chain between the Clearing House and the ultimate customer, and thereby minimizing the number of opportunities for settlement bank failure or transit risk to occur, and (ii) diffusing the concentration of settlement flows so that a settlement failure with a clearing member that is a DFP Guarantor would not be as large as it otherwise might have been had the DFP remained a customer of the DFP Guarantor (in its capacity as an FCM).

To be clear, for purposes of the Basel III leverage ratio (i.e., Supplementary Leverage Ratio, as implemented by U.S. banking regulators) the Exchanges do not understand DFP clearing membership to have any impact on the ability or inability of a clearing member, whether acting as an FCM with respect to a customer or as a DFP Guarantor with respect to a DFP, to use amounts that are segregated as performance bond to offset its leverage exposures for the cleared derivatives guaranteed by such clearing member.

### **CFTC Regulatory Requirements**

The Exchanges are proposing the Proposed Rules in connection with Sections 5(d)(11) and 5b(c)(2)(B), (C), (D), and (G) of the Commodity Exchange Act (“CEA”) and Parts 38 and 39 of the CFTC’s regulations.<sup>2</sup>

As is relevant to this submission, CEA Section 5(d)(11) requires each designated contract market (“DCM”) to have rules ensuring the financial integrity (including clearing through a derivatives clearing organization) of transactions entered into on or through the DCM’s facilities.<sup>3</sup> Regulations 38.601(b) and 38.602 implement CEA Section 5(d)(11) by setting forth a general requirement for each DCM to coordinate with each derivatives clearing organization (“DCO”) that clears the DCM’s transactions to develop rules to facilitate prompt and efficient transaction processing and a general requirement that each DCM provide for the financial integrity of its transactions by establishing appropriate minimum financial standards for its members and non-intermediated market participants.<sup>4</sup>

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<sup>1</sup> Any capitalized term that is not defined herein is defined in CME’s Rulebook.

<sup>2</sup> 7 U.S.C. §§ 7(d)(11), 7a-1(c)(2)(B), (C), (D) and (G); 17 C.F.R. parts 38 and 39.

<sup>3</sup> 7 U.S.C. § 7(d)(11).

<sup>4</sup> 17 C.F.R. §§ 38.601(a) and 38.602.

As is relevant to this submission, CEA Section 5b(c)(2)(B) requires each DCO to have adequate financial, operational and managerial resources to discharge its responsibilities as a DCO. Regulation 39.11(a)(1) implements CEA Section 5b(c)(2)(B) by setting forth a general requirement that a DCO maintain financial resources sufficient to enable it to meet its financial obligations to clearing members notwithstanding a default by the clearing member creating the largest financial exposure to the DCO in extreme but plausible market conditions.<sup>5</sup> Regulation 39.33(a)(1) implements the same statutory provision by setting forth a general requirement that a systemically important DCO maintain financial resources sufficient to enable it to meet its financial obligations to clearing members notwithstanding a default by the two largest clearing members, creating the largest combined loss to the DCO in extreme but plausible market conditions.<sup>6</sup>

As is relevant to this submission, CEA Section 5b(c)(2)(C) requires each DCO to establish appropriate and continuing eligibility standards for members and establish and implement minimum procedures to verify, on an ongoing basis, the compliance of each member with such standards. Regulation 39.12(a) implements CEA Section 5b(c)(2)(C) by setting forth several standards that a DCO must consider as part of its admission and continuing participation requirements for clearing members.<sup>7</sup> Specifically, Regulation 39.12(a) requires a DCO's membership requirements to: (1) permit fair and open access to clearing members and prospective members; (2) ensure members have access to sufficient financial resources to meet obligations under extreme but plausible market conditions; (3) ensure members have adequate operational capacity to meet the obligations of membership; (4) establish procedures for the DCO to monitor the clearing member; (5) require the clearing member to provide the DCO with periodic financial reports; and (6) provide the DCO with the ability to enforce its membership requirements against a clearing member.<sup>8</sup>

As is relevant to this submission, CEA Section 5b(c)(2)(D) generally requires each DCO to ensure that it has the ability to manage the risks associated with its responsibilities as a DCO through the use of appropriate policies and procedures. Regulation 39.13(e) implements CEA Section 5b(c)(2)(D) by expressly requiring each DCO to measure its credit exposure to each of the DCO's clearing members.<sup>9</sup> Regulation 39.13(f) implements CEA Section 5b(c)(2)(D) by requiring each DCO to implement margin requirements and other risk control mechanisms to limit the DCO's exposure to potential defaults by its clearing members to ensure (1) that the DCO's operations would not be disrupted, and (2) the non-defaulting clearing members would not be exposed to losses beyond their anticipation or control.<sup>10</sup> Regulation 39.13(h)(1)(i) implements CEA Section 5b(c)(2)(D) by requiring each DCO to impose risk limits on each clearing member, in order to prevent such clearing member from carrying positions whose attendant risk exposure exceeds specified thresholds relative to the clearing member's and/or DCO's financial resources.<sup>11</sup> Regulation 39.13(e) implements CEA Section 5b(c)(2)(D) by requiring each DCO to establish and enforce time deadlines for initial margin payments to the DCO by its clearing members.<sup>12</sup>

As is relevant to this submission, CEA Section 5b(c)(2)(G) requires each DCO to have rules and procedures designed to allow for the efficient, fair and safe management of events during which clearing members become insolvent or otherwise default on obligations to the DCO. These procedures must be clearly stated and publicly available, and must allow for the DCO to take timely action to contain losses and liquidity pressures and continue meeting obligations of the DCO.<sup>13</sup> Regulation 39.16(c)(2) implements CEA Section 5b(c)(2)(G) by requiring each DCO to set forth in its default procedures what actions the DCO may take

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<sup>5</sup> 17 C.F.R. § 39.11(a)(1).

<sup>6</sup> 17 C.F.R. § 39.33(a)(1).

<sup>7</sup> 17 C.F.R. § 39.12(a).

<sup>8</sup> 17 C.F.R. § 39.12(a)(1) – (6).

<sup>9</sup> 17 C.F.R. § 39.13(e).

<sup>10</sup> 17 C.F.R. § 39.13(f).

<sup>11</sup> 17 C.F.R. § 39.13(h)(1)(i).

<sup>12</sup> 17 C.F.R. § 39.13(e).

<sup>13</sup> 7 U.S.C. § 7a-1(c)(2)(G).

upon a default and any obligations of its clearing members to participate in auctions or accept allocations of customer or house positions.<sup>14</sup>

### **Purpose, Operation and Effect of DFP Clearing Membership**

**Purpose of DFP Clearing Membership.** The purpose of DFP clearing membership is to offer market participants an alternative form of clearing membership that offers several key benefits relative to the FCM-customer relationship and the direct clearing membership. Unlike existing customers of FCMs, a DFP would post collateral to and settle all payments with the Clearing House directly, thereby eliminating transit risk and the risk of pro rata loss allocation that a DFP might otherwise face if it instead were a customer of an FCM, and possibly reducing FCM settlement bank risk. In addition, since the DFP's performance bond would not pass through its DFP Guarantor, the DFP Guarantor should not be required hold the DFP's cash collateral on balance sheet subject to capital requirements (assuming the applicability of U.S. GAAP). Finally, by maintaining a relationship with its DFP Guarantor, the DFP can outsource operational functions to its DFP Guarantor that it would otherwise need to implement as a direct clearing member. Each of these benefits is explained in greater detail below.

Futures customer collateral posted with an FCM presently is exposed to the risk of pro rata loss allocation in the event of a customer-led FCM default (i.e., a "double default") and futures and swaps customer collateral presently are exposed to the risk of pro rata loss allocation if there is a shortfall in any of the respective customer accounts in an FCM bankruptcy (i.e., shortfalls due to operational or investment risks). Even in situations where these customers may ultimately recover 100% of the collateral they posted with their FCM, they nonetheless will face some amount of uncertainty, albeit temporary, regarding their positions and collateral and, ultimately, may face a lengthy process before the full value of collateral due back is recovered. For certain customers of FCMs, the risk of pro rata loss allocation, combined with the threat of uncertainty and possible delayed recovery, however small, may be worth avoiding given the importance of their positions and the amount of collateral posted, in aggregate.

Under U.S. GAAP, performance bond that is posted by a customer in the form of cash directly to a bank-affiliated FCM generally would be recorded on the FCM's balance sheet. Under the Basel III Leverage Ratio (i.e., Supplementary Leverage Ratio, as implemented by U.S. banking regulators), this on-balance sheet treatment would have the effect of increasing the on-balance sheet component of the FCM's leverage exposures, which in turn increases such FCM's leverage capital requirement. In contrast, a DFP's performance bond is posted directly to the Clearing House without the intermediation of the DFP Guarantor. Accordingly, the cash performance bond posted by a DFP should not similarly impact the leverage capital requirements of its DFP Guarantor as the cash performance bond of a customer might impact the leverage capital requirements of its FCM. Existing and potential clearing members within bank holding company structures have noted potential capital benefits where affiliated entities clear positions directly with the Clearing House as DFPs rather than indirectly via the clearing members' proprietary account.

The DFP may also utilize its relationship with its DFP Guarantor for back-office services and regulatory reporting.

**Operation of DFP Clearing Membership.** As explained in detail below, a DFP will operate as any other clearing member,<sup>15</sup> but its membership will differ from that of an ordinary clearing member in the following ways:

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<sup>14</sup> 17 C.F.R. § 39.16(c)(2).

<sup>15</sup> Accordingly, in the event that CME runs an ad-hoc settlement cycle, a DFP would be subject to the ad-hoc cycle just the same as any other clearing member.

- Limits on Trading and Direct Relationship with Clearing House. A DFP would only be permitted to clear trades for itself; a DFP would not be permitted to clear trades for any third parties, including any affiliated entities (absent a change in the DFP's membership status).<sup>16</sup> A DFP would only be permitted to clear the products that its DFP Guarantor itself is approved by the Exchanges to clear (and a DFP Guarantor may only guarantee a DFP with respect to products that the DFP Guarantor has been itself approved by the Exchanges to clear.) Like any other clearing member, a DFP would post or pay related performance bond, option premium, variation settlements and other amounts directly to the Clearing House.
- Financial Obligations Guaranteed by DFP Guarantor. A DFP would be expected to meet the same settlement cycles and timing as any other clearing member. Unlike ordinary clearing members, a DFP's performance on its financial obligations to the Clearing House and the Exchanges would be guaranteed by its DFP Guarantor.

If a DFP were to fail to meet any settlement cycle (or any other payment obligation to the Exchanges), the Exchanges may declare such DFP to be in default under existing Rules 802.A.(1) or 8G802.A.(1). Proposed Rule 900.C.3.a. would provide the Clearing House with authority to automatically draw on the DFP Guarantor's house account any amounts unpaid by its DFP. So, for a DFP's activity in Base products, if the DFP's settlement bank failed to irrevocably commit to payments for either of the applicable 7:30 a.m. or 1:30 p.m. (Central) deadlines for the end-of-day or intraday settlement cycles (respectively), Clearing House staff would promptly notify the DFP Guarantor of the DFP's failure. Clearing House staff then would promptly notify the settlement bank of its intent to draw on the DFP Guarantor's house settlement account for any amounts unpaid by the DFP. Either the settlement bank would immediately and irrevocably commit to such draw, or Clearing House staff, immediately following the settlement bank's failure to commit to such draw, would notify the DFP Guarantor of the pending obligation and the DFP Guarantor would have until 8:30 a.m. or 2:30 p.m. (Central) (for the end-of-day and intraday settlement cycles, respectively) to settle the DFP's unpaid amounts. For settlement cycles with respect to IRS Contracts, the same timing and process would apply, only without an intraday settlement cycle.

If the DFP Guarantor answers for its DFP's unpaid amounts and the DFP ultimately defaults, Proposed Rule 900.C.3.e. would ensure that the amounts drawn from the DFP Guarantor's house settlement account would be treated as a conditional collect of the DFP's obligation to the Clearing House and repaid to the DFP Guarantor by the Clearing House, to the extent that the Clearing House has any remaining collateral of the DFP after the DFP's positions are closed out and any loss to the Exchanges or the Clearing House have been set off against such collateral.

If the DFP Guarantor fails to answer for the DFP's unpaid amounts, the Clearing House may declare such DFP Guarantor to be in default under existing Rule 802.A.1. or CME Rule 8G802.A.1.

- Guaranty and Reimbursement Agreement. Pursuant to Proposed Rule 900.C.2, a DFP Guarantor would guarantee complete responsibility for all of the financial obligations to the Exchanges arising from the DFP's operations as a DFP, in the event the DFP fails to meet them.<sup>17</sup>

A DFP Guarantor also would be responsible for indemnifying the Exchanges against any loss associated with the default of its DFP (including any losses, costs and expenses incurred by the

<sup>16</sup> A DFP cannot carry "customer" positions or accounts, or accept "customer" collateral. See 7 U.S.C. § 1a(28) (defining an "FCM" as an individual or entity that "solicits or accepts orders"); 17 C.F.R. § 1.3(k) (defining a "customer" as any person who uses an FCM "as agent in connection with trading in any commodity interest. . .").

<sup>17</sup> This guaranty, however, would not apply to amounts owed by the DFP to CME as a result of an enforcement or similar action taken by CME in its capacity as a self-regulatory organization against the DFP other than any amounts that may be owed jointly by the DFP and DFP Guarantor in connection with a joint enforcement action against the DFP and DFP Guarantor.

Exchanges in managing the default of such DFP). If a DFP Guarantor fails to promptly satisfy its obligations as guarantor, the Exchanges may declare such DFP Guarantor to be in default under existing Rule 802.A.1. or CME Rule 8G802.A.1.

Each DFP would be required to execute a Reimbursement Agreement with its DFP Guarantor in a general form prescribed by the Exchanges. The Reimbursement Agreement will serve as the contractual mechanism that ensures the DFP is obligated to reimburse its DFP Guarantor for any and all payments made by such DFP Guarantor pursuant to its guaranty under the DFP program. The general form of Reimbursement Agreement is attached under separate cover as Exhibit 2, confidential treatment requested. Although the parties may alter the Reimbursement Agreement or may enter into separate agreements that reflect additional commercial terms, as between the DFP and the DFP Guarantor, any alteration of the form of Reimbursement Agreement may be rejected by the Clearing House in its sole discretion as certain types of provisions may adversely impact the legal analysis with respect to whether a DFP's performance bond is "customer property" in an insolvency of the DFP Guarantor, as described below and further reflected in a Memorandum of Law provided by CME's outside counsel, and such changes should therefore be undertaken with caution and with appropriate advice of counsel on the potential impact of the changes.

- Risk Controls and Reporting to DFP Guarantor. Clearing House staff would risk monitor and manage a DFP clearing member's activity just as it risk monitors and manages any other self-clearing member's activities, except that Clearing House staff also would give effect to the risk controls prescribed by the DFP Guarantor herein. Presently, all clearing members in both the Base and IRS clearing services are subject to exposure limits, which are monitored on a daily basis by Clearing House staff. The Clearing House has the authority to impose lower limits on any clearing member should Clearing House staff deem the clearing member's exposure limit to be disproportionately large. CME Clearing has the authority and ability to revise limits for its clearing members as deemed appropriate.

A DFP Guarantor must prescribe pre-trade risk controls in the manner that would be required by CFTC Regulation 1.73 if the DFP were a "customer" of an FCM for purposes of such rule on all DFPs for which it acts as a Guarantor. Because the DFP Guarantor guarantees the financial obligations of its DFP to the Exchanges, the DFP Guarantor would also be permitted to prescribe risk controls for its DFP to the Exchanges. These risk controls may include, but would not be limited to, credit controls, increased minimum margin requirements and stricter collateral restrictions and concentration limits. Each of these risk requirements would be additive to any requirements the Exchanges already impose on their clearing members. Proposed Rules 900.C.1.e. and 900.C.2.f. would also provide the Clearing House with broad discretion to impose further risk requirements on a DFP.

To facilitate a DFP Guarantor's ability to monitor the activity of its DFP, the Clearing House would provide a DFP Guarantor with reports relating to each of its Designated DFPs.<sup>18</sup> These reports would include, but would not be limited to, initial margin reports (broken down by currency and product), variation margin reports (broken down by currency and product), trade registers (verifying trading activity and positions) and asset inventory trial balance (detail of collateral deposited with the Clearing House).

- Additional Margin Requirements for DFP. In order to ensure that, between the margin of the DFP and the capital of its DFP Guarantor, the same amount of assets exists to address a defaulted DFP as would otherwise exist if the DFP had been a defaulted customer of an FCM that would have set aside the minimum capital of no less than 8% of its defaulted customer's total risk margin requirement, the Clearing House would have heightened margin requirements for a DFP (and its DFP Guarantor would be subject to additional capital requirements, as discussed below).

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<sup>18</sup> Defined in Proposed Rule 900.C.1.a as a DFP which is guaranteed by a particular DFP Guarantor.

Proposed Rule 900.C.1.d. provides that the performance bond requirement for each position of a DFP would be the greater of what is required by Rule 826 or 104% of what otherwise would be required in the absence of Rule 826.<sup>19</sup> The remaining capital would be accounted for through the imposition of capital requirements equal to 4% of the DFP's total risk margin requirement applied to the DFP Guarantor.

- Additional Capital Requirements for DFP Guarantor. Because the financial obligations of a DFP would be guaranteed by its DFP Guarantor, Proposed Rule 900.C.2.c. would adjust the DFP Guarantor's existing capital requirements to account for the activity of its DFP. Under Proposed Rule 900.C.2.c., the DFP Guarantor's adjusted capital requirement would be the greatest of: (1) \$5,000,000, unless the DFP Guarantor is an IRS Clearing Member or a CDS Clearing Member or clears OTC Derivatives other than agricultural OTC Derivatives, in which case the minimum capital requirement would be \$50,000,000; (2) the applicable regulatory capital requirement set forth in CFTC Regulation 1.17(a)(1)(i)(B) for positions carried in customer and noncustomer accounts<sup>20</sup> plus 4% of the total risk margin requirement for each DFP's open positions that are being guaranteed by the DFP Guarantor in its capacity as DFP Guarantor; (3) the applicable regulatory capital requirement set forth in CFTC Regulation 1.17(a)(1)(i)(D); or (4) 20% of the total risk margin requirement for the DFP Guarantor's proprietary IRS Contracts and CDS Contracts, its customers' IRS Contracts and CDS Contracts and each DFP's IRS Contracts that are being guaranteed by the DFP in its capacity as DFP Guarantor. Taken together, the increased margin requirements for a DFP (as adjusted by Proposed Rule 900.C.1.d.) and the adjusted capital requirements for the DFP Guarantor (as adjusted by Proposed Rule 900.C.2.c.), will ensure that, at a minimum, the same amount of assets exists to address a defaulted DFP as would otherwise exist if the DFP had been a defaulted customer of an FCM where the FCM would have set aside the minimum capital of no less than 8% of its defaulted customer's total risk margin requirement.
- Sizing Guaranty Fund Contribution of DFP Guarantor. A DFP would not be required to make contributions to the Guaranty Fund, but instead its DFP Guarantor would have its Guaranty Fund contributions sized to account for the activity of the DFP guaranteed by the DFP Guarantor. The DFP Guarantor's Guaranty Fund contribution would be sized differently for Base Products and for IRS Products. For additional information, please see Submission No. 16-301SRR, Appendix A (confidential treatment requested). For financial resource sizing purposes, DFPs and their affiliated<sup>21</sup> DFP Guarantors will be stressed separately and independently, and where the combined stress results are higher the affiliates will be treated as a single entity. Aggregation of separate DFP positions managed by a single entity will be driven by a linked probability of default between the two DFPs.
- Default of a DFP. In the event a DFP fails to meet a payment or other obligation and (i) such failure is determined by the Clearing House staff not to be the result of the DFP's creditworthiness, and (ii) the DFP Guarantor has paid all amounts owed by such DFP to the Clearing House, then the DFP Guarantor could request that the DFP be converted into a customer and some or all of its positions and associated collateral be transferred to the DFP Guarantor's appropriate customer account(s).<sup>22</sup> The Clearing House would have sole discretion to grant or deny such a request. Under Proposed Rule 900.C.3.b, the Clearing House would not make such a transfer unless the

<sup>19</sup> Rule 826 provides that other than for agricultural commodity derivatives contracts that meet the exclusion criteria established in Article 2 of the February 24, 2016 European Commission equivalence determination for cleared-only OTC products, CME shall ensure performance bond requirements for a Clearing Member's proprietary positions are calculated (on a net basis) and collected using a liquidation period of not less than 2 days.

<sup>20</sup> For the avoidance of doubt, the capital requirements set out in CFTC Regulation 1.17(a)(1)(i)(B) do not apply to DFP positions guaranteed by the DFP guarantor.

<sup>21</sup> Affiliated in this context means (1) one DFP has a 50% or greater ownership stake in another DFP or (2) is under common ownership indicating a linked probability of default.

<sup>22</sup> This alternative was suggested in discussions with clearing members, who pointed out that they may be interested in preserving their customer relationship by converting a DFP back into a customer if the DFP faced difficulty with the operational requirements attendant to clearing membership.

following conditions have been satisfied: (1) all amounts that the Designated DFP failed to pay to the Clearing House must be promptly satisfied; (2) the DFP Guarantor's request to transfer open positions of the DFP must have been received by the Clearing House within 8 hours of the DFP's failure, unless a period of time longer than 8 hours is deemed appropriate by the Clearing House Risk Committee or, if the DFP is only approved for IRS Products, by the IRS Risk Committee; (3) the Designated DFP must reimburse the applicable DFP Guarantor for all amounts owed under their Reimbursement Agreement; (4) the DFP Guarantor must represent to the Clearing House that the Designated DFP's open positions and associated collateral, if transferred into the appropriate customer account, would not present an undue risk to the appropriate customer accounts under the DFP Guarantor's existing credit policies and procedures; and (5) the Designated DFP must satisfy any additional conditions specified by the Clearing House. Upon satisfaction of each of these conditions, the Clearing House may permit the transfer of the Designated DFP's open positions and associated collateral into the DFP Guarantor's appropriate customer accounts; however, the Clearing House cannot transfer such positions and collateral any sooner than the first settlement cycle on the second business day after the receipt of the DFP Guarantor's request, unless a longer or shorter period of time is deemed appropriate by the Clearing House Risk Committee or, if the DFP is only approved for IRS Products, by the IRS Risk Committee. And even if these conditions are met, the Clearing House has sole discretion over whether or not to make such a transfer.

Each person's status as DFP and DFP Guarantor (relative to such DFP) shall terminate concurrently with the completion of the transfer and/or liquidation of all of the Designated DFP's positions.

In determining whether the DFP's failure to meet a payment or other obligation was related to its creditworthiness, the Clearing House would look to the specific facts and circumstances concerning the failure, the market and credit risk evaluations that the DFP Guarantor performs in the ordinary course on each of its customers and Exchange and Clearing House staff perform in the ordinary course on each of their clearing members, available data on the DFP's recent trading activity, the composition of the DFP's collateral with the Clearing House, any signals from the DFP Guarantor (i.e., recently lowered credit limits, recently increased minimum margin requirements, historical lowering of credit limits or increases of margin levels), direct conversations with the DFP (and requests for additional information and/or specific representations, if appropriate) and any other information Exchange or Clearing House staff deem necessary in order to ensure a DFP's failure was not related to its creditworthiness. At the same time, the DFP Guarantor will be going through a similar exercise, and the Exchanges expect a DFP Guarantor would look to the routine credit diligence it performs on all guaranteed parties in the ordinary course (relying both on its historical diligence of the DFP and updating its diligence of the DFP) and any other information the DFP Guarantor deems necessary in order to ensure that its DFP remains a good credit risk.<sup>23</sup> If the Clearing House is unable to adequately determine whether a DFP's failure was related to its creditworthiness, the DFP Guarantor's request would be denied and Clearing House staff, at its discretion, may liquidate the DFP's positions.

In the event of the suspension of or default by a DFP, its DFP Guarantor, if called upon by the Clearing House, would be obligated to act as liquidating agent for the Exchanges in liquidating the positions, and hedging the risks, of the defaulted DFP's portfolio. In this role, the DFP Guarantor would be required to use commercially reasonable efforts, based on the complexity of the DFP's portfolio and market conditions, to liquidate the DFP's open positions using commercially reasonable methods including but not limited to transactions in the market, novation or auction. Proposed Rule 900.C.3.c.(4) would expressly authorize a DFP Guarantor, as liquidating agent, to engage in any commercially reasonable transaction to hedge the risks of the DFP's portfolio and disclose the DFP's portfolio to third parties reasonably appropriate (in the judgment of the DFP

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<sup>23</sup> CME has been advised by a clearing member that sufficient diligence into the DFP's creditworthiness could be performed within 48 hours.

Guarantor, as liquidating agent) in order to effect the liquidation. The DFP's positions and collateral will remain with the Clearing House throughout the liquidation, as opposed to being moved into the DFP Guarantor's house accounts. Any remaining assets of the suspended or defaulted DFP that are available to the Clearing House would be used to discharge any loss to the Exchanges or the Clearing House associated with such suspension or default, and remaining performance bond thereafter will, at the Clearing House's discretion, be available to satisfy any obligations secured by any second lien permitted under Proposed Rule 900.C.7. A DFP Guarantor that has paid the Clearing House for obligations of its DFP may also have the right, under common law or contractual subrogation, to step into the shoes of the Clearing House and enforce those claims directly against the DFP. Per Proposed Rule 900.C.9, the DFP Guarantor's subrogation rights are waived and cannot be exercised until the payment in full of all obligations of the DFP to the Exchanges and the Clearing House and the satisfaction of all claims of the Exchanges and the Clearing House against the DFP.

- Default, Suspension or Withdrawal of a DFP Guarantor. In the event of a DFP Guarantor's default, suspension or withdrawal, the Clearing House will be permitted to take any action with respect to the positions of the defaulted DFP Guarantor's DFP as if the DFP itself had defaulted. Proposed Rule 900.C.6.b. gives the Clearing House the express discretion to allow a DFP to (i) liquidate its open positions guaranteed by its DFP Guarantor; (ii) find a replacement DFP Guarantor; (iii) 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; and/or (iv) transfer its open positions to one or more Clearing Members. The DFP must make a declaration of its intent to the Clearing House within 24 hours of the earlier of (x) the Clearing House notifying the DFP of its DFP Guarantor's suspension or default, (y) the Clearing House publishing an advisory of the DFP Guarantor's suspension or default, or (z) the DFP Guarantor submitting a notice of withdrawal from its status as DFP Guarantor with respect to the DFP, unless the Clearing House Risk Committee or, if the DFP is only approved for IRS Products, the IRS Risk Committee, deems that a period of time longer than 24 hours is appropriate. The DFP must also agree to any additional conditions as specified by the Clearing House.

The DFP must have completed one (or a combination) of the actions in Proposed Rule 900.C.6.b. with respect to all of its open positions by no later than the last settlement cycle of the first business day after the Clearing House receives the declaration from the DFP, unless the Clearing House Risk Committee or, if the DFP is only approved for IRS Products, the IRS Risk Committee, deems that a longer period of time is appropriate.

- Exception from Specific Rulebook Provisions. DFPs would be generally subject to the provisions of the CME/CBOT/NYMEX/COMEX Rulebook as would any other clearing member; however, Proposed Rule 900.C.1.c. would specifically except DFPs from certain requirements that are otherwise applicable to other clearing members.<sup>24</sup> Each of these exceptions is described briefly herein:

**Financial capitalization.** A DFP would be excepted from the financial capitalization requirements in CME Rules 8F004, 8G04.1, 8G04.2, and Exchange Rules 901.F and 970.A, and from the notification, filing and preparation requirements in CME Rule 8F011.A.2. and Exchange Rule 970.A relating to such financial capitalization requirements. Because a DFP's financial performance would be guaranteed by its DFP Guarantor, such guaranty obviates the need for the Exchanges to impose a financial capitalization requirement, although it does not prevent the DFP Guarantor from imposing minimum financial capitalization requirements as a condition of guaranteeing the DFP's performance. Any such commercial terms negotiated between the DFP and its DFP

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<sup>24</sup> Additionally, provisions in the CME Rulebook dealing with customer-specific issues generally would be inapplicable to DFP clearing members, since they are prohibited from clearing trades for customers.

Guarantor may be memorialized in the Reimbursement Agreement, which must be entered into as a condition of the DFP's membership, as described above, or in a separate agreement between the parties.

**Parent guarantee.** A DFP would be excepted from the parent guarantee requirements in Rules 901.G and 901.L because its financial performance would be guaranteed by its DFP Guarantor.

**Membership requirements.** A DFP would be excepted from the membership requirements in Rule 902.A. Instead, the minimum number of memberships required of a DFP are codified in Proposed Rule 902.B. Under Proposed Rule 902.B., a DFP would be required to have at least: one CME membership of any division for the privilege of clearing CME products, one CBOT membership of any division<sup>25</sup> for the privilege of clearing CBOT products, two NYMEX memberships for the privilege of clearing NYMEX products and two COMEX memberships for the privilege of clearing COMEX products. The membership requirement in Proposed Rule 902.B. reflects the minimum number of memberships required for clearing privileges under the organizational documents of each of the respective DCMs.

**Financial statements.** A DFP would be excepted from the requirement to produce financial statements in CME Rule 84004.8 and Exchange Rules 970.A, 970.B and 970.C because its financial performance would be guaranteed by its DFP Guarantor. This form of guaranty obviates the need for the Exchanges to require a DFP to produce financial statements, although it does not prevent the DFP Guarantor from demanding financial statements from its DFP as a condition of guaranteeing the DFP's performance to the Exchanges. Any such commercial terms negotiated between the DFP and its DFP Guarantor may be memorialized in the Reimbursement Agreement required as a condition of the DFP's membership or in a separate agreement between the parties.

**Guaranty Fund contribution.** A DFP would be excepted from the requirement to contribute to the guaranty fund as required by CME Rules 8F007, 8G07 or Exchange Rule 816. As discussed in detail above, the DFP Guarantor's Guaranty Fund contribution would be sized to account for the activity of its DFP.

**Assessments.** A DFP would be excepted from the requirement to pay assessments in CME Rules 8G802.B, 8G802.C or Exchange Rule 802.B. Because assessments are calculated relative to the Guaranty Fund contribution of a clearing member, any assessments levied against a DFP Guarantor would incorporate the activity of its DFP.

**Loss mitigation exercises.** If a DFP were an IRS clearing member, it would be excepted from the requirement to participate in the mitigation of losses of another IRS clearing member pursuant to CME Rule 8G14 and from the requirement to nominate persons to the Active Base OTC Default Management Committee or IRS Default Management Committee pursuant to CME Rules 8F004.11 or 8G04.4.

Notwithstanding the aforementioned exceptions, a DFP remains subject to the Clearing House's authority under Proposed Rule 900.C.1.e. to implement all risk requirements that the Clearing House or the DFP Guarantor may impose.

**Effect of DFP Clearing Membership.** Because operation of DFP clearing membership would be substantially similar to that of a self-clearing member, the effects of many of the aspects of DFP clearing membership would not be material to the Exchanges, the Clearing House, clearing members or the markets. The significant effects of DFP clearing membership are as follows:

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<sup>25</sup> CME, IMM, IOM and GEM are divisional memberships at CME. Full, AM, GIM, IDEM and COM are divisional memberships at CBOT. Please see <http://www.cmegroup.com/company/membership/individual.html>.

- Sizing the Guaranty Fund Contribution of DFP Guarantor. The Proposed Rules would ensure that a DFP Guarantor's contributions to the Base Guaranty Fund and the IRS Guaranty Fund would be sized to account for the activity of its DFP. As explained above, any increase to the overall Guaranty Fund sizing as a result of DFPs will be allocated back only to, and additional contributions collected only from, those clearing members that are DFP Guarantors. For the IRS Guaranty Fund, the DFP Guarantor's Guaranty Fund contribution would be sized using the same methodology the Clearing House presently uses for IRS Guaranty Fund sizing, except that the stress shortfall of a DFP Guarantor that is an LND would be calculated to include its house account and its two largest non-house accounts – without regard to whether those accounts are customer accounts or DFP account(s). The positions of DFPs that have a 50% or greater ownership stake in another DFP or are under common ownership that indicates a linked probability of default between the two DFPs will drive aggregation for the purposes of sizing financial resources requirements.
- DFP Guarantor Financial Guaranty of DFP Performance to the Clearing House and Exchanges. A DFP Guarantor would guarantee complete responsibility for all of the financial obligations to the Clearing House and Exchanges arising from the DFP's operations as a DFP, in the event the DFP fails to meet them. The nature of the DFP Guarantor's guaranty would be substantially similar but not identical to the guaranty an FCM provides to its customer. Accordingly, the Proposed Rules would impose DFP-focused capital requirements on a DFP Guarantor (discussed immediately below) to account for such differences.
- Additional Capital Requirements for DFP Guarantor. The Proposed Rules would impose DFP focused capital requirements on a DFP Guarantor because the DFP Guarantor would guarantee the financial obligations of its DFP. The DFP Guarantor's capital requirements, as adjusted by the Proposed Rules, and the additional margin requirements that would be imposed on the DFP by the Proposed Rules, ultimately would ensure that, between the margin of the DFP and the capital of its DFP Guarantor, no fewer assets are available to address a defaulted DFP as would otherwise be available if the DFP had been a defaulted customer of an FCM that would have set aside the minimum capital of no less than 8% of its defaulted customer's total risk margin requirement. Exchange and Clearing House staff would monitor the DFP Guarantor's capital in the same manner that it currently monitors the minimum required capital of its clearing members.
- Management of DFP Suspension or Default. In the event a DFP fails to meet a payment or other obligation to any Exchange or the Clearing House, there would be two choices for resolution. First, to the extent that such failure has been determined by the Clearing House not to be the result of the DFP's creditworthiness, and the DFP Guarantor has paid all amounts owed by such DFP to the Exchanges and the Clearing House, then the DFP Guarantor could request that the DFP be converted into a customer and some or all of its positions and associated collateral be transferred to the DFP Guarantor's appropriate customer account(s). In any other circumstance, the DFP's failure to satisfy a payment obligation to the Exchanges or the Clearing House may result in the suspension or default of the DFP, in which case its DFP Guarantor would be obligated to act as liquidating agent for the Exchanges in liquidating the positions, and hedging the risks, of the defaulted DFP's portfolio. Any remaining assets of the suspended or defaulted DFP that are available to the Exchanges and the Clearing House would be used to discharge any loss to the Exchanges and the Clearing House associated with such suspension or default, and thereafter may be made available, in the discretion of the Clearing House, to satisfy any obligations secured by any second lien that is permitted under and described in Proposed Rule 900.C.7.
- Management of DFP in Event of DFP Guarantor Suspension or Default. In the event of the suspension or default of the DFP Guarantor, the Exchanges would be permitted to take any action with respect to the positions of the defaulted DFP Guarantor's DFP as if the DFP itself had defaulted. As discussed in detail above, the Exchanges also may allow a DFP to (i) find a replacement DFP Guarantor, (ii) request its clearing membership status be changed to that of a

non-DFP clearing member (which status would be provisionally approved pending subsequent approval by Exchange and Clearing House staff), (iii) transfer its open positions to the customer origin(s) of one or more clearing members, (iv) liquidate open positions guaranteed by the DFP Guarantor, and/or (v) satisfy any additional conditions specified by the Clearing House.

- Risk Controls, Reporting to DFP Guarantor. The Clearing House will impose its ordinary complement of risk controls on each DFP by virtue of the DFP's status as a clearing member. Additionally, the Proposed Rules oblige each DFP Guarantor to impose risk-based limits and risk management controls on any DFPs it guarantees as if the DFP were a "customer" for purposes of CFTC rules and as if the DFP Guarantor were required to comply with CFTC Regulation 1.73. The Clearing House will also be responsible for implementing additional risk controls prescribed by a DFP Guarantor with respect to its Designated DFPs. As discussed above, these additional controls may include credit limits, minimum margin requirements, collateral requirements and risk controls. To facilitate a DFP Guarantor's ability to monitor the activity of its DFP, the Clearing House also would provide a DFP Guarantor with reports relating to each of its Designated DFPs. As discussed above, these reports would include, but would not be limited to, initial margin reports (broken down by currency and product), variation margin reports (broken down by currency and product), trade registers (verifying trading activity and positions) and asset inventory trial balance (detail of collateral deposited with the Clearing House).
- Impact to the Risks in Customer Origin and Capital Requirements of Guarantor (as FCM). If a DFP withdraws as a customer of an FCM in favor of becoming a DFP and the DFP's former FCM acts as DFP Guarantor, such withdrawal would have the following impact on the customer segregated accounts and cleared swap customer accounts of the DFP's former FCM: First, the withdrawal of the DFP means that the customer accounts of the DFP's former FCM will no longer be exposed to the risks attendant to the positions of the DFP (which was formerly a customer). Without knowing the remaining positions in the DFP's former FCM's customer accounts, it is not possible to know the net impact of such withdrawal on the overall risk in the customer accounts (and even if it was possible to know the net impact at a specific point in time, it is not possible to predict whether such impact would remain constant over time) but it is clear that the DFP could no longer cause a hole in the customer origin and the attendant loss sharing that would result from that hole if the FCM defaulted. In addition, the DFP would now be required to place an enhanced level of margin with the Clearing House (at minimum, a 4% increase) which would reduce the likelihood that the DFP's default would negatively impact the capital position of the DFP Guarantor. Second, the withdrawal of the DFP is likely to have the immediate result of somewhat decreasing the amount of capital (measured as a raw number) that the former FCM is required to maintain.<sup>26</sup> Consequently, if one of the remaining customers of the DFP's former FCM defaulted (after the DFP's withdrawal as a customer), it is possible that the DFP's former FCM would have less capital (measured as a raw number) to address the customer's default even though the DFP's capital would represent the same percentage of the performance bond associated with the segregated customer pool.<sup>27</sup>

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<sup>26</sup> Recall that FCMs are required to maintain capital in the amount of at least 8% of "the total risk margin requirement for positions carried by the [FCM] in its customer accounts and noncustomer accounts." 17 C.F.R. § 1.17(a)(1)(i)(B). Accordingly, a DFP's withdrawal from the customer origin of an FCM is likely to have the immediate effect of decreasing the total risk margin requirement in the customer account. The decreased total risk margin requirement in the customer account, when multiplied by 8%, results in a smaller number than it otherwise would have been prior to the DFP's withdrawal due to the fact that the DFP Guarantor would hold 4% capital against the DFP's total risk margin requirement.

<sup>27</sup> The Exchanges note that while there are circumstances in which DFP membership could have the immediate impact of decreasing the minimum capital maintained by the DFP's former FCM (expressed as a raw number), the customer accounts of the DFP's former FCM would no longer bear the risks attendant to the DFP's positions and the DFP's former FCM would continue to maintain no less than the minimum amount of capital the Commission has deemed appropriate under CFTC Regulation 1.17. To the extent that the Commission believes that the presence of a DFP is a factor that customers of the DFP's former FCM should consider, we would support the DFP's former FCM updating its public disclosures, as required by CFTC Regulation 1.55, to disclose the presence of the DFP and any attendant perceived potential risks.

## **Expected Risks and the Exchanges' Plans to Manage Any Such Risks**

The Exchanges expect that the nature and level of risks to the Clearing House, clearing members or the market introduced by the addition of the DFP clearing membership category would be substantially similar to those already presented by other clearing members, with three exceptions:

- **Operational Risks.** The Exchanges expect that certain operational risks attendant to DFP clearing membership may exist, namely the increased operational risks to the Clearing House and the risk of operational failures by DFPs though each DFP will be subject to the same level of scrutiny in regard to its operational capabilities as any other clearing member. The increased operational risks to the Clearing House result from its responsibility to implement risk controls prescribed by a DFP Guarantor with respect to each of its Designated DFPs, which is a function generally performed by FCMs with respect to their customers rather than by the Clearing House. The Clearing House plans to manage these risks by allocating Clearing House staff to develop, manage and continually update systems that will support the implementation and application of such risk controls. If the implementation or application of any risk controls for a DFP introduces a nature or level of risk that the Clearing House is not comfortable with, Proposed Rule 900.C.2.d. would require the DFP Guarantor to prescribe pre-trade risk controls on all DFPs and would further allow the Clearing House to impose additional conditions or requirements on the DFP's membership, which authority could be used to mitigate such risk.

As recognized above, we also believe that the DFP model will minimize certain other existing operational risks. In particular, direct settlements between the DFP and the Clearing House are expected to (i) remove a link in the settlement chain between the Clearing House and the beneficial owner of positions, and thereby minimizing the number of opportunities for settlement bank failure or transit risk to occur, and (ii) diffuse the concentration of settlement flows so that a settlement failure with a clearing member that is a DFP Guarantor would not be as large as it otherwise might have been had the DFP remained a customer of the DFP Guarantor (in its capacity as an FCM).

Ultimately, the risk of operational failures by DFPs will be unique to each DFP and will depend on the DFP's resources and sophistication and the nature and volume of its trading. The Exchanges plan to manage these risks by carefully vetting each DFP applicant and scrutinizing the applicant's financial and operational resources and capabilities. In addition, the Exchanges would (and expect that DFP Guarantors also would) use the authority in Proposed Rule 900.C.1.e. and 900.C.2.d. to craft discretionary risk controls that would address any operational concerns with a DFP. Finally, Proposed Rule 900.C.3.b provides a mechanism for a DFP Guarantor to request that a DFP be converted to a "customer" (for purposes of CFTC rules) of the DFP Guarantor (which would then be acting as a traditional FCM and not as DFP Guarantor) or be moved into the DFP Guarantor's house account, if the DFP is an affiliate of the DFP Guarantor (again, with the DFP Guarantor now acting in the capacity of a traditional clearing member) in the event of operational failures by the DFP.

- **Settlement Risks.** The DFP's performance on each settlement cycle would be guaranteed by its DFP Guarantor, and any amounts unpaid by the DFP may be drawn from the DFP Guarantor's house settlement account by the Clearing House. The ability of the Clearing House to immediately draw from a DFP Guarantor's house settlement account for unpaid obligations of an unaffiliated third party would present a slightly different version of an existing risk to the DFP Guarantor's house settlement account (the existing risk being an FCM's obligation to answer for its customer's failure to meet a margin call). If a DFP Guarantor were to answer for a DFP's unpaid settlement cycle obligations, it would result in an immediate capital charge to the DFP Guarantor, which is different from the situation where an FCM answers for a customer's failure to meet a margin call (in which case a capital charge ordinarily would not be immediately incurred). This too would present a potential new risk to the DFP Guarantor.

A DFP Guarantor's ability to impose higher margin requirements would provide the DFP Guarantor with an opportunity to require excess performance bond from which any unpaid obligations of its DFP might ultimately be settled.

- Suspension or Default Procedures. In the event that the DFP or its DFP Guarantor is suspended or defaulted, the Proposed Rules would introduce new mechanics to the Exchanges' existing mechanics for the suspension or default of a clearing member.

With respect to the operational default of a DFP, the Exchanges would address potential risks by: (1) leaving the transition of the DFP's positions and collateral to the DFP Guarantor's customer origin account(s) to each Exchange's sole discretion, (2) requiring the DFP Guarantor to diligence its DFP and make affirmative representations to the Exchanges about the risks of such transition relative to the DFP Guarantor's existing credit policies and procedures, (3) requiring the DFP itself to reimburse the DFP Guarantor for any amounts owed under their Reimbursement Agreement, and (4) waiting to perform any such transfer until the first settlement cycle on the second business day.

With respect to any other suspension or default of a DFP, because each DFP's financial obligations to the Clearing House will be guaranteed by one or more DFP Guarantors (each of whom are themselves clearing members) and DFP Guarantors will have their Guaranty Fund contributions and assessments adjusted to account for the activity of each of their Designated DFPs, the Exchanges expect that the nature and level of financial risks attendant to a DFP suspension or default to be sufficiently addressed.

The Clearing House would address the prospective risks introduced by the suspension or default of a DFP Guarantor by: (1) reserving the authority to take action against the DFP as if the DFP itself was suspended or defaulted, (2) reserving the authority to liquidate the DFP's open positions guaranteed by the suspended or defaulted DFP Guarantor, (3) reserving the authority to require the DFP to satisfy any additional conditions specified by the Clearing House, and (4) requiring the DFP to declare its intention within 24 hours of the earlier of (x) Clearing House or Exchange staff notifying the DFP of its DFP Guarantor's suspension or default, or (y) the Clearing House publishing an advisory of the DFP Guarantor's suspension or default (unless the Clearing House Risk Committee or, if the DFP is only approved for IRS Products, by the IRS Risk Committee, deems that a period of time longer than 24 hours is appropriate).

## **Core Principle Review**

The Exchanges reviewed the designated contract market core principles ("DCM Core Principles") and the derivatives clearing organization core principles ("DCO Core Principles") as set forth in the CEA and identified that the Proposed Rules and rule amendments may have some bearing on the following principles:

- DCM Core Principle 7 – Availability of Public Information. The Proposed Rules will be added to the Clearing House's publicly available rulebook and this Submission 16-301RR will be posted to CME Group's public website concurrently with its submission to the Commission.
- DCM Core Principle 11 – Financial Integrity. The Proposed Rules would provide for the financial integrity of transactions entered into by DFPs on or through the Exchanges' facilities and would establish appropriate minimum financial standards for DFPs. Specifically, the DFP's financial performance to the Exchanges would be guaranteed by its DFP Guarantor, whose Guaranty Fund contributions (and therefore, assessments) would be sized to account for the DFP's activity. Furthermore, the DFP Guarantor's capital requirements would be increased to account for the guaranty the DFP Guarantor provides to its DFP.

- DCO Core Principle B – Financial Resources. The Proposed Rules would ensure that a DFP's financial obligations are guaranteed by a DFP Guarantor, that a DFP Guarantor must be capitalized to account for the activity of its DFP(s) and that a DFP Guarantor's Guaranty Fund contributions (and therefore assessments) are sized to account for the activity of its DFP(s), inclusive of affiliated DFPs. These measures would ensure that the Clearing House maintains adequate financial, operational, and managerial resources sufficient to ensure that the Clearing House discharges its responsibilities as a DCO. Similarly, the Clearing House's minimum financial resources would continue to exceed the total amount that would enable the Clearing House to meet its financial obligations to its members and participants notwithstanding a default by its largest two clearing members, in each waterfall, in extreme but plausible market conditions.
- DCO Core Principle C – Participant Eligibility. The Proposed Rules would establish appropriate and continuing eligibility standards for DFPs and establish and implement minimum procedures to verify, on an ongoing basis, the compliance of each DFP with such standards. Specifically, Proposed Rule 900.C would permit fair and open access to all persons that are admitted, or seek to be admitted, as DFPs. In vetting DFP applicants and examining DFP members, Clearing House and Exchange staff will ensure that both prospective DFPs and admitted DFPs have and maintain sufficient financial resources (through their DFP Guarantors and the additional requirements imposed on them in the Proposed Rules) and adequate operational capacity to meet the obligations of membership.
- DCO Core Principle D – Risk Management. The Proposed Rules would ensure that the Clearing House has the ability to manage its risks and responsibilities as a DCO, through the use of appropriate policies and procedures. Specifically, the Proposed Rules require DFP Guarantors to impose risk controls on all DFPs it guarantees and would further leave the Clearing House with the ability to impose additional risk requirements on a DFP and broad discretion in managing the operational and non-operational defaults (or suspensions) of DFPs, as well as the suspension or default of DFP Guarantors. The Proposed Rules would further allow the Clearing House discretion to adjust the Guaranty Fund contributions (and therefore, assessments) of DFP Guarantors, as well as to prescribe additional capital requirements. Each of these discretionary powers or express requirements ensures the Clearing House retains its ability to manage its risks and responsibilities as a DCO. Additionally, each DFP, as a clearing member, will be subject to the provisions of CME Rule 982, which, *inter alia*, requires all clearing members to maintain written risk management policies and procedures in accordance with CFTC Regulation 39.13(h)(5).
- DCO Core Principle G – Default Rules and Procedures. Similar to existing risk management practices for defaulting clearing members, the Proposed Rules would leave the Clearing House with broad authority to take timely action with respect to the default of a DFP or a DFP Guarantor, particularly to contain losses and liquidity pressures. The Proposed Rules further would generally set forth the actions that the Clearing House is authorized to take upon the suspension or default of the DFP and/or its DFP Guarantor.
- DCO Core Principle L – Public Information. The Proposed Rules will be added to the Clearing House's publicly available rulebook, permitting customers, clearing members and prospective clearing members to account for the Proposed Rules' potential impact.

### **Brief Explanation of Any Substantive Opposing Views**

The Exchanges have discussed DFP clearing membership extensively with their clearing members. One substantive opposing view has been that the heightened capital requirements that would be imposed on a DFP Guarantor should instead be imposed on the DFP itself, in order to mitigate (or at least avoid further aggravating) the existing capital strains imposed on FCMs. The Exchanges reviewed the concern and

determined that it is not appropriate to shift the capital burden solely to the DFP (in the form of a minimum margin of 108% of what would be required in the absence of Rule 826) in light of the views expressed by other market participants, as opposed to an equitable distribution of the capital requirements between the DFP and its DFP Guarantor. The Exchanges also question whether the DFP program does in fact create heightened capital requirements on the DFP Guarantor as compared to the capital requirements set out for FCM clearing members with respect to customers under Commission regulations. Further, the Exchanges believe that an appropriate amount of additional capital held by the DFP Guarantor is important to prudent risk management.

In a letter to the CFTC dated October 17, 2016, the FIA outlined certain concerns with the DFP rules. The FIA requested clarification from the CFTC regarding the inapplicability of certain CFTC rules to DFP Guarantors acting in that capacity. The Exchanges will work with CFTC staff to provide the requested assurance that the specified regulatory provisions will not apply to a DFP Guarantor registered as an FCM when it acts in its capacity as a DFP Guarantor with respect to its designated DFP.

The FIA requested an examination of the impact that a second-priority lien in the collateral of the DFP granted to bank-affiliated clearing members would have on CME's "customer property" bankruptcy analysis. We have worked with our outside counsel to evaluate the impact of allowing (but not requiring) a DFP to grant a DFP Guarantor a second priority lien on the performance bond posted by the DFP on the question of whether such performance bond constitutes "customer property" in the event of the Guarantor's insolvency under the Bankruptcy Code. We have concluded that, subject to the restrictions on second liens in Proposed Rule 900.C.7., the existence of a second lien in favor of a DFP Guarantor in a DFP's performance bond should not alter the conclusion that such performance bond should not be "customer property." Proposed Rule 900.C.7. permits second liens, but any such second liens may secure only (1) obligations of the DFP to the DFP Guarantor under the Reimbursement Agreement and (2) other obligations of a DFP to its DFP Guarantor that do not arise from and are not related to any "commodity contract," as defined in the Bankruptcy Code. The analysis with respect to second liens is described in a Memorandum of Law from CME's outside counsel provided to CME that is providing to the CFTC staff as Exhibit 4 hereto, for which confidential treatment is requested but will be made available to FIA members upon request.

The FIA asked that CME establish a maximum time frame for a DFP Guarantor's withdrawal from acting in such capacity. The time frame is addressed in proposed Rule 900.C.5.a., set forth in Exhibit A.

The FIA asked for elimination of the requirement that a DFP Guarantor serve as the Exchanges' liquidating agent in the event of a DFP default. The Exchanges' view is the DFP Guarantor is in the best position to know how to manage its Designated DFP through a default as the DFP Guarantor guarantees the DFP's financial obligations to the Clearing House and risk-manages the DFP's portfolio. For example, it may be that one or more swaps are a hedge to some other position the Designated DFP has with its DFP Guarantor. Further, the designated DFP may have numerous other financial relationships with the DFP Guarantor that are not subject to the jurisdiction of the Exchanges' rules or DFP framework (e.g., cleared activity on another CCP, securities prime brokerage if the DFP Guarantor is also registered as a broker-dealer, etc.). Accordingly, we believe the DFP Guarantor must continue to serve as the Exchanges' liquidating agent to facilitate default management of any potentially complex DFP portfolios.

The FIA requested the Exchanges provide legal memoranda analyzing (i) the impact of DFP rules on a DFP Guarantor's capital requirements, and (ii) the application of the "customer property" definition in the Bankruptcy Code and Part 190 Rules in the event of the DFP Guarantor's default (where the DFP Guarantor also serves as an FCM of the DFP with respect to trading on other exchanges). The Exchanges note in respect of item (i) that the impact of DFP on a DFP Guarantor's capital requirements would depend on the DFP Guarantor's entity type, organizational structure, jurisdiction and operations, to name only a few variables. Analyzing the potential impacts on capital requirements for all DFP Guarantors is beyond the scope of analysis the Exchanges could reasonably request from counsel. In respect of item (ii), outside counsel has prepared the requested Memorandum of Law, as described above, and which is attached hereto as Exhibit 4.

Lastly, one FIA member questioned the necessity of the indemnity provision in Proposed Rule 900.c.3.d, under which DFP Guarantors, acting as liquidating agents for the Clearing House with respect to a defaulted DFP's collateral, indemnify the Clearing House and the Exchanges against claims associated with the liquidation of the collateral. The Exchanges view this indemnity as necessary to protect the Exchanges and Clearing House in a number of scenarios, including, *inter alia*, those in which a post-liquidation shortfall exists, the DFP Guarantor pursues the DFP for the shortfall, and the DFP in turn sues the Exchange(s) as principal for the agent's failure to obtain a full recovery on the collateral, and those in which the liquidated value of the collateral satisfies the claims of the Exchange(s), Clearing House and DFP Guarantor, but unsecured creditors, equity holders, or the estate of the DFP take the position that the collateral should have yielded greater value to be returned to the DFP, and such parties sue the Exchange(s) as principal for the agent's failure to maximize the recovery on the collateral. Accordingly, the Exchanges intend to keep this indemnity provision in Proposed Rule 900.c.3.

The text of the proposed changes is reflected on the attached Exhibit 1, with additions underlined and deletions ~~struck through~~.

The Exchanges certify that the above Proposed Rules and rule amendments comply with the CEA and the regulations thereunder.

Notice of this submission has been concurrently posted on CME Group's website at <http://www.cmegroup.com/market-regulation/rule-filings.html>.

If you require any additional information regarding this submission, please contact the undersigned at 212-299-2200 or via e-mail at [CMEGSubmissionInquiry@cmegroup.com](mailto:CMEGSubmissionInquiry@cmegroup.com).

Sincerely,

/s/ Christopher Bowen  
Managing Director & Chief Regulatory Counsel

cc: Board of Governors of the Federal Reserve System

Attachments: Exhibit 1 – CME/CBOT/NYMEX/COMEX Rulebook Amendments (blackline format)  
Exhibit 2 – Form of Reimbursement Agreement (revised August 25, 2017) (attached under separate cover) (confidential treatment requested)  
Exhibit 3 – Responses to DCR 40.10(c) Questions dated June 8, 2017 (attached under separate cover) (confidential treatment requested)  
Exhibit 4 – Memorandum of Law: "Customer Property" Characterization of Performance Bond in Direct Funding Participant Clearing Membership Program, dated August 25, 2017 (attached under separate cover) (confidential treatment requested)

# EXHIBIT 1

## CME/CBOT/NYMEX/COMEX RULEBOOKS

(Additions are underlined; deletions ~~struck through~~)  
(Red text indicates revisions as against Submission 16-301RR, dated April 19, 2017)

### Chapter 9 Clearing Members

#### 900.- CATEGORIES OF CLEARING MEMBERS

\* \* \* \* \*

#### 900.C. Direct Funding Participant Clearing Member

##### 1. Direct Funding Participant Qualifications and Requirements

- a. A person may be admitted as a Direct Funding Participant (“DFP”) for the purpose of clearing trades for its own account (and not for others, including affiliates of the DFP). A DFP must be guaranteed by a Clearing Member (“DFP Guarantor”) that is registered with the CFTC as an FCM and that is entitled to clear all of the products that the DFP seeks to clear pursuant to such guaranty (such DFP, which is guaranteed by a particular DFP Guarantor, is hereinafter referred to as a “Designated DFP” of such DFP Guarantor).
- b. An applicant for Clearing Membership as a DFP must submit an executed Reimbursement Agreement in the form prescribed by the Clearing House from time to time and any other documents and information that the Clearing House may require. A DFP shall have a duty to update the Reimbursement Agreement submitted to the Clearing House for approval immediately in the event of any change in the Reimbursement Agreement previously submitted to the Clearing House. Any Reimbursement Agreement that diverges materially from the form of Reimbursement Agreement approved by the Clearing House may be rejected by the Clearing House in its sole discretion. DFPs and DFP Guarantors shall not include in any Reimbursement Agreement any provision that creates any obligation of a DFP Guarantor to the DFP. Further, subject to Rule 900.C.10 below, DFPs and DFP Guarantors shall not enter into any other agreement related to a guaranty provided under this Rule 900.C that creates any obligations of the DFP Guarantor to the DFP.
- c. A DFP shall be subject to all applicable rules governing Clearing Members and all of the Clearing House’s rights with respect to a Clearing Member (including, without limitation, all rights in the event of a Clearing Member’s suspension or default), including, without limitation, those contained in Chapters 8, 8F, 8G and 9, with the exception of:
  - (1) The financial capitalization requirements pursuant to Rules 8F004, 8G04.1, 8G04.2, 901.F and 970.A and the notification, filing and preparation requirements in Rules 8F011.A.2, and 970.A relating to such financial capitalization requirements;
  - (2) The parent guarantee requirements pursuant to Rules 901.G and 901.L;
  - (3) The membership requirements pursuant to Rule 902.A;
  - (4) The financial statement requirements pursuant to Rules 8F004.8, 970.A, 970.B and 970.C;

- (5) The responsibility to make a contribution to any guaranty fund pursuant to Rule 816, 8F007 or 8G07;
  - (6) The responsibility to pay any Clearing House assessment pursuant to Rule 802.B, 8G802.B or 8G802.C; and
  - (7) The responsibility to participate in the mitigation of losses of another IRS Clearing Member pursuant to Rule 8G14 and to nominate persons to the Active Base OTC Default Management Committee or IRS Default Management Committee pursuant to Rule 8F004.11 or 8G04.4.
- d. The performance bond requirement for each position of a DFP shall be the greater of: (x) that which would be required by Rule 826, or (y) 104% of that which would be required by Chapter 8 of the Rulebook without giving effect to Rule 826.
- e. A DFP must meet all risk requirements as the Clearing House or the applicable DFP Guarantor may impose from time to time.

## 2. DFP Guarantor Qualifications, Requirements and Operations

- a. A Clearing Member may be permitted to act as a DFP Guarantor only with respect to products that the Clearing Member itself is approved to clear. A DFP Guarantor shall assume and guarantee, and upon the execution and delivery of the documents required pursuant to Rule 900.C.1.b., does hereby assume and guarantee complete responsibility for all of the obligations to the Exchange and Clearing House arising from each of its Designated DFP's operations as a DFP, in the event the DFP fails to meet them (but excluding amounts owed by the DFP to the Exchange or Clearing House as a result of an enforcement or similar action taken ~~by the Clearing House in its capacity as a self-regulatory organization against the DFP~~~~of which the~~, other than any amounts owed jointly by the DFP and DFP Guarantor ~~was not a party~~ in connection with an enforcement or similar action taken jointly against the DFP and DFP Guarantor). A Clearing Member that has been permitted to act as a DFP Guarantor may withdraw from its status as a DFP Guarantor by following the procedures in Rule 900.C.5.a.
- b. A DFP Guarantor's contribution to each guaranty fund shall be adjusted to account for each of its Designated DFP's open positions subject to each such guaranty fund, including any minimum established by the Clearing House.
- c. A DFP Guarantor's capital requirement shall be adjusted to account for each of its Designated DFP's open positions, such that the DFP Guarantor's minimum capital requirement will be the greatest of:
- (1) \$5,000,000, unless the DFP Guarantor is an IRS Clearing Member, or CDS Clearing Member or clears OTC Derivatives other than agricultural OTC Derivatives, in which case the minimum capital requirement will be \$50,000,000;
  - (2) the sum of: (x) the applicable regulatory capital requirement set forth in CFTC Regulation 1.17(a)(1)(i)(B) (which, for the avoidance of doubt, would not factor in any margin posted by a DFP), plus (y) 4% of the total risk margin requirement of each DFP's open positions that are being guaranteed by the DFP Guarantor in its capacity as DFP Guarantor;
  - (3) the applicable regulatory capital requirement set forth in CFTC Regulation 1.17(a)(1)(i)(D); or

(4) twenty percent of the total risk margin requirement for the DFP Guarantor's proprietary IRS Contracts and CDS Contracts, its customer IRS Contracts and CDS Contracts and each DFP's IRS Contracts that are being guaranteed by the DFP Guarantor in its capacity as DFP Guarantor.

d. A DFP Guarantor must prescribe ~~risk-based limits and~~ pre-trade risk controls on all DFPs for which it acts as a ~~g~~Guarantor ~~as if each DFP were a customer and as if the DFP Guarantor were required to comply in a manner consistent~~ with CFTC Regulation 1.73. A DFP Guarantor may prescribe risk requirements for each of its Designated DFPs (including, without limitation, credit limits, minimum margin requirements and collateral requirements) in addition to the DFP risk procedures provided by the Clearing House. The Clearing House shall give effect to any such limits, requirements and controls prescribed by a DFP Guarantor provided to the Clearing House.

e. The Clearing House will provide the DFP Guarantor with reports relating to each of its DFPs.

f. A DFP Guarantor must meet such additional requirements as the Clearing House may impose from time to time.

### 3. Direct Funding Participant Termination; Default Management

a. If a DFP fails to meet a payment or other obligation to the Exchange or the Clearing House, the Clearing House will promptly notify the applicable DFP Guarantor and the Clearing House may draw any unpaid amounts from such DFP Guarantor's house settlement account. If the amount in such DFP Guarantor's house settlement account is insufficient to meet such DFP Guarantor's obligation, such DFP Guarantor must pay the amount of such insufficiency to the Clearing House by the deadline set by the Clearing House, which may require immediate payment.

b. If a DFP's failure to meet a payment or other obligation to the Exchange or the Clearing House is not the result of such DFP's creditworthiness (as determined by the Clearing House in its sole discretion), the Clearing House may permit the transfer of all or some portion of the DFP's open positions and associated collateral into the DFP Guarantor's appropriate customer ~~or house~~ accounts at the request of such DFP Guarantor and upon satisfaction of the following conditions:

(1) ~~all~~All amounts that the Designated DFP failed to pay to the Exchange or the Clearing House must be promptly satisfied;

(2) ~~T~~he DFP Guarantor's request to transfer open positions and associated collateral of the DFP must have been received by the Clearing House within 8 hours of the DFP's failure, unless a period of time longer than 8 hours is deemed appropriate by the Clearing House Risk Committee or, if the DFP is only approved for IRS Products, by the IRS Risk Committee. All amounts described in Rule 900.C.3.b.(1) must have been satisfied in advance of the DFP Guarantor making a request pursuant to this Rule 900.C.3.b.(2);

(3) ~~T~~he Designated DFP must reimburse the applicable DFP Guarantor for all amounts owed under its Reimbursement Agreement, including any of the amounts described in Rule 900.C.3.b.(1) that were satisfied by the DFP Guarantor;

(4) ~~T~~he DFP Guarantor must represent to the Clearing House that the Designated DFP's open positions and associated collateral, if transferred into the appropriate customer

or house account, would not present an undue risk to the appropriate customer or house account under the DFP Guarantor's existing credit policies and procedures; and

(5) The DFP and Designated DFP must satisfy any additional conditions specified by the Clearing House.

Upon satisfaction of each of the conditions in Rule 900.C.3.b.(1) through (5), the Clearing House may permit the transfer of the Designated DFP's open positions and associated collateral into the DFP Guarantor's appropriate customer or house accounts, provided, however, that the Clearing House shall not permit the transfer of such positions and collateral any sooner than the first settlement cycle on the second business day after the receipt of the DFP Guarantor's request per Rule 900.C.3.b.(2), unless a longer or shorter period of time is deemed appropriate by the Clearing House Risk Committee or, if the DFP is only approved for IRS Products, by the IRS Risk Committee.

Each person's status as DFP and DFP Guarantor (relative to such DFP) shall terminate concurrently with the completion of the transfer and/or liquidation of all of the Designated DFP's positions and collateral and such Designated DFP shall be moved into the customer account and become a customer of its former DFP Guarantor or into the DFP Guarantor's house account, as appropriate.

c. Unless the circumstances described in Rule 900.C.3.b. have been satisfied and the DFP has been ~~converted~~ moved into a the customer or house account of its former DFP Guarantor, if a DFP fails to promptly discharge any obligation, including, without limitation, a payment obligation, to the Exchange or the Clearing House or becomes subject to any bankruptcy, reorganization, arrangement, insolvency, moratorium, or liquidation proceedings, or other similar proceedings under U.S. federal or state bankruptcy laws or other applicable law, the Clearing House may, in its sole discretion, suspend and/or declare such DFP to be in default, without regard to whether the applicable DFP Guarantor has satisfied such DFP's obligation. If a DFP is declared in default:

(1) Such DFP shall be suspended by the Exchange and/or Clearing House;

(2) The Clearing House may draw any unpaid amounts from such DFP Guarantor's house settlement account;

(3) The DFP shall immediately make available to its DFP Guarantor and the Clearing House upon request all information deemed necessary to manage the risk associated with the DFP's default;

(4) The Clearing House shall be required to liquidate such DFP's portfolio and, if called upon by the Clearing House, the applicable DFP Guarantor shall be obligated to act as liquidating agent for the Clearing House and shall use commercially reasonable efforts, based on the complexity of the portfolio and market conditions, to liquidate such DFP's open positions using commercially reasonable methods;

(5) As liquidating agent, such DFP Guarantor may:

(i) be permitted by the Clearing House to engage in any commercially reasonable transaction to hedge the risks of the DFP's portfolio; and/or

(ii) disclose such DFP's portfolio to third parties as the applicable DFP Guarantor reasonably considers appropriate in order to effect the liquidation;

(65) All assets of such DFP that are available to the Clearing House and the Exchanges, including, without limitation, any performance bond, excess performance bond or other collateral and settlement variation gains held for such DFP (collectively, the "DFP Collateral"), and amounts paid under the guaranty of such DFP Guarantor shall be applied by the Clearing House to discharge any loss to the Exchange or the Clearing House associated with such suspension or default (a "DFP Loss"). A DFP Loss shall include, but not be limited to, costs associated with the liquidation and managing of such DFP's open positions, hedging costs and other costs incurred by the Exchange or the Clearing House related to managing the risk surrounding the suspension or default of such DFP; and/or

(76) The Clearing House may also take any other action against such DFP in the event of such DFP's suspension or default that is authorized by these rules.

d. A DFP Guarantor, pursuant to its obligations as a guarantor, shall be responsible to the Clearing House and the Exchange for any DFP Loss and shall indemnify and hold harmless the Clearing House, the Exchange, and their respective directors, officers, employees and agents against any claim arising from such DFP Guarantor's performance as ~~liquidation~~ liquidating agent. If such DFP Guarantor fails to pay any amount due to the Exchange or the Clearing House pursuant to its guaranty of such DFP or the indemnification it provides as ~~liquidation-liquidating~~ agent, the Clearing House may, in its sole discretion, declare such DFP Guarantor to be in default of its obligations as a Clearing Member.

e. Any amount drawn from the DFP Guarantor's house settlement account or paid by the DFP Guarantor pursuant to the DFP Guarantor's guarantee of a DFP and as permitted by this paragraph 900.C.3. shall be considered a conditional collect of the DFP's obligation to the Exchange and Clearing House, which shall be repaid to the DFP Guarantor by the Clearing House to the extent that any DFP Collateral remains after the Clearing House deducts all other amounts making up the DFP Loss.

#### 4. Direct Funding Participant Default to DFP Guarantor

a. If a DFP fails to meet any of the obligations in its Reimbursement Agreement with its DFP Guarantor (or in any other documentation executed by the parties to establish the relationship between the DFP and its DFP Guarantor), such DFP Guarantor shall promptly notify the Clearing House of such failure. The Clearing House will, at the request of such DFP Guarantor, facilitate the suspension of such DFP. The Clearing House shall not be required to investigate the relevant provision or verify any failure asserted by a DFP Guarantor.

b. Upon suspension of a DFP under Rule 900.C.4.a, the Clearing House, at the request of the applicable DFP Guarantor, may attempt to transfer all or some portion of such DFP's open positions and associated collateral in the manner specified in Rule 900.C.3.b. If such a transfer is not performed with respect to any of the DFP's positions, the remaining open positions of the Designated DFP must be liquidated in the manner specified in Rule 900.C.3.c. or transferred to one or more Clearing Members. Each person's status as a DFP and DFP Guarantor (relative to the Designated DFP) shall terminate concurrently with the completion of the transfer and/or liquidation of all of the Designated DFP's positions.

c. The DFP Guarantor, pursuant to its obligations as a guarantor, will be responsible to the Exchange and the Clearing House for any liability or loss resulting from a suspension of each of its Designated DFPs pursuant to Rule 900.C.4.a.

#### 5. Withdrawal of DFP Guarantor

- a. A DFP Guarantor may request to withdraw from its status as a DFP Guarantor with respect to one or more of its Designated DFPs by providing written notice of such intent to the Clearing House and each of such Designated DFPs. A DFP Guarantor's withdrawal shall be effective on the earlier of (i) 30 business days after the date on which the notice of intent to withdraw was submitted, (ii) the date Clearing House staff approves such withdrawal or (iii) the 1st Business Day following the date of the clearing cycle in which each Designated DFP of the withdrawing DFP Guarantor either (x) has liquidated or transferred all of its open positions, (y) becomes guaranteed with respect to all of its open positions by another DFP Guarantor and the new DFP Guarantor has funded any Guaranty Fund contributions and become liable for any assessments attributable to the Designated DFP or (z) changes its clearing membership status to that of a clearing member that is not a DFP, which status would be provisional pending subsequent approval by the Clearing House.
- b. A request by a DFP Guarantor to withdraw from clearing membership in accordance with Rule 8G913 or 913 shall also be deemed to be a request to withdraw from its status as a DFP Guarantor with respect to each of its Designated DFPs relative to that product class.

#### 6. Impact of DFP Guarantor Default or Withdrawal

- a. If the Clearing House declares a DFP Guarantor to be suspended or in default of its obligations as a Clearing Member, or if a DFP Guarantor otherwise has submitted a written notice of intent to withdraw from its status as DFP Guarantor with respect to one or more of its Designated DFPs, notwithstanding anything in Rule 900.C.5.a., the Clearing House may take any action in relation to each such Designated DFP's open positions that it is authorized to take against a suspended or defaulted Clearing Member, as if each such Designated DFP were itself subject to the suspension or default, including liquidation of each such Designated DFP's open positions.
- b. The Clearing House may, in its sole discretion, refrain from taking any action described in Rule 900.C.6.a (without waiving its right to take such action at a later time), if:
  - (1) ~~the~~The Clearing House receives a declaration from the Designated DFP within 24 hours of the earlier of (x) the Clearing House notifying the Designated DFP of its DFP Guarantor's suspension or default, (y) the Clearing House publishing an advisory of the DFP Guarantor's suspension or default or (z) the DFP Guarantor submitting to the Designated DFP a notice of intent to withdraw from its status as DFP Guarantor with respect to the Designated DFP, unless the Clearing House Risk Committee or, if the DFP is only approved for IRS Products, by the IRS Risk Committee, deems that a period of time longer than 24 hours is appropriate. The declaration must contain a representation that the Designated DFP will:
    - (i) liquidate its open positions guaranteed by its DFP Guarantor;
    - (ii) find a replacement DFP Guarantor;
    - (iii) 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; and/or
    - (iv) open one or more customer accounts with and transfer its open positions to one or more Clearing Members; and
  - (2) ~~the~~The Designated DFP agrees to any additional conditions as specified by the Clearing House.

The Designated DFP must have completed one (or a combination) of the actions in Rule 900.C.6.b.(1)(i) through (iv) with respect to all of its open positions by no later than the last settlement cycle of the first business day after the Clearing House receives the declaration, unless the Clearing House Risk Committee or, if the DFP is only approved for IRS Products, by the IRS Risk Committee, deems that a longer period of time is appropriate.

## 7. Second Liens in Performance Bond

a. In addition to the Clearing House's first priority and unencumbered security interest and lien against any property, cash, securities or collateral deposited with the Clearing House by a DFP pursuant to Rule 819, a DFP may, from time to time, grant to its DFP Guarantor a subordinate security interest (a "second lien") in performance bond held by the Clearing House in order to secure (1) obligations of the DFP to the DFP Guarantor under the Reimbursement Agreement between the DFP and the DFP Guarantor, and (2) other obligations of a DFP to its DFP Guarantor, provided that in no event shall a second lien described in clause (2) of this Rule 900.C.7.a. secure any obligation of the DFP arising from or related to any "commodity contract," as defined in the United States Bankruptcy Code (subject to Rule 900.C.10 below).

b. Any second lien shall be subordinated in all respects to the Clearing House's first priority and unencumbered security interest and lien against a DFP's performance bond. No DFP Guarantor may exercise any remedies with respect to any such second lien unless the Clearing House consents to such exercise in writing or until the Clearing House's interest in such performance bond is released.

c. At any time the Clearing House would otherwise release performance bond posted by a DFP from the Clearing House's first priority and unencumbered security interest and lien, any DFP Guarantor with a second lien in such performance bond may request that the Clearing House deliver it to an account designated by the DFP Guarantor. By submitting such a request to deliver performance bond posted by a DFP to the Clearing House, the DFP Guarantor shall:

(1) ~~be-Be~~ deemed to represent that the DFP Guarantor has the legal right to take possession of such performance bond due to a default by the Designated DFP on an obligation of the Designated DFP secured by the second lien;

(2) ~~indemnify-Indemnify~~ and hold harmless the Clearing House, the Exchanges, and their respective directors, officers, employees and agents against all losses or expenses (including attorneys' fees) reasonably incurred by such person related to the delivery of the performance bond as directed by the DFP Guarantor, such indemnity being in addition to any other indemnity provided under these rules; and

(3) ~~provide-Provide~~ to the Clearing House all documentation requested by the Clearing House supporting its legal right to take possession of performance bond pursuant to this Rule 900.C.7.c.

Upon satisfaction of the conditions prescribed in this Rule 900.C.7.c, the Clearing House may in its sole and absolute discretion, unless prohibited by applicable law or regulation or court order, deliver such performance bond as directed by the DFP Guarantor. The Clearing House shall have no obligation with respect to any second lien and, unless expressly provided in the rules of the Clearing House, no obligation with respect to performance bond subject to a second lien in favor of a DFP Guarantor. The Clearing

House shall have no liability to any DFP Guarantor, DFP or other party with respect to any action or failure to act by the Clearing House with respect to a DFP Guarantor's second lien in performance bond or with respect to performance bond subject to such second lien.

- d. Any attempt by a DFP or DFP Guarantor to create a lien in performance bond of a DFP in favor of the DFP Guarantor in a manner not consistent with this Rule 900.C.7. shall be void.

## 8. Limitation on Liability

For the avoidance of doubt, the liability of the Exchange and the Clearing House for any activities concerning this Rule 900.C. shall be limited by Rule 578 and any related dispute shall be subject to the arbitration requirements of Rule 578.

## 9. Subrogation and Other Claims

Subject to Rule 900.C.7.b, ~~E~~each DFP Guarantor hereby waives, and agrees not to exercise, any subrogation or other rights with respect to performance bond ~~and~~ posted by a DFP prior to payment in full of all obligations of the DFP to the Exchange and Clearing House and the satisfaction of all claims of the Exchange and Clearing House against the DFP.

## 10. Services Agreements

For the avoidance of doubt, a customary arm's-length facilities management services agreement under which a DFP Guarantor provides certain administrative services, including back office and regulatory reporting services, to a DFP with respect to transactions entered into under the DFP Program shall not violate Rule 900.C.1.a., and a grant by a DFP to a DFP Guarantor of a second lien in performance bond held by the Clearing House to secure obligations arising under such an agreement shall not violate Rule 900.C.7.a; provided that any such agreement is documented separately from any Reimbursement Agreement, and is not structured to create a claim of the DFP against its DFP Guarantor on account of any commodity contract made, received, acquired, or held by or through the DFP Guarantor or otherwise create a claim of the DFP against the DFP Guarantor arising out of (i) the making, liquidation, or change in the value of a commodity contract, (ii) a deposit or payment of cash, a security or other property with the DFP Guarantor for the purpose of making or margining such a commodity contract, or (iii) the making or taking of delivery on such a commodity contract.

\* \* \* \* \*

## **912. APPROVAL**

### **912.A. Approval of Clearing Member Applicants**

An applicant for clearing membership (other than applicants for clearing membership as an IRS Clearing Member or CDS Clearing Member) receiving a majority vote of the full membership of the Clearing House Risk Committee shall be approved effective immediately.

An applicant (other than applicants for clearing membership as an IRS Clearing Member or CDS Clearing Member) that fails to receive a majority vote shall be informed by the Clearing House Risk Committee chairman and shall have 10 days thereafter to file an appeal to the Board seeking

further consideration. The Board may approve such applicant by a majority vote if it is satisfied that the Clearing House Risk Committee's decision was arbitrary, capricious or an abuse of the Committee's discretion.

**912.B. Approval of DFP Applicants**

The Clearing House Risk Committee delegates to Clearing House staff the authority to approve applicants for clearing membership as a DFP (other than applicants for DFP clearing membership as an IRS Clearing Member).

\* \* \* \* \*

**Chapter 8  
Clearing House and Performance Bonds**

\* \* \* \* \*

**820. PERFORMANCE BONDS**

Performance bond requirements will be as determined by Exchange staff from time to time. Subject to the terms and conditions as approved by Exchange staff, the Clearing House will accept as performance bond, cash, equity securities, shares of mutual funds, United States Treasury and agency Securities, Letters of Credit, units in CME's Interest Earning Facility Program, shares in CME's Interest Earning Facility 2 Program, permitted investments allowable under CFTC Regulation 1.25, "readily marketable securities" as defined by Securities and Exchange Commission Rules, as applicable, and "London Good Delivery" gold, as defined by the London Bullion Market Association (as used in this Rule 820, such assets and any proceeds thereof are collectively referred to as "Assets"), all of which must be and remain unencumbered, except as otherwise expressly permitted in Rule 900.C. The Clearing House may include other forms of collateral within the definition of "Assets" upon the approval of the Clearing House Risk Committee and notice to clearing members.

\* \* \* \* \*

**830. CROSS-MARGINING**

\* \* \* \* \*

**830.C. [Reserved] Direct Funding Participant Clearing Members**

Notwithstanding any other provision in this Rule 830, a DFP shall not be eligible to become a Participating Clearing Member in a Joint or Guaranteed Cross-Margining Program.

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**CME Rulebook Chapter 8G  
Interest Rate Derivative Clearing**

**8G831. COMMINGLING OF ELIGIBLE FUTURES AND SWAPS POSITIONS**

\* \* \* \* \*

“Commingled Futures Positions” shall mean any positions in Base Guaranty Fund Products commingled with positions in IRS Contracts in accordance with Rule 8G831. With respect to a DFP Clearing Member’s positions, only those Base Guaranty Fund Products and IRS Contracts that are guaranteed by the same DFP Guarantor in its capacity as DFP Guarantor can be commingled as Commingled Futures Positions. As used in Rule 8G802.A, except as otherwise provided therein, the term “IRS Contracts” shall include Commingled Futures Positions.

\* \* \* \* \*

**8G832-9121. [RESERVED]**

\* \* \* \* \*

**8G912. APPROVAL**

1. An applicant for clearing membership as an IRS Clearing Member receiving a majority vote of the full membership of the IRS Risk Committee shall be approved effective immediately.
2. An applicant for clearing membership as an IRS Clearing Member that fails to receive a majority vote shall be informed by the IRS Risk Committee chairman and shall have 10 days thereafter to file an appeal to the Board seeking further consideration. The Board may approve such applicant by a majority vote if it is satisfied that the IRS Risk Committee's decision was arbitrary, capricious or an abuse of the Committee’s discretion.
3. The IRS Risk Committee delegates to Clearing House staff the authority to approve applicants for clearing membership as a DFP IRS Clearing Member.

**CME Rulebook Chapter 9  
Clearing Members**

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**902. CLEARING MEMBERSHIP ASSIGNMENT REQUIREMENTS**

\* \* \* \* \*

**902.B. [Reserved]Assignment Requirement for DFPs**

Notwithstanding anything in Rule 902.A., a DFP is only required to have at least: one CME membership for the privilege of trading CME products, one CBOT membership for the privilege of trading CBOT products, two NYMEX memberships for the privilege of trading NYMEX products and two COMEX memberships for the privilege of trading COMEX products.

Notwithstanding anything in Rule 902.A., a DFP is required to own one membership of any CME division and assign it to the Clearing House for the privilege of clearing CME products. Notwithstanding anything in Rule 900.A., DFPs will receive member fee rates only if approved as a corporate member under Rule 106.

Upon default of a DFP in meeting its obligations to the Clearing House or upon the Clearing House Risk Committee's, or, if the DFP is only approved for IRS Products, by the IRS Risk Committee's determination that a DFP's financial position jeopardizes the financial integrity of the Clearing House, the Clearing House may direct the sale of any or all of the DFP's assigned memberships. The proceeds from the sale of the memberships shall be used to satisfy Rule 110 obligations.

**CBOT Rulebook Chapter 9  
Clearing Members**

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**902. CLEARING MEMBERSHIP ASSIGNMENT REQUIREMENTS**

\* \* \* \* \*

**902.B. ~~[Reserved]~~ Assignment Requirement for DFPs**

~~Notwithstanding anything in Rule 902.A., a DFP is only required to have at least: one CME membership for the privilege of trading CME products, one CBOT membership for the privilege of trading CBOT products, two NYMEX memberships for the privilege of trading NYMEX products and two COMEX memberships for the privilege of trading COMEX products.~~

Notwithstanding anything in Rule 902.A., a DFP is required to own one membership of any CBOT division for the privilege of clearing CBOT products. Notwithstanding anything in Rule 900, DFPs will receive member fee rates only if approved as a corporate member under Rule 106.

Upon default of a DFP in meeting its obligations to the Clearing House or upon the Clearing House Risk Committee's determination that a DFP's financial position jeopardizes the financial integrity of the Clearing House, the Clearing House may direct the sale of any or all of the DFP's assigned memberships. The proceeds from the sale of the memberships shall be used to satisfy Rule 110 obligations.

**NYMEX/COMEX Rulebook Chapter 9  
Clearing Members**

\* \* \* \* \*

**902. CLEARING MEMBERSHIP ASSIGNMENT REQUIREMENTS**

\* \* \* \* \*

902.B.

~~[Reserved]~~ Assignment Requirement for DFPs

~~Notwithstanding anything in Rule 902.A., a DFP is only required to have at least: one CME membership for the privilege of trading CME products, one CBOT membership for the privilege of trading CBOT products, two NYMEX memberships for the privilege of trading NYMEX products and two COMEX memberships for the privilege of trading COMEX products.~~

~~Notwithstanding anything in Rule 902.A., a DFP is required to have at least two NYMEX memberships for the privilege of clearing NYMEX products and two COMEX memberships for the privilege of clearing COMEX products. DFPs will receive member fee rates only if approved as a corporate member under Rule 106.~~

~~At least one membership required for DFP membership pursuant to this rule must be owned by the DFP or a person, including a parent company, with an acceptable proprietary interest in such DFP, if such DFP was approved for membership after July 1, 2009. The second membership may be independently assigned.~~

~~Upon default of a DFP in meeting its obligations to the Clearing House or upon the Clearing House Risk Committee's determination that a DFP's financial position jeopardizes the financial integrity of the Clearing House, the Clearing House may direct the sale of any or all of the DFP's assigned memberships. The proceeds from the sale of the memberships shall be used to satisfy Rule 110 obligations.~~

**EXHIBIT 2**

**Reimbursement Agreement (updated August 25, 2017)**

**(CONFIDENTIAL TREATMENT REQUESTED)**

(attached under separate cover)

**EXHIBIT 3**

**CME Responses to DCR 40.10(c) Questions dated June 8, 2017**

**(CONFIDENTIAL TREATMENT REQUESTED)**

(attached under separate cover)

**EXHIBIT 4**

**Memorandum of Law: “Customer Property” Characterization of Performance Bond in Direct Funding Participant Clearing Membership Program dated August 25, 2017**

**(CONFIDENTIAL TREATMENT REQUESTED)**

(attached under separate cover)