

Advisory Notice

Clearing House

10-256

TO: Clearing Member Firms
Back Office Managers

FROM: CME Clearing

DATE: June 17, 2010

RE: **UPDATE #1 – and SPECIAL NOTE:
Clearing and Bookkeeping Processing for New OTC Account Class**

UPDATE #1 – and SPECIAL NOTE:

The only products affected are products that are currently treated as 30.7 Secured. Nothing is moving **out** of Customer Seg (*ie*, the futures account class). All standard CME-cleared futures and options, and all other products currently covered by a 4d order, remain as part of standard customer segregation.

The set of affected products at this time are:

- NYMEX wet freight forwards – product codes **FB9, FC2, FC4, FC5, FC6, FDD, FPA, FT3, FT5, FT7**
 - COMEX OTC London gold forwards – product code **GB**
 - CME S&P-GSCI Excess Return forwards and swaps – product codes **ERF, GCO, GDI, SE2, SE3, SES**
 - CBOT DJ-UBSCI Excess Return forwards and swaps – product codes **DG2, DG3, DGS**
 - CME-cleared CDS contracts
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On May 6, 2010, the U.S. Commodity Futures Trading Commission put into effect new Part 190 regulations that created a new customer account class for “cleared OTC derivatives” (as defined in new CFTC Regulation 190.01(o)). As stated in the CFTC adopting release for these new regulations, “a position in an OTC derivative (and relevant collateral) that a customer clears through an FCM with a DCO, which position (and relevant collateral) is not subject to a Section 4d Order, would be considered part of the cleared OTC derivative account class, as soon as, but only after, a DCO rule ... that requires such positions (and relevant collateral) to be held in a separate account for cleared OTC derivatives becomes effective”

On **Monday September 13, 2010**, subject to Clearing House Risk Committee and other approvals, CME rules requiring customer “cleared OTC derivatives” to be held in a separate account will become effective. On that date, existing customer positions and collateral currently in the 30.7 Secured Account will be transferred to the new Cleared OTC Customer Account.

So for example, currently customer positions in the new NYMEX wet freight forward contracts are maintained in the 30.7 Secured Account. As of September 13, 2010, they will be maintained in the Cleared OTC Customer Account.

In terms of how bookkeeping systems interface with the clearing system, the impact of this change should be minimal. On trades, there will still be exactly two **origin codes** supported, customer and house. Exactly as a clearing firm does currently, the firm indicates via the origin code on each trade whether the account is a proprietary (house) account of the firm, or whether it is for a customer of the firm.

Position account codes which hold customer positions in 30.7 Secured products are typically denoted with an appended "S". We will use an appended "T" to denote position accounts holding customer positions in Cleared OTC Derivatives. For example, suppose the clearing firm uses firm **CME 123** to clear customer trades in CME products:

- Positions in US futures products (along with products subject to a Section 4d Order) would be in position account **123 CUST**.
- Positions in the new Cleared OTC Derivatives class would be in position account **123T CUST**.

On the FIXML Trade Register file, the position account ID is contained in party role 38.

In the back-end modules of the clearing system – the modules for financial Settlement, Asset Management and Banking – we are introducing a new **funds segregation type**, denoted as **COTC**, to indicate accounts for "cleared OTC derivatives" pursuant to CME rules. In other words:

- **CSEG** will continue to be the designation for customer segregation for US futures products (and products subject to a Section 4d Order).
- **COTC** ("Cleared OTC" Derivatives) will be the new designation for funds related to positions in "cleared OTC derivatives" pursuant to CME rules.

So the clearing firm will see the new **COTC** funds segregation type on Settlement and Banking reports for funds related to these products, but there shouldn't be any impact to firm bookkeeping systems.

CME Clearing will begin to provide firms with testing opportunities for the new OTC account class in late July. Again, from a processing point of view, the impact is limited to having customer position account ID's appended with a "T" instead of an "S".

When effective, CME rules will require clearing firms to maintain funds in cleared OTC customer accounts for all amounts owed to cleared OTC customers and to prepare a daily Cleared OTC Derivative Customer Statement. The calculation of the Cleared OTC Derivative Customer Statement will be similar to the CFTC's daily Segregation Statement. Clearing firm FCMs will be required to compute their cleared OTC customer requirement, the funds held in Cleared OTC Customer Accounts and any excess (or deficiency) of funds in Cleared OTC Customer Accounts. CME rules regarding the administration of this new account class will be very similar to the CFTC's customer segregation rules, including but not limited to the rules regarding recordkeeping and investment of customer funds.

CME rules will also require that clearing firm FCMs call for and collect performance bond collateral for positions in cleared OTC derivatives. Collateral that may be accepted by a clearing firm FCM from its customers and affiliates to meet performance bond requirements is outlined in each Exchange's Rule 930.

FCMs should begin to develop the necessary accounting and operational systems, procedures and controls to ensure they are able to adhere to these new requirements when the rules become effective. In addition, FCMs should open new bank and safekeeping accounts for cleared OTC customer assets. These accounts should be titled "Cleared OTC Customer" and the FCM should obtain satisfactory acknowledgment letters (similar to those currently received for segregated accounts) from these depositories acknowledging that these assets are held for the benefit of the FCM's cleared OTC customers. CME rules will indicate that these funds held at CME Clearing are held in a Cleared OTC Customer Account and it will not be necessary to obtain an acknowledgement letter from CME Clearing for these assets.

The Cleared OTC Derivatives Customer Statement prepared as of month-end will be required to be submitted with the monthly CFTC Form 1-FR or SEC FOCUS Report which is filed with the Audit Department. This statement will be added as an Exchange Supplemental Schedule in Winjammer™, the electronic financial statement filing software used by clearing members.

For more information, please contact CME Clearing at 312-930-3170.