

Advisory Notice

Clearing House

TO: Back Office Managers and Service Providers
FROM: CME Clearing
ADVISORY #: 08-105
SUBJECT: Improving the Balancing Process for Customer Positions in OTC Products
DATE: May 27, 2008

This advisory describes some simple enhancements to the FIXML Trade Register file which will make it easier for firms to balance positions resulting from customer non-reg activity in over-the-counter products. Currently, these products are the CBOT OTC ethanol contracts: the forward-month swap, previous-month swap, three basis swap contracts, and the cash-settled option contracts (clearing codes 71, 72, 73, 74, 75, and 76).

These changes are available the New Release environment now, and will be moved to production after firm testing has completed.

The clearing system allows firms to specify the origin on trades in these contracts as either customer or house, depending on whether the account is a customer or proprietary one. For regulatory reasons, however, when the transaction is booked to a clearing "position account", it must be booked to a house account, even if the firm had specified customer on the trade.

This causes balancing problems for firms, since they know the trade as customer, but on the Trade Register report, and in the FIXML Trade Register file, the trade is booked to the house position account.

To assist firms with resolving such problems, we are making the following two enhancements.

1. Ability to put the customer non-reg positions, to a special "D" house position account.

Effective immediately (and for many firms this is already in place), firms may elect to have customer trades in these non-reg products, booked to a special "D" house position account, leaving normal house trades to be booked as they are now.

For example, suppose trades done by CBT firm 111, are booked to position accounts as follows:

- if the origin on the trade is customer, the trade goes go position account 111B CUST
- if the origin on the trade is house, the trade goes to position account 111B HOUS.

With this enhancement, and presuming the firm elects this choice (rather than grouping customer trades with house trades in the house account), the logic goes as follows:

- **if the origin on the trade is customer, and the trade is in one of the OTC (non-reg) products, then the trade is booked to position account 111D HOUS.**
- if the origin on the trade is customer, **and the trade is in a normal regulated product**, then the trade goes to position account 111B CUST.
- if the origin on the trade is house, the trade goes to position account 111B HOUS.

2. Ability to distinguish on the FIXML Trade Register, the origin on the trade versus the origin on the position account

Currently, only the origin of the position account to which the trade was posted is provided on the FIXML Trade Register file for a trade (TrdCaptRpt, Party Role "38"). This means that if the trade posted to position account 111D HOUS, because the origin on the trade was customer and it was in a non-reg product, there is nothing on the register that tells you that the origin on the trade was customer.

With this change, on the FIXML Register file we're going to provide **both origins** -- the origin on the trade, **and** the origin on the position account.

On the FIXML Register file, for Position Reports (PosRpt), since there is no Customer Account on these messages, we will add a "Sub" to Party Role 1 (Executing Firm). The change will look like this (Sub ID "1" = Customer, "2" = House):

Before: <Pty ID="775" R="1"/>
After: <Pty ID="775" R="1"> <Sub ID="1" Typ="26"/></Pty>

On the FIXML Register file, for Trade Capture Reports (TrdCaptRpt), we will now show the Customer Account with the origin equal to that of the submitted trade. However, the Position Account Party Block (Role 38) will have a Sub ID="2" for all OTC products, regardless of the origin submitted with the original trade message.

Here is an annotated excerpt of FIXML Trade Register messages in "D" accounts, as they will appear for OTC trades submitted to Clearing with a customer origin:

Position Report Party Blocks:

| | |
|----------------------------------------------------|------------------------------------------|
| <Pty R="21" ID="CME"/> | clearing organization |
| <Pty R="4" ID="020"/> | clearing firm ID |
| <Pty R="22" ID="CBT"/> | firm exchange |
| <Pty R="1" ID="020"><Sub Typ="26" ID="1"/></Pty> | default executing firm and origin |
| <Pty R="38" ID="020B"><Sub Typ="26" ID="2"/></Pty> | position account & origin |

Trade Capture Report Party Blocks:

| | |
|-------------------------------------------------------|-------------------------------------|
| <Pty R="21" ID="CME"/> | clearing organization |
| <Pty R="4" ID="020"/> | clearing firm ID |
| <Pty R="22" ID="CBT"/> | firm exchange |
| <Pty R="1" ID="020"/> | executing firm |
| <Pty R="12" ID="0B0L"/> | trader ID / executing broker |
| <Pty R="17" ID="000"/> | opposite firm |
| <Pty R="37" ID="000A"/> | opposite broker |
| <Pty R="24" ID="ACCTNUM"><Sub Typ="26" ID="1"/></Pty> | customer account with origin |
| <Pty R="38" ID="020B"><Sub Typ="26" ID="2"/></Pty> | position acct & origin |

So, with this change, you will be able to see both that you had the trade as done by firm CBT 111 as a customer trade, and that it posted to position account 111D HOUS, keeping these trades from being grouped with other house OTC trades.

With both of these new pieces of information, we expect that clearing firms will be able to make enhancements to their bookkeeping systems which will eliminate the reconciling issues.

We've pushed this out to New Release on an expedited basis, so firms will have plenty of time to verify that their balancing processes are unaffected by the new fields, even if they choose not to make use of them at first. Please make sure that your firm or your service provider can process these files once they become available.

A sample trade register file is available at <ftp://ftp.cme.com/pub/span/data/cme/test/OTCTradeRegisterSample.xml>, where you can substitute your clearing firm for "XXX", your executing firm for "YYY", and a specific opposite firm for "ZZZ" to create a firm-specific test file.

For more information, please contact CME Clearing at 312-207-2525.