

## Advisory Notice

Clearing House

TO: Clearing Member Firms  
Chief Financial Officers  
Treasury Managers  
Back Office Personnel

FROM: Clearing House Department

ADVISORY #: 05-82

SUBJECT: **Review of Collateral Control Limits and Performance Haircuts**

DATE: May 12, 2005

### **Outline of the Control Limit and Haircut Administration Process**

As part of its financial safeguards, the CME Clearing House ensures that each clearing member maintains a diversified portfolio of collateral. As with each new collateral product offering, CME institutes policies to control the concentration of asset types in order to achieve diversification.

The CME Clearing House protects itself against price fluctuations through the administration of margin haircuts applied to acceptable collateral. Haircuts are set to ensure that upon liquidation in a time of market stress, that cash received would equal the performance bond value of the security.

This memo will review the existing control limits of acceptable collateral and the associated haircuts. For descriptions of specific security types and haircuts, please visit CME's website at <http://www.cme.com/clearing/set/ac/accepcoll1365.html> for further details.

### **United States Treasury Securities (Delivered via the Fed Securities Wire)**

Specifically – **U.S. Treasury Bills, U.S. Treasury Bonds, U.S. Treasury Notes and U.S. Treasury Strips (including TIPS)**

- Eligible to meet **ALL** forms of margin requirements, core, reserve and concentration; as well as security deposit requirements
- Have a highly liquid secondary market
- Are explicitly guaranteed by the U.S. Government
- Are not limited in amount deposited
- All pledges must be in \$5,000.00 increments

#### **U.S. Treasury Bills**

- No margin haircuts applied to market value

#### **U.S. Treasury Bonds**

#### **U.S. Treasury Notes**

0-5 years	5-10 years	10-30 years	If security is off the run
2.00%	3.50%	5.00%	0.50% added

### **U.S. Treasury Strips (Principal & Coupon)**

- 10% margin haircut applied to market value of security

### **Government Sponsored Enterprises (GSE) (Delivered via the Fed Securities Wire) select debit issues from:**

- Can be used to meet core, reserve and concentration requirements with limits listed below for core.
- Federal Home Loan Bank – Freddie Mac – (FHLB)
- Federal National Mortgage Association (FNMA)
- Federal Farm Credit Banks (FFCB)
- Federal Home Loan Mortgage Corp. (FHLMC)
- In addition, certain GSE mortgage backed securities (MBS) from the following agencies:

- FNMA
- FHLB
- GNMA-Ginnie Mae

- While an aggregate limit is not enforced, clearing firms are subject to the following rules and methodologies for all GSE's as well as Letters of Credit (LOC).

Clearing firms are limited to the combination of letters of credit and government agencies of:

No more than 50% of clearing member's core requirement in excess of \$5 million  
This restriction does not apply to the clearing firm's reserve or concentration requirements.

- Select Mortgage Backed Securities have a haircut that is 10% of market value

### **GSE haircuts range from:**

**Discount Notes** (with remaining maturity of no more than 12 months)

- 3% margin haircut on market value
- (0.50% added if security is off the run)

### **Agency Bonds and Notes**

Have a haircut of market value:

0-5 years	5-10 years	10+ years	If the security is off the run
3.00%	4.50%	6.00%	0.50%

### **Stocks**

As with GSE's and LOC's, an aggregate limit is not enforced. However, stock is acceptable **only** for reserve and concentration requirements and in certain denominations based on volume and price characteristics of the individual security.

There is a 30% margin haircut of market value for each stock pledged.

To view the Official Stock Pledge Table for the current quarter, please use the link below:

**<http://www.cme.com/files/SP500%202qtr05.pdf>**

### **Sovereign Debt**

CME controls the total maximum deposit amount of sovereign debt that can be deposited. The aggregate maximum allowable, by firm, is \$500 million in USD equivalence. Eligible countries include Canada, France, Germany and the United Kingdom.

Sovereign debt may be used to meet **ALL** forms of margin requirements; core, reserve and concentration.

Margin haircuts range from:

Discount Bills	0-5 years	5-10 years	10-30 years	< 30 years
3.00%	5.50%	7.00%	8.50%	10.00%

### **IEF® – CME's Money Fund**

- A clearing member's limit is determined by the overall size of the portfolio to ensure that each member's investment is proportional to the overall portfolio's size.
- IEF is eligible to meet **ALL** forms of margin requirements at CME, core, reserve and concentration; as well as security deposit requirements.
- There are no margin haircuts associated with this product.

### **IEF2 – CME's Institutional Money Funds**

- On a monthly basis, CME monitors and ensures that no one firm's investment will be more than 5% of the aggregate balance of a specific money market mutual fund. CME also ensures that all aggregate funds invested through CME, of a particular fund, will not be more than 25% of the total fund.
- CME also maintains a money market mutual funds diversification policy which is based on the size of the clearing member's requirement. To view the current IEF2 Diversification Policy, please use the following link: <http://www.cme.com/clearing/clr/clradv/9549.html>
- To view the current list of Mutual Market Fund participants, please use the following link: <http://www.cme.com/clearing/set/ief/finunits/ief21358.html>
- IEF2 shares can be used to meet **ALL** forms of margin requirements and "Core" funds (funds of certain settlement banks) can be used to meet security deposit requirements.
- There is a 1% margin haircut on this product.

### **IEF3 & IEF4 – CME's Securities Administration Program**

CME will allow a combined total of IEF3 & IEF4 of up to a \$500 million for each firm, for both origins combined. Specifically, firms may utilize assets pledged under the IEF3 and IEF4 programs to meet:

Up to 25% of a firm's core requirement plus  
Up to 50% of a firm's reserve requirement plus  
Up to 100% of a firm's concentration requirement

Margin haircuts range from 2% up to 12.5% based on the type and maturity of the security.

**IEF5 – CME's Cash with Interest**

Specifically, firms may utilize IEF5 to meet:

Up to 50% of a firm's core requirement plus  
Up to 100% of a firm's reserve requirement plus  
Up to 100% of a firm's concentration requirement

- CME will allow up to a \$1 billion limit for a firm, for both origins combined.
- There are no haircuts associated with this product
- CME does allow an exposure of more than \$7 billion with the current provider, in aggregate, in the program

Should you have questions, please visit CME's website at: <http://www.cme.com/clearing/set> or contact Timothy Golomb at 312-930-3194 or the Financial Management Group at 312-207-2594.