

Advisory Notice

Clearing House

11-157

TO: Clearing Member Firms

FROM: CME Clearing

DATE: May 2, 2011

RE: **IMPORTANT: Clearing and Bookkeeping Processing for USDCLP Cash-Settled FX Forwards – Effective May 16, 2011**

On May 16, 2011, CME Clearing will begin clearing privately-negotiated deals in cash-settled (non-deliverable) spot, forward and swap transactions on the exchange rate between US Dollars (USD) and Chilean Pesos (CLP). Deals will be submitted for clearing through CME Clearport.

Deals may be submitted for any valid value date for this currency pair, from the spot value date going out as far as two years forward. A date is valid if it is a banking business day for both USD Dollars and Chilean Pesos.

Final cash settlement will be to the spot exchange rate as determined by the Bank of Chile at 8:00 p.m. Santiago time, on the last Chilean banking business day on which transactions for the specified value date are deemed “spot”.

Contracts will be offered as **USDCLP**, meaning that you are dealing USD, and prices are quoted in CLP per USD. This is the standard interbank convention for trading this currency pair.

Deals may be submitted for any arbitrary notional quantity of USD, down to the penny (0.01 USD). The maximum price precision will be **0.0001 CLP per one USD**. Because these prices are per **one** dollar, therefore the contract value factor used for calculating mark-to-market amounts will be **1.0**. For example, a typical **USDCLP** deal might be, “sell 10,000,000 USD at 523.1234 CLP per one USD.”

Following standard FX market flexibility, when you submit the deal to CME Clearport you can specify either USD or CLP as the dealt currency. Normally the trade quantity will be the amount of USD. But you can elect to provide the trade quantity as the amount of CLP, and if you do so, this will be normalized to USD in the clearing system. So your bookkeeping system never has to worry about this. Trade quantities in clearing and books for this product will **always** refer to the amount of USD.

For example, suppose you submit the **USDCLP** deal to Clearport as a sell of 500,000,000 CLP at 523.1234 CLP per USD. Dividing 500,000,000 by 523.1234 and rounding the result to the nearest penny, this would be normalized to be a purchase of 955,797.43 USD, and that's what you'll get on the clearing trade confirmation message.

These contracts are **forwards**, not futures, in two senses.

First, **there is normally no liquidation. All trades are held open, at their original trade price.** The exception is that deals can be **torn up** upon explicit instructions to CME Clearing, if you have cleared a transaction which is precisely offsetting to an original transaction – same value date, same price, opposite market side. The tearup may be partial or complete. It may be with your original counterparty or with a different party, and you may request that a cash payment, in either direction, accompany the tearup to take into account the current market price.

Second, **there is no daily cash mark to market banked every day.** Instead, mark to market amounts are discounted to present value and netted together, and the result is either an increment or a decrement to your initial margin (performance bond) requirement. We say that the mark-to-market amounts are **collateralized** rather than **banked**.

For example, suppose on July 19 you cleared a **USDCLP** sell of 10,000,000 USD for value on August 18 at 523.1234 CLP per one USD, and the end-of-day settlement price on July 19 is 526.9876 CLP per one USD. And assume that the discount factor is 0.981234. The discounted mark to market amount will be calculated as:

$$(526.9876 - 523.1234) * 1.0 * -10,000,000 * 0.981234 = -37,916,844.228 \text{ CLP}$$

Which is rounded normally to -37,916,844 CLP

In other words, mark-to-market amount is calculated as the product of:

- The price difference (settlement price less trade price)
- The contract value factor (1.0 in this case)
- The trade quantity (positive for a buy, negative for a sell)
- The discount factor

Which is then rounded normally to the normal precision of the currency.

So in this example your initial margin (performance bond) requirement is increased by 37,916,844 CLP, which may be met by any collateral asset type that CME Clearing accepts.

All contracts are **cash-settled** (non-deliverable) forwards. This means that at contract maturity, the mark to market on maturing trades is calculated one final time, using the final settlement price as specified by the Bank of Chile. This final amount is banked in USD on the morning of the value date through normal clearing settlement cycle processing on the previous night.

The final price for the contract for the second subsequent business day is specified at 8pm Santiago time, which is the same as New York time and one hour forward from Chicago time. Note that this is substantially later than the time when CME Clearing publishes end-of-day settlement price files and SPAN files. For this and other reasons, the contract's maturity date ("clearing settlement date") will be the clearing processing day immediately prior to the value date.

For example, take a contract for value on Wednesday August 17.

- The contract's final settlement price will be the spot rate for value on Wednesday August 17, specified by the Bank of Chile at 8pm Santiago time on Monday August 15.
- The contract's maturity date ("clearing settlement date") will be one day prior to the value date, or Tuesday August 16.
- The last day on which deals will be accepted for clearing for value on Wednesday August 17, will likewise be Tuesday August 16, although it is unlikely that any deals will be submitted on that date given that the final price was determined the previous night.

At contract maturity, the final mark-to-market amount is converted from CLP to USD by dividing by the final value for the spot rate for USDCLP on that date, and rounding to the nearest penny. This USD amount is then banked – *ie*, moved in cash.

Continuing with our example, the maturity date for a USDCLP contract for value on Wednesday August 17, will be Tuesday August 16. The final settlement price for our contract will be the spot rate, the rate specified on Monday night August 15 for value on Wednesday August 17. Suppose it comes out as 533.9876 CLP per one USD. The discounted mark-to-market amount will be calculated as:

$$(533.9876 - 523.1234) * 1.0 * -10,000,000 * 1.000000 = -108,642,000.000001 \text{ CLP}$$

Which is rounded normally to -108,642,000 CLP

(note that the discount rate will be exactly 1 at contract maturity)

Divide by the spot rate:

$$-108,642,000 \text{ CLP} / (533.9876 \text{ USD per CLP}) = -203,454.1626 \text{ USD}$$

Which is rounded normally to -203,454.16 USD

So for this one trade, in the end-of-day clearing cycle on Tuesday August 16, you will have a pay of 203,454.16 USD to the Clearing House. The cash will physically move at the bank on the morning of the value date, Wednesday August 17.

Note that there is no need to maintain bank accounts denominated in Chilean Pesos, or to bank any monies denominated in CLP. Prior to contract maturity, then the mark-to-market amounts being collateralized are denominated in CLP. But if these are negative – in other words, if you are losing money, and your margin requirement has increased, the increase may be met by any type of acceptable collateral. And at contract maturity, the final CLP-denominated amount is converted to USD to be banked.

Customer positions in these contracts will be held in the Cleared OTC Customer Sequestered regulatory class.

In most respects, contracts are processed in the clearing system and in bookkeeping systems in exactly the same manner as the physically-delivered COMEX OTC London Gold forwards, and the cash-settled NYMEX wet freight forwards. The trade type will be **OPNT**, short for generic over-the-counter privately-negotiated trade. The product type will be **FWD**, short for forward.

And the contract period code will indicate the exact value date of the deal – for example **20110818** for a deal for value on August 18, 2011. The only new features are that (a) trade quantities represent the notional amount of USD, and hence (a) can get very large and (b) may go down to the penny, and (b) at contract maturity the final mark to market amount must be converted from CLP to USD before being banked.

Exactly as with COMEX OTC London Gold forwards and NYMEX wet freight forwards, a special Trade Register report and FIXML datafile will be provided, which will include **all** open trades, not just those cleared on the current day. In addition, special CSV (spreadsheet format) files are provided, which show all open trades and all open positions by value date.

Exactly as with the other forwards, positions are margined using SPAN normally. For **USDCLP**, the **equivalent position factor** will be provided as **100,000**. This means that to determine the positions to be run through SPAN, you take the true notional position quantity, divide by 100,000, and round up (away from zero) to the nearest integer.

The New Release testing environment is now available for firms to submit deals through CME Clearport, and to test their bookkeeping systems against the CME clearing system. Settlement price files and SPAN files generated from this New Release environment contain sample data for the USDCLP forwards.

Large Trader position reporting is **not** required at this time for USD/CLP forwards.

For full details about forwards processing at CME Clearing, please see:
<http://www.cmegroup.com/clearing/files/Clearing-and-Bookkeeping-Processing-for-Forwards.pdf>

For additional information about USDCLP cash-settled forwards, please see:
Special Executive Report S-5713, at:
http://www.cmegroup.com/rulebook/files/S_5713.pdf

The New Contract Notice for USDCLP cash-settled forwards is at:
<http://www.cmegroup.com/tools-information/lookups/advisories/clearing/files/NPadv11-24.pdf>

For information about NYMEX wet freight forwards, please see:
<http://www.cmegroup.com/tools-information/lookups/advisories/clearing/files/NPadv10-09.pdf>

For information about COMEX OTC London gold forwards, please see:
<http://www.cmegroup.com/tools-information/lookups/advisories/clearing/Chadv09403.html>

For more information or assistance with testing, please contact CME Clearing at 312-207-2525.