CME Group | Advisory Notice

12-139

DATE: March 29, 2012

TO: Clearing Member Firms

FROM: CME Clearing

SUBJECT: **New Reporting Requirements Regarding Gross Customer Margining and LSOC**

Introduction

This advisory details new reporting requirements for FCMs stemming from certain CFTC regulations going into effect on November 8, 2012. There are two inter-related functional areas: **Customer Gross Margining** (CGM) and **LSOC** (Legally Segregated, Operationally Commingled). Customer Gross Margining will apply both to products which are under the futures regulatory regime and to products which are classified as cleared swaps for regulatory purposes. LSOC will apply only to cleared swaps customer accounts.

Reporting for Customer Gross Margining

Customer Gross Margining will require a significant change in how derivatives clearing organizations (DCOs) calculate performance bond (initial margin) requirements for customer positions. Specifically, under CFTC Regulation 39.13(g)(8)(i), DCOs will be required to set minimum performance bond levels as the sum of requirements calculated for each individual customer account.

This new method of customer gross margining will require CME Clearing and some other DCOs to switch from the “modified customer gross margining method” which has long been used. Under the existing method, clearing firms categorize individual customer account positions according to the degree to which risk offsets exist, and report this data twice daily (as the “spreads” information included in the PCS submission used to determine open interest). The new method will assure that client account risk offsets will be applied only for the benefit of each individual customer account.

The key operational implication of Customer Gross Margining is that the DCO must know positions for all customers. For interest rate swaps (IRS) and credit default swaps (CDS), CME Clearing already keeps positions customer by customer. For certain other cleared swaps and for futures, however, customer positions are held in the clearing system in position accounts which typically commingle positions of many individual customers.

For customer positions in futures and in these other types of cleared swaps, therefore, clearing firms must submit a datafile, to identify positions by individual customer, so that CME Clearing may calculate margins customer by customer. The file must be submitted for both the end-of-day settlement cycle and the intraday cycle. We are referring to this file as the **Customer Gross Margin file**, or simply the **CGM file**.

The industry has selected FIXML as a standard format for the CGM file. The format is highly analogous to the FIXML PCS format widely in use. The "firm number" in the file should be provided in exactly the same manner as is currently used for PCS submissions, and the account ID will identify the individual customer account. Where multiple customer accounts have the same owner, the account ID may be provided as the "related master" account which ties all the detail accounts together.

For positions in expiring options: clearing firms differ in the timing of when they process final exercises and assignments in books. Clearing firms have a choice, therefore, in how these positions are represented in the CGM file: either prior to final E&A processing, or after such processing.

Reporting for LSOC

Separately, new Part 22 of the CFTC Regulations, which also goes into effect on November 8, 2012, will implement a form of protection for customer cleared swaps and related collateral that has been referred to as "LSOC" (Legally Segregated, Operationally Commingled). LSOC poses a number of additional operational requirements for FCM clearing members. It requires that FCM clearing members report their customer positions in cleared swaps (the "portfolio of rights and obligations", in the language of the CFTC regulation) to CME Clearing at least once per business day. Also, if the FCM transmits to CME Clearing any collateral posted by a cleared swaps customer in excess of the amount required by CME Clearing (as permitted under CME rules), the FCM must identify, for each such customer, the value of collateral posted with CME Clearing in addition to the minimum margin requirement.

LSOC Position Reporting

For IRS and CDS, FCM clearing members already do position reporting to CME Clearing in real time, as they submit trades identified by customer and do allocations to individual customers. But for other cleared swaps, the LSOC "portfolio of rights and obligations" mandate will require that FCM clearing firms submit an end-of-day datafile, identifying cleared swaps positions customer by customer.

CME Clearing will not require a separate datafile to be submitted for this purpose. Rather, pending regulatory approval, the same CGM datafile of customer positions in these cleared swaps will serve two purposes: (a) for customer gross margining, and (b) for LSOC reporting of the "portfolio of rights and obligations".

Omnibus accounts and position reporting

For futures, the Customer Gross Margining mandate does not require any changes in how clearing firms handle omnibus accounts. Firms may continue to hold omnibus accounts on their books, and these may be fully disclosed, partially disclosed, or entirely non-disclosed.

The CGM file format supports all three of these possibilities. If you provide an omnibus account with no detail subaccounts, this is the "entirely non-disclosed" case. If you provide an omnibus account with detail accounts, and the sum of the detail account positions is equal to the omnibus account positions, then the omnibus account is fully disclosed. If you provide detail accounts, but the sum of the positions in detail accounts is less than the positions in the omnibus account, then the omnibus account is partially disclosed.

For Customer Gross Margining, the calculation of the margin requirement for an omnibus account will follow long-established practices. First, normal portfolio margin requirements are calculated for each disclosed subaccount. The remaining non-disclosed positions are considered "naked", and are margined without recognizing any risk offsets. The total requirement for the omnibus account, then, is the sum of the portfolio requirements for the disclosed subaccounts, and the naked requirements for the non-disclosed positions.

For customer cleared swaps, if a domestic omnibus account is utilized, the new CFTC LSOC regulations will require the non-clearing FCM (*i.e.,* a “Depositing Futures Commission Merchant”) to disclose to the carrying FCM (*i.e.,* a “Collecting Futures Commission Merchant”), which, in turn, must disclose to the DCO: (a) “information sufficient to identify” each Cleared Swaps Customer in the domestic omnibus account; and (b) on a daily basis, each Cleared Swaps Customer’s “portfolio of rights and obligations arising from the Cleared Swaps that the Depositing Futures Commission Merchant intermediates for such customer.” CME Clearing’s own policies require full disclosure of end customer positions for interest-rate swaps and credit default swaps. Note that other regulatory mandates may affect omnibus accounts and cleared swaps, and that additional information on this subject will be published in the future.

LSOC reporting of additional collateral

As noted above, LSOC requires that clearing firms provide an additional daily report to the DCO for customers with positions in cleared swaps. For each such customer, pending regulatory approval, the report will identify the value of collateral provided to CME Clearing that is in excess of the collateral meeting the clearing minimum margin requirement.

CME Clearing has worked together with other DCOs to develop a scheme for this reporting that will provide firms with flexibility in how this additional collateral reporting will work.

For each such cleared swaps customer, and for each currency in which margin requirements may be denominated and/or in which collateral may be deposited, the clearing firm may specify the customer’s additional collateral amount in several different ways:

- The additional collateral amount may be specified either as a percentage of the minimum margin requirement, or as an absolute money amount, or both.

- In addition to the capabilities specified in the first bullet, and again for each currency, the clearing firm may specify a collateral floor amount. If provided, the collateral floor specifies a minimum value for collateral on deposit at the DCO for that customer.

- Last, as an alternative to the methods described in the first two bullets, the clearing firm may specify a total value of collateral. The additional collateral value then is determined as the amount by which the total value exceeds the clearing minimum margin requirement.

We’re calling this file the **LSOC Additional Collateral file**, and it must be reported at the end of each clearing business day. In a manner exactly analogous to that for the FIXML Customer Gross Margin file, we’ve worked together with other DCOs and through the FIA to develop a standard file format using FIXML.

Testing and implementation

CME Clearing’s goal is to provide our clearing firms with maximum time for implementation and testing, and we are working with service providers and the broader industry to develop an overall plan and schedule. We intend to begin accepting submissions of the Customer Gross Margin and LSOC Additional Collateral files on a date to be specified, and to **require** firms to begin submitting them by a date to be specified.

Daily reports will be provided to firms allowing the comparison of customer-origin requirements calculated the new way versus the existing way.

For more information please contact CME Clearing's Risk Department at 312-648-3888.

Technical Details

Customer Gross Margining Position Submission via FIXML

```
<PosMntReq                              // position maintenance request message
    ReqID=”123456789”                   // unique record ID
    TxnTyp=”4”                          // position specification
    AdjTyp=”tbd”                        // customer-specific submission
    Actn=”1”                            // new submission
    BizDt=”2012-02-06”                  // clearing business date
    SetSesID=”EOD”                      // settlement cycle (end-of-day)
    TxnTm=”2012-02-06T18:23:49”>        // submission time

<Pty ID=”CME” R=”21”/>                          // clearing organization
<Pty ID=”111” R=”4”/>                           // clearing member firm ID
<Pty ID=”NYMEX” R=”22”/>                        // firm exchange
<Pty ID=”111” R=”1”/>                           // trade mgmt firm ID
<Pty ID=”ABC12345” R=”24”>                      // customer account
    <Sub ID=”1” Typ=”26”/>                      // customer origin
    <Sub ID=”ACCT NAME” Typ=”5”/>               // account name
    <Sub ID=”H” Typ=”tbd”/>                     // customer account type
    <Sub ID=”OMNIACCT” Typ=”tbd”/>              // omnibus account, if relevant
</Pty>

<Instrmt                                // contract data
    Exch=”NYMEX”
    ID=”CL”
    SecTyp=”FUT”
    MMY=”201203”/>

<Qty Typ=”TQ” Long=”4250” Short=”1243”/>        // long and/or short quantity
</PosMntReq>
```

Notes on the party specifications:

For CME, the clearing member firm ID (party role 4) is optional, and may be omitted. OCC and NYPC require it, however.

The account name is as specified on the firm's books and is optional for the purposes of customer gross margining reporting.

The customer account type indicates whether the account is member, hedge, spec or omnibus. If not provided, the default is spec.

If the account is a disclosed subaccount of an omnibus account, the “omnibus account” role specifies that omnibus account. It should not be provided for detail accounts that are **not** disclosed subaccounts of an omnibus account.

There is variability across the CCP’s in the usage of the “position account” role (role number 38) in FIXML. (CCP’s use the term “position account” in the same manner, but differ in how the value is assigned.) For the sake of discussion, we’ll denote this as the “CME usage” and the “ICE usage”.

For CME:

> Position account is a value, typically three or four alphanumeric bytes, which clearing firms typically do not know and do not use. It is provided by CME on output back to the firm, but again, firms typically do not know and do not use it.
>
> Rather, CME derives the position account from the submitted data: (a) the trade management firm ID; (b) the product; (c) the customer account and origin code.
>
> Note that the origin is submitted as a sub role of the customer account.

For ICE:

> Position account is a single byte, roughly corresponding to the origin and regulatory class of the account and product. It is a required part of the submission.
>
> For ICE, then, the origin is **not** provided as a sub role of the customer account.

So the party submission for ICE would look something like this:

```
<Pty ID=”ICE” R=”21”/>                          // clearing organization
<Pty ID=”111” R=”4”/>                           // clearing member firm ID
<Pty ID=”ICE” R=”22”/>                          // firm exchange
<Pty ID=”111” R=”1”/>                           // trade mgmt firm ID
<Pty ID=”C” R=”38”>                             // position account
<Pty ID=”ABC12345” R=”24”>                      // customer account
        <Sub ID=”ACCT NAME” Typ=”5”/>           // account name
        <Sub ID=”H” Typ=”tbd”                   // customer account type
        <Sub ID=”OMNIACCT” Typ=”tbd”/>          // omnibus account, if relevant
</Pty>
```

Note that position account may be submitted for CME, but if so, it **must** correspond to the CME usage, not the ICE usage.

Notes on the instrument block
The instrument block usage is standard. The example above shows how it looks for a future.

Here's an example of how it would look for a vanilla option on future, where underlying need not be specified:

```
<Instrmt
    Exch="NYMEX"
    ID="LC"
    SecTyp="OOF"
    PutCall="1"
    StrkPx="32.75"
    MMY="201203"/>
```

For an option, such as a flexible option, where the underlying must be explicitly enumerated, the "Undly" sub element must be included:

```
<Instrmt
    Exch="CME"
    ID="XP"
    SecTyp="OOF"
    PutCall="1"
    StrkPx="32.75"
    MMY="20120327">
    <Undly
        Exch="CME"
        ID="SP"
        SecTyp="FUT"
        MMY="201412"/>
</Instrmt>
```

The **Src** attribute is optional, and may be provided, as: **Src="H"**, indicating that the value is the clearing product code.

Again, nothing different from existing usage.

LSOC Collateral Report Submission via FIXML

Customer-specific report:

```
<CollRpt                                // collateral report
        RptID=”123456789”               // unique record ID
        BizDt=”2012-02-06”              // clearing business date
        SetSesID=”EOD”                  // settlement cycle (end-of-day)
        TxnTm=”2012-02-06T18::49”       // submission time

        Stat=”2“                        // status = assigned to this customer
        ApplTyp=”0”>                            // customer-specific report type

<Pty ID=”CME” R=”21”/>                  // clearing organization
<Pty ID=”111” R=”4”/>                           // clearing member firm ID
<Pty ID=”NYMEX” R=”22”/>                // firm exchange
<Pty ID=”111” R=”1”/>                           // trade mgmt firm ID
<Pty ID=”ABC12345” R=”24”>                      // customer account
        <Sub ID=”1” Typ=”26”/>          // customer origin
        <Sub ID=”ACCT NAME” Typ=”5”/>           // account name
        <Sub ID=”H” Typ=”tbd”/>         // customer account type
</Pty>

<CollAmt Typ=”1” Amt=”10000000” Pct=”0.10” Ccy=”USD”/>
<CollAmt Typ=”2” Amt=”30000000” Ccy=”USD”/>
<CollAmt Typ=”1” Amt=”20000000” Pct=”0.20” Ccy=”EUR”/>
<CollAmt Typ=”1” Pct=”0.30” Ccy=”JPY”/>
<CollAmt Typ=”2” Amt=”40000000” Ccy=”CHF”/>
<CollAmt Typ=”3” Amt=”50000000” Ccy=”GBP”/>

</CollRpt>
```

The report is used to specify: (a) for a given customer of an FCM, (b) for collateral deposited by the FCM with this DCO, that is (c) denominated in a particular currency, (d) the additional collateral value over and above the minimum margin requirement, that (e) is attributable to this customer.

Any number of Collateral Amount elements may be provided, one per currency and type.

A collateral amount of type 1 means: the additional collateral amount is specified as either a percentage of the minimum margin requirement denominated in this currrency, or an absolute amount, or both.

A collateral amount of type 2 means: a floor below which the total value of collateral attributable to that currency may not be allowed to drop.

A collateral amount of type 3 means: the total value of collateral including the minimum margin requirement and any additional amount.

For the different currencies, these different types of Collateral Amount elements may be mixed and matched by the FCM as desired and appropriate. For any given currency, however, the message may contain either (a) types 1 or 2 or both, or (b) type 3.

For a given customer and currency, if the report is provided via type 1 and/or 2, then the total value of collateral attributable to that customer and denominated in that currency is calculated as:

- Take the minimum margin requirement.
- Add on the specified percentage of the minimum and the specified absolute amount.

- Take the larger of this value and the floor.

A report can also be provided as a percentage without specifying a currency, which means that the percentage applies to all currencies in which minimum margin requirements are denominated.

"Minimum margin" in this context means the contribution for that customer of the minimum margin assessed by the DCO to the FCM – not the minimum assessed by the FCM to the customer, which may be higher.

"Value" in this context means haircutted market value as determined by the DCO.

In these examples, the FCM is saying:

- For USD, add in an additional 10% of the minimum margin, plus another $10M, and in any event don't let the collateral attributable to this customer go below $30M.

- For EUR, add in an additional 20% of the minimum margin, plus another 20M.

- For JPY, add in an additional 30% of the minimum margin.

- For CHF, don't let the total value of collateral on deposit go below 40M.

- For GBP, the total value of collateral on deposit is 50M.

In all cases, the additional collateral attributable to a customer is calculated as the total collateral value less the minimum margin requirement.

The value of collateral attributable to the FCM that is not attributable to any specific customer, then, is equal to the total value of collateral deposited by the FCM for cleared swaps customers, less the sum across customers of total collateral value attributable to each customer.

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