CME Group Advisory Notice

12-360

DATE: August 22, 2012

TO: Clearing Member Firms

FROM: CME Clearing

SUBJECT: **CME Clearing's LSOC Implementation Plan**

CME recognizes that with the Thursday, November 8, 2012 deadline for LSOC implementation fast approaching, it is important that the industry receive clear specifications from CME, sufficient to clarify important details of our implementation of LSOC. At the same time, CME remains committed to listening to the industry so that our implementation plan can incorporate sensible feedback to ease implementation burdens as much as reasonably possible.

CME will implement LSOC in a two-phase process. As previously indicated, LSOC will apply to FCM clearing member firms of CME holding customer positions in cleared swaps.

The first phase will begin on **Monday, November 5, 2012**. In this initial period, LSOC will be implemented in an **unallocated excess** mode.

The second phase will begin on **Monday, February 4, 2013**. On that date, CME clearing firms may begin operating in a **client-specific excess** mode. Firms will have until **Monday May 27, 2013** to complete the transition; beginning on that date, all CME clearing firms with customer positions in cleared swaps must operate in a client-specific mode.

LSOC Operations in an Unallocated Excess mode

Based on feedback from FCM's, and presuming confirmation from the CFTC, CME has developed a plan to support LSOC with unallocated client excess, but without imposing the burden on FCM's of providing a daily LSOC certification:

- At the end-of-day settlement cycle, we will identify client accounts whose initial margin requirement has **increased** compared to its level at the prior end-of-day.

- We will always issue a margin call to cover the sum of those client-specific initial margin increases.

- The settlement bank confirmation deadline will not be changed from its current value of 8:30am New York time.

- After the initial margin call has been met, FCM's will have the option (but will not be required) to request the withdrawal of all or part of the amount by which client requirements decreased.

The following example illustrates this:

	IM Client A	IM Client B	IM Client C	Total
Day 1	100	100	100	300
Day 2	110	95	90	295
Increases	10			10
Decreases		5	10	15

CME issues the required margin call of 10.
Once this is met, the FCM may elect to withdraw up to 15.

LSOC Operations in a Client-Specific Excess mode

When operating in a **client-specific excess** mode, firms will have until **6:00am New York time** to submit their **daily LSOC collateral value report.** For each cleared swaps customer, and for each guarantee fund in which that customer maintains positions, this provides the haircutted market value of collateral provided by the FCM to CME Clearing, that belongs to that customer.

In addition, for customer positions for that guarantee fund, it will provide the value of the **firm buffer** – the amount of collateral value provided by the FCM itself. Note that in this mode, CME Clearing will generate an additional margin call for each guarantee fund if the value of the firm buffer for that fund is insufficent to cover the sum of client-specific margin deficits for that fund below the minimum requirement calculated by CME.

When operating in a **client-specific excess** mode, in addition to the one daily required submission, firms are encouraged to submit additional partial or complete LSOC collateral value files at other times during the day.

For example, firms might elect to provide additional files (a) after the satisfaction of the morning margin call but prior to the effect of any intraday collateral transactions, (b) after the completion of morning collateral transactions, or (c) after the completion of all daily collateral transactions. Such files could be used to provide the updated LSOC collateral value files reflecting the satisfaction of the morning margin call by CME Clearing, the effect of intraday collateral transactions, or the satisfaction of margin calls issued by the FCM to its customers.

Several firms have requested that it would simplify their operations if they were also able to specify an amount of **unallocated client excess** when operating in client-specific mode. CME will allow this, but note that it doesn't change the core requirement of client-specific LSOC – that the firm buffer at least cover the sum of the client-specific margin deficits.

When requesting intraday collateral withdrawals from CME Clearing, to the extent that the value of a withdrawal exceeds the available value of the firm buffer, firms will be required to provide the customer-specific breakdown of the excess value being withdrawn, and the withdrawal will not be approved until this breakdown has been provided. Firms may provide this breakdown via the submission of an updated LSOC collateral value file.

Use of dirty prices for coupon-bearing debt securities

Note that for valuing coupon-bearing debt securities such as Treasury bonds and notes, **CME Clearing will adopt the use of dirty prices.** This is to ensure that the values used by CME Clearing will be determined on the same basis that firms are using for LSOC collateral value calculations, and will more accurately reflect the value to be received by CME in the event of post-default collateral liquidation. Clearing firms are encouraged likewise to use dirty prices but may elect to continue using clean prices if they already do so.

Specifications for the daily LSOC Collateral Value Reports

These were published on June 28, 2012, in Clearing Advisory 12-268, available at: http://www.cmegroup.com/tools-information/lookups/advisories/clearing/files/Chadv12-268.pdf