CME Group | Advisory Notice

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DATE: September 24, 2013

TO: Clearing Member Firms

FROM: CME Clearing

SUBJECT: **CME to Allow Excess LSOC Collateral Value to Cover Variation Margin Losses**

On Monday, October 21, 2013, CME Clearing will introduce an important enhancement to its LSOC offering for clearing firms which have elected to operate in the "with-excess" mode. In particular, firms will be able to use a client's excess LSOC value to cover a client's variation loss, to the extent that the needed cash is on deposit in the currency in which the variation loss is denominated.

For example, suppose the FCM had exactly one client, clearing swaps at CME:

Client's initial margin requirement	100 USD
Client's end-of-day LSOC Value	120 USD
Client's variation loss	-10 USD
Cash collateral on deposit	30 USD

Under the current practice, CME would issue a $10 variation call to the firm. The client would continue to have $20 in excess value, which could be withdrawn upon request. With the new practice, however, CME would simply take the $10 from cash on deposit. The client's LSOC value would be reduced from 120 to 110.

We are referring to this practice as **combined cash flow (CCF) under LSOC**, or just **LSOC-style CCF.**

The use of excess value to cover a variation loss is of course constrained by two factors – the amount of excess available and the amount of cash available. The cash must be available in the currency in which the variation is denominated. And a client's variation loss may be covered only by excess value of that client, or excess value provided by the firm (the "firm buffer").

The use of this new capability is **optional**. Firms that have elected to implement LSOC with CME in the "with-excess" mode may further elect to use LSOC-style combined cash flow, or not.

The process will work sequentially, currency by currency, for currencies in there is a net variation loss across the clients. It will first attempt to cover variation losses in currencies which take two days to settle, and then move on to the one-day currencies (CAD, EUR, GBP and finally USD). This convention is selected so as to yield maximum savings in banking transaction costs.

For a given currency in which there is a net variation loss across the clients, if multiple client accounts have both variation losses denominated in that currency and excess value, then the use of the excess value will be apportioned on a *pro rata* basis according to the amount of the variation loss. In other words, everything else being equal, the greater the client's variation loss, the greater the reduction in the client's LSOC value.

The reports that are produced for participating clearing firms at end of day, will be enhanced to show for each affected client, the variation loss by currency and the amount which was offset by excess LSOC value. Across clients, the report will show the reduction in the amount of the cash variation margin call by currency.

Note that initial margin calls under LSOC will be unaffected by the implementation of this feature, since only client excess value or firm excess value may be used to offset variation losses. The sole effect to the clearing firm, will be the reduction in variation margin calls for certain currencies. The process will never result in an **increase** in a margin call.

For more information please contact CME Clearing at 312-930-3170 or lsoc@cmegroup.com.