

MEMO# 23346

March 24, 2009

SEC Issues Approval for CME to Operate as Central Counterparty for Swaps

[23346]

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TO: SEC RULES MEMBERS No. 31-09
EQUITY MARKETS ADVISORY COMMITTEE No. 13-09 RE: SEC ISSUES APPROVAL FOR CME
TO OPERATE AS CENTRAL COUNTERPARTY FOR SWAPS

The Securities and Exchange Commission approved conditional exemptions that allow the Chicago Mercantile Exchange, Inc. ("CME") to operate as a central counterparty for clearing credit default swaps ("CDS"). [\[1\]](#) The central counterparty would serve for CDS contracts submitted to or traded through CMDX, a trading and clearing platform for CDS created through a joint venture between CME and Citadel Investment Group LLC. [\[2\]](#)

According to the approval order, the trades submitted to or executed on the CMDX platform would be processed straight-through to CME for clearing and settlement. CME clearing and settlement of cleared CDS [\[3\]](#) would operate using the established systems, procedures and financial safeguards package that stand behind trading in CME's primary futures market, and such activities would be subject to oversight of risk management and collateralization procedures by the Commodity Futures Trading Commission. CME also would extend its current monitoring procedures to cleared CDS cleared by CME, and it would monitor for and investigate unusual trading patterns or volumes.

The SEC granted similar exemptions to allow two other parties to act as central counterparties for clearing CDS. [\[4\]](#) The CMDX platform differs from these other counterparties in a number of ways. For example, participants of CMDX would not be subject to the margin requirements for CDS set forth in recently proposed FINRA Rule 4240. [\[5\]](#) Instead, the proposed rule requires that for CDS cleared by CME, the applicable margin should be calculated pursuant to CME rules. It also requires a broker-dealer to assess whether the CME margin requirements are adequate with respect to their customers, and to increase the margin in excess of the minimum where applicable.

As with the SEC approval orders for the other central counterparties, the temporary exemptions are subject to a number of conditions. Among them, CME must, directly or indirectly, make available to the public on terms that are fair and reasonable: (1) all end-of-day settlement prices and any other prices with respect to cleared CDS that CME may establish to calculate mark-to-market margin requirements for CME participants; and (2) any other pricing or valuation information with respect to cleared CDS as is published or distributed by CME. In addition, to the extent that a CME clearing member receives or holds funds or securities of U.S. customers for the purpose of purchasing, selling, clearing, settling, or holding cleared CDS positions, the CME clearing member shall segregate such funds and securities of U.S. customers from the CME clearing member's own assets (i.e., the member may not permit U.S. customers to "opt out" of applicable segregation requirements for such funds and securities even if regulations or laws would permit the customer to "opt out"). In its approval order, the SEC stated that the conditional exemptions provide it with regulatory oversight of CMDX, and should enhance the quality of the credit default swap market and the SEC's ability to protect investors.

The SEC's temporary exemptions expire on December 14, 2009.

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endnotes

[1] See Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With the Request of Chicago Mercantile Exchange Inc. and Citadel Investment Group, L.L.C. Related to Central Clearing of Credit Default Swaps, and Request for Comments, SEC Release No. 59578 (March 13, 2009), 74 FR 11781 (March 19, 2009). The approval order may be found at www.sec.gov/rules/exorders/2009/34-59578.pdf.

[2] According to the approval order, CMDX trading, booking and migration services would be available only to persons that satisfy the definition of an "eligible contract participant" in Section 1a(12) of the Commodity Exchange Act (other than paragraph (C) thereof). In addition, each participant on the CMDX platform must be a clearing member of CME or have a clearing relationship with a CME clearing member that agrees to assume responsibility for the participant's CDS contracts cleared by CME. Initially, CMDX would offer CDS that mirror as closely as possible the terms of existing over-the-counter CDS. The coupons and maturities would be standardized to the extent necessary to permit centralized clearing.

[3] "Cleared CDS" is a defined term for purposes of the approval order.

[4] See Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection with Request of LIFFE Administration and Management and LCH.Clearnet Ltd.

Related to Central Clearing Of Credit Default Swaps, and Request for Comments, SEC Release No. 59164 (December 24, 2008), 74 FR 139 (January 2, 2009), available at www.sec.gov/rules/exorders/2008/34-59164.pdf; and Order Granting Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With Request on Behalf of ICE US Trust LLC Related to Central Clearing of Credit Default Swaps, and Request for Comments, SEC Release No. 59527 (March 6, 2009), 74 FR 10792 (March 12, 2009), available at www.sec.gov/rules/exorders/2009/34-59527.pdf.

[5] See Proposed Rule Change Relating to Margin Requirements for Certain Transactions in Credit Default Swaps, SR FINRA 2009-012.

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