SUBMISSION COVER SHEET

***IMPORTANT*: Check box if Confidential Treatment is requested** ☐

Registered Entity Identifier Code (optional): <u>16-316 (2 of 4)</u>

Organization: <u>The Board of Trade of the City of Chicago, Inc. ("CBOT")</u>

Filing as a: ☒ **DCM** ☐ **SEF** ☐ **DCO** ☐ **SDR**

Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): <u>9/19/16</u> Filing Description: <u>Amendments to Rule 538. ("Exchange for Related Positions") and Issuance of CME Group Market Regulation Advisory Notice RA1612-5.</u>

SPECIFY FILING TYPE

Please note only ONE choice allowed per Submission.

Organization Rules and Rule Amendments

☒	Certification	§ 40.6(a)
☐	Approval	§ 40.5(a)
☐	Notification	§ 40.6(d)
☐	Advance Notice of SIDCO Rule Change	§ 40.10(a)
☐	SIDCO Emergency Rule Change	§ 40.10(h)

Rule Numbers: 538

New Product **Please note only ONE product per Submission.**

☐	Certification	§ 40.2(a)
☐	Certification Security Futures	§ 41.23(a)
☐	Certification Swap Class	§ 40.2(d)
☐	Approval	§ 40.3(a)
☐	Approval Security Futures	§ 41.23(b)
☐	Novel Derivative Product Notification	§ 40.12(a)
☐	Swap Submission	§ 39.5

Product Terms and Conditions (product related Rules and Rule Amendments)

☐	Certification	§ 40.6(a)
☐	Certification Made Available to Trade Determination	§ 40.6(a)
☐	Certification Security Futures	§ 41.24(a)
☐	Delisting (No Open Interest)	§ 40.6(a)
☐	Approval	§ 40.5(a)
☐	Approval Made Available to Trade Determination	§ 40.5(a)
☐	Approval Security Futures	§ 41.24(c)
☐	Approval Amendments to enumerated agricultural products	§ 40.4(a), § 40.5(a)
☐	"Non-Material Agricultural Rule Change"	§ 40.4(b)(5)
☐	Notification	§ 40.6(d)

Official Name(s) of Product(s) Affected:

Rule Numbers:

CME Group

Christopher Bowen
Managing Director and Chief Regulatory Counsel
Legal Department

September 19, 2016

VIA ELECTRONIC PORTAL

Mr. Christopher J. Kirkpatrick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, DC 20581

RE: CFTC Regulation 40.6(a) Certification. Amendments to Rule 538. ("Exchange for Related Positions") and Issuance of CME Group Market Regulation Advisory Notice RA1612-5.
CME/CBOT/NYMEX/COMEX Submission No. 16-316 (2 of 4)

Dear Mr. Kirkpatrick:

Pursuant to Commodity Futures Trading Commission ("CFTC" or "Commission") Regulation 40.6(a), Chicago Mercantile Exchange Inc. ("CME"), The Board of Trade of the City of Chicago, Inc. ("CBOT"), New York Mercantile Exchange, Inc. ("NYMEX") and Commodity Exchange, Inc. ("COMEX") (collectively, the "Exchanges") hereby notify the Commodity Futures Trading Commission ("CFTC" or "Commission") that they are self-certifying amendments to Rule 538. ("Exchange for Related Positions") (hereinafter, "EFRPs") and the issuance of CME Group Market Regulation Advisory Notice RA1612-5 ("RA1612-5") which provides further regulatory guidance concerning EFRPs. RA1612-5 supersedes CME Group Market Regulation Advisory Notice RA1311-5RR ("RA1311-5RR") dated June 27, 2014. This Submission and RA1612-5 shall become effective on Tuesday, October 4, 2016.

Since the issuance of RA1311-5RR, the Market Regulation Department ("Market Regulation") and other customer-facing departments of CME Group have received inquiries, comments and suggestions surrounding the execution of EFRPs in our markets. Based on those interactions, the Exchanges, in conjunction with input and guidance from the Commission, are adopting amendments to Rule 538. and the associated regulatory guidance contained in RA1612-5.

The amendments to Rule 538.: 1) modify the definition of an Exchange of Option for Option ("EOO"); 2) modify the requirements concerning Immediately Offsetting FX EFPs, 3) allow any third party to facilitate, as principal, the related position component of an EFRP; and 4) codify that the facilitation of the execution of an EFRP by any party that knows such EFRP is non bona fide and, therefore, constitutes a violation of Rule 538.

The amendment regarding the definition of an EOO codifies that the only permissible related position component to such a transaction is an OTC option. The revision is intended to eliminate confusion in the marketplace with respect to what constitutes an acceptable related position component of an EOO.

Rule 538.K. ("Immediately Offsetting EFPs in Foreign Currency Futures") permits parties to immediately offset the cash leg of an FX EFP. Since adoption of this provision in 2014 (see Submission No. 14-251 dated June 26, 2014), the Exchanges have required that underlying clients of CTAs and other account controllers have an open cash account for the booking of the immediately offsetting cash leg of the immediately offsetting EFP in the instance where the FX futures leg of the transaction fails to clear. The

Exchanges are eliminating such requirement and adopting a provision which will require any resulting profit or loss generated by the offset of the cash leg, in the event the futures leg does not clear, to be passed down to the client on whose behalf the transaction was attempted to be executed. This change requires revisions to Section A. ("Parties to an EFRP") to permit any third party to facilitate, as principal, the related position component of an EFRP on behalf of a customer in lieu of the current provision which permits only member firms to facilitate the related position on behalf of customers. The Exchanges are also adopting language in Section A. to codify that the related position component of an immediately offsetting FX EFP does not need to be passed down to the customers of the CTA or account controller, but requiring any profit or loss attendant to the offset of the related position component to be passed to the underlying customer in the circumstance where the futures leg fails to clear.

The amendment to Rule 538.C. ("Related Position") codifies that the facilitation of the execution of an EFRP by any party that knows such EFRP is non bona fide constitutes a violation of Rule 538.

The revisions to Rule 538. appear in Exhibit A with additions underscored and deletions overstruck.

In addition to the amendments to Rule 538., the Exchanges are adopting several addition changes to the regulatory guidance contained in RA1612-5.

The current EFRP MRAN (RA1311-5RR) permits an EFRP to have multiple Exchange components provided that all of the Exchange components have the same market bias (long or short). Market Regulation has continued to receive numerous requests from clients to permit non-transitory EFRPs to have multiple Exchange components with different market biases. Given that Market Regulation does not see any current regulatory impediment to permitting such multidirectional EFRPs, provided that such EFRPs are not transitory, the Exchanges will begin to permit such trades.

The Exchanges are eliminating the current requirement that the futures or options on futures leg of an EFRP executed between 6:00 a.m. and 6:00 p.m. CT (for CME and CBOT products) and between 7:00 a.m. and 5:45 a.m. ET (for NYMEX and COMEX products) be submitted to CME Clearing within one hour of execution. The revised language indicates that EFRPs should be submitted to the Exchange as soon as possible following agreement to the relevant terms by the parties to the trade. The guidance states that absent extenuating circumstances, Market Regulation expects submission to occur on the same day that the EFRP is executed.

Lastly, we are modifying the standard applicable to firms that execute or clear EFRPs on behalf of customers. Currently, the language indicates that such firms should establish, document and execute controls that are reasonably designed to prevent and detect the execution of non-bona fide EFRPs. The revised standard requires firms to exercise due diligence in identifying circumstances in which a customer's EFRP transactions may be non-bona fide.

The Exchanges reviewed the designated contract market core principles ("DCM Core Principles") as set forth in the Commodity Exchange Act ("CEA" or "Act") and identified that the issuance of RA1612-5 may have some bearing on the following principles:

- <u>Compliance with rules</u>: Consistent with Core Principle 2, RA1612-5 proposed to be issued provides comprehensive guidance to the marketplace regarding the regulatory requirements attendant to EFRPs. Pursuant to Exchange rules, Market Regulation has the authority to obtain records related to EFRP transactions and has a surveillance program in place to appropriately monitor and enforce compliance with the amended Rule and Market Regulation Advisory Notice.

- <u>Availability of General Information</u>: RA1612-5 will be posted on the CME Group website in satisfaction of this core principle. RA1612-5 will be disseminated to the marketplace on September 20, 2016.
- <u>Execution of transactions</u>: Core Principle 9 permits designated contract markets ("DCMs") to authorize, for bona fide business purposes, transactions executed away from the DCM's centralized marketplace. The amendments to Rule 538. and to the associated Market Regulation

Advisory Notice comprehensively detail the requirements for EFRP transactions authorized by CME Group DCMs consistent with this core principle.

Pursuant to Section 5c(c) of the Act and CFTC Regulation 40.6(a), the Exchanges certify that the amendments to Rule 538. and the issuance of RA1612-5 comply with the Act and regulations thereunder. There were no substantive opposing views to this proposal.

The Exchanges certify that this submission has been concurrently posted on the Exchanges' website at http://www.cmegroup.com/market-regulation/rule-filings.html.

If you require any additional information regarding this submission, please contact me at 212.299.2200 or you may contact us by email at CFTCSubmissionInquiry@cmegroup.com.

Sincerely,

/s/ Christopher Bowen
Managing Director and Chief Regulatory Counsel

Attachments: Exhibit A: Amendments to Rule 538. ("Exchange for Related Positions")
Exhibit B: RA1612

EXHIBIT A

CME/CBOT/NYMEX/COMEX
Chapter 5 – Trading Qualifications and Practices

(additions are underscored; deletions are ~~overstruck~~)

Rule 538. EXCHANGE FOR RELATED POSITIONS

An Exchange for Related Position ("EFRP") transaction involves a privately negotiated off-exchange execution of an Exchange futures or options contract and, on the opposite side of the market, the simultaneous execution of an equivalent quantity of the cash product, by-product, related product, or OTC derivative instrument corresponding to the asset underlying the Exchange contract.

The following types of EFRP transactions are permitted to be executed outside of the Exchange's centralized market in accordance with the requirements of this rule:

> Exchange of Futures for Physical ("EFP") – the simultaneous execution of an Exchange futures contract and a corresponding physical transaction or a forward contract on a physical transaction.
>
> Exchange of Futures for Risk ("EFR") – the simultaneous execution of an Exchange futures contract and a corresponding OTC swap or other OTC derivative transaction.
>
> Exchange of Option for Option ("EOO") – the simultaneous execution of an Exchange option contract and a corresponding transaction in an OTC option~~ or other OTC instrument with similar characteristics~~.

For purposes of this rule, EFPs, EFRs and EOOs shall collectively be referred to as EFRP transactions.

538.A. Parties to an EFRP

One party to the EFRP must be the buyer of the Exchange contract and the seller of (or the holder of the short market exposure associated with) the related position; the other party to the EFRP must be the seller of the Exchange contract and the buyer of (or the holder of the long market exposure associated with) the related position. The Exchange contract and the corresponding related position must be executed for accounts with the same beneficial ownership.

~~Notwithstanding the foregoing, a~~A third party~~member firm~~ may facilitate, as principal, the related position component of an EFRP on behalf of a customer. Except for immediately offsetting foreign currency EFPs executed pursuant to Section K., such third party must be able to~~ provided that the member firm can~~ demonstrate that the related position was passed through to the customer who received the Exchange contract as part of the EFRP.

Specifically with respect to the execution of immediately offsetting foreign currency EFPs pursuant to Section K. by CTAs, account controllers, or other Persons acting on behalf of another party, the initiating and offsetting cash legs are not required to be passed through to the customer who received the Exchange contract as part of the EFRP. However, in a circumstance where the futures leg of the transaction fails to clear, the underlying customer must receive the profit or loss, if any, attendant to the offset of the offsetting cash leg.

Parties to an EFR or EOO transaction must comply with all relevant CFTC regulations governing eligibility to participate in the related position component of such transactions.

538.B. Independently Controlled Accounts

[Section B. is unchanged.]

538.C. Related Position

The related position component of an EFRP must be the cash commodity underlying the Exchange contract or a by-product, a related product or an OTC derivative instrument of such commodity that has a reasonable degree of price correlation to the commodity underlying the Exchange contract. The related position component of an EFRP may not be a futures contract or an option on a futures contract.

Each EFRP requires a bona fide transfer of ownership of the underlying asset between the parties or a bona fide, legally binding contract between the parties consistent with relevant market conventions for the particular related position transaction.

The execution of an EFRP transaction may not be contingent upon the execution of another EFRP or related position transaction between the parties where the transactions result in the offset of the related position without the incurrence of market risk that is material in the context of the related position transactions.

The facilitation of the execution of an EFRP by any party that knows such EFRP is non bona fide shall constitute a violation of this Rule.

[The remainder of the Rule is unchanged.]

EXHIBIT B

MARKET REGULATION ADVISORY NOTICE

Exchange	**CME, CBOT, NYMEX & COMEX**
Subject	**Exchange for Related Positions**
Rule References	**Rule 538**
Advisory Date	**September 20, 2016**
Advisory Number	**CME Group RA1612-5**
Revised Effective Date	**October 4, 2016**

Effective on trade date October 4, 2016, and pending all relevant CFTC regulatory review periods, this Advisory Notice will supersede CME Group Market Regulation Advisory Notice RA1311-5RR from June 27, 2014. It is being issued as a result of several changes to the text of Rule 538 ("Exchange for Related Positions") and the associated regulatory guidance contained in this Advisory Notice. The text of amended Rule 538 begins on page 3 of this Advisory Notice.

The changes to the Rule and regulatory guidance contained in the Advisory Notice include the following:

- Allowing a non-transitory EFRP to contain multiple Exchange components, eliminating the requirement that such Exchange components have the same market bias;
- Allowing a third party to facilitate, as principal, the related position component of an EFRP, eliminating the requirement that such parties be member firms;
- Modifying the requirements with respect to CTAs or other account controllers facilitating immediately offsetting foreign currency EFPs;
- Clarifying the responsibility of firms executing or clearing EFRPs on behalf of customers;
- Clarifying that the related position component of an EOO must be an OTC option;
- Modifying submission time requirements for EFRPs to CME Clearing;
- Clarifying that all underlying account statements are required to uniquely identify EFRP transactions;
- Clarifying that the facilitation of the execution of a non-bona fide EFRP by any party constitutes a violation of the Rule; and
- Eliminating the use of summary fines pursuant to Rule 512 for failure to provide requested records to Market Regulation in a complete and timely manner.

Market participants should note that no changes have been made with respect to the continued prohibition on the execution of transitory EFRPs in any products.

The execution of transitory EFRPs, which prior to August 4, 2014 had been permitted in CME foreign currency products, NYMEX energy products and COMEX and NYMEX metals products remain strictly prohibited.

As defined in Rule 538, transitory EFRPs are EFRPs in which the execution of an EFRP is contingent upon the execution of another EFRP or related position transaction between the parties and where the transactions result in the offset of the related positions without the incurrence of market risk that is material in the context of the related position transactions. Questions 13-16 in the FAQ provide additional guidance in this regard.

The time period between the transactions is a factor considered in assessing whether the EFRP is a transitory EFRP; however, the legitimacy of the transactions will be evaluated based on whether the transactions have integrity as independent transactions exposed to market risk that is material in the context of the transactions.

Questions regarding this Advisory Notice may be directed to the following individuals in Market Regulation:

For NYMEX and COMEX Products
Tom Dixon, Manager, 212.299.2901
Ryne Toscano, Director, 212.299.2879

For CME and CBOT Products
Brian Babinski, Lead Analyst, 312.341.5822
Michael Joubert, Specialist, 312.341.7714
William Lange, Director, 312.341.7757
Chris Reinhardt, Senior Director, 312.435.3665

For media inquiries concerning this Advisory Notice, please contact CME Group Corporate Communications at 312.930.3434 or news@cmegroup.com.

Text of Amended Rule 538 – ("Exchange for Related Positions")

An Exchange for Related Position ("EFRP") transaction involves a privately negotiated off-exchange execution of an Exchange futures or options contract and, on the opposite side of the market, the simultaneous execution of an equivalent quantity of the cash product, by-product, related product, or OTC derivative instrument corresponding to the asset underlying the Exchange contract.

The following types of EFRP transactions are permitted to be executed outside of the Exchange's centralized market in accordance with the requirements of this rule:

> Exchange of Futures for Physical ("EFP") – the simultaneous execution of an Exchange futures contract and a corresponding physical transaction or a forward contract on a physical transaction.
>
> Exchange of Futures for Risk ("EFR") – the simultaneous execution of an Exchange futures contract and a corresponding OTC swap or other OTC derivative transaction.
>
> Exchange of Option for Option ("EOO") – the simultaneous execution of an Exchange option contract and a corresponding transaction in an OTC option.

For purposes of this rule, EFPs, EFRs and EOOs shall collectively be referred to as EFRP transactions.

538.A. Parties to an EFRP

One party to the EFRP must be the buyer of the Exchange contract and the seller of (or the holder of the short market exposure associated with) the related position; the other party to the EFRP must be the seller of the Exchange contract and the buyer of (or the holder of the long market exposure associated with) the related position. The Exchange contract and the corresponding related position must be executed for accounts with the same beneficial ownership.

A third party may facilitate, as principal, the related position component of an EFRP on behalf of a customer. Except for immediately offsetting foreign currency EFPs executed pursuant to Section K., such third party must be able to demonstrate that the related position was passed through to the customer who received the Exchange contract as part of the EFRP.

Specifically with respect to the execution of immediately offsetting foreign currency EFPs pursuant to Section K. by CTAs, account controllers, or other Persons acting on behalf of another party, the initiating and offsetting cash legs are not required to be passed through to the customer who received the Exchange contract as part of the EFRP. However, in a circumstance where the futures leg of the transaction fails to clear, the underlying customer must receive the profit or loss, if any, attendant to the offset of the offsetting cash leg.

Parties to an EFR or EOO transaction must comply with all relevant CFTC regulations governing eligibility to participate in the related position component of such transactions.

538.B. Independently Controlled Accounts

The opposing accounts to an EFRP transaction must be (a) independently controlled accounts with different beneficial ownership; (b) independently controlled accounts of separate legal entities with common beneficial ownership; or (c) independently controlled accounts of the same legal entity, provided that the account controllers operate in separate business units.

For EFRP transactions between accounts with common beneficial ownership, the parties to the trade must be able to demonstrate the independent control of the accounts and that the transaction had economic substance for each party to the trade.

538.C. Related Position

The related position component of an EFRP must be the cash commodity underlying the Exchange contract or a by-product, a related product or an OTC derivative instrument of such commodity that has a reasonable degree of price correlation to the commodity underlying the Exchange contract. The related position component of an EFRP may not be a futures contract or an option on a futures contract.

Each EFRP requires a bona fide transfer of ownership of the underlying asset between the parties or a bona fide, legally binding contract between the parties consistent with relevant market conventions for the particular related position transaction.

The execution of an EFRP transaction may not be contingent upon the execution of another EFRP or related position transaction between the parties where the transactions result in the offset of the related position without the incurrence of market risk that is material in the context of the related position transactions.

The facilitation of the execution of an EFRP by any party that knows such EFRP is non bona fide shall constitute a violation of this Rule.

538.D. EFPs in Connection with Inventory Financing of Storable, Non-Financial Commodities

A party providing inventory financing for a storable agricultural, energy or metals commodity may, through the execution of an EFP, purchase the commodity and sell the equivalent quantity of futures contracts to a counterparty, and grant to the counterparty the non-transferable right, but not the obligation, to execute a second EFP during a specified time period in the future which will have the effect of reversing the original EFP.

538.E. Quantity Equivalence

The quantity of the related position component of the EFRP must be approximately equivalent to the quantity of the Exchange component of the EFRP. Appropriate hedge ratios between the Exchange and related position components of the EFRP may be used to establish equivalency.

538.F. Prices and Price Increments

The Exchange component of the EFRP transaction must be priced in accordance with the applicable futures price increments or option premium increments as set forth in the rules governing the Exchange contract.

EFRPs may be transacted at such commercially reasonable prices as are mutually agreed upon by the parties to the transaction. EFRPs may not be priced to facilitate the transfer of funds between parties for any purpose other than as the consequence of legitimate commercial activity.

538.G. EFRPs Following the Termination of Trading in Exchange Contracts

EFRP transactions in certain Exchange contracts may be executed for a defined period of time following the termination of trading in accordance with the applicable product rules governing each Exchange contract. Such transactions may be executed only to liquidate Exchange positions.

538.H. Recordkeeping

Parties to an EFRP transaction must maintain all records relevant to the Exchange contract and the related position transaction, including order tickets, records customarily generated in accordance with relevant market practices, records reflecting payments between the parties and, where appropriate, transfer of title, as well as any other records required to be kept pursuant to CFTC Regulation 1.35. Brokers who facilitate EFRP transactions must maintain all records corresponding to their facilitation of the transactions.

Records related to EFRP transactions must be provided to the Exchange upon request. It shall be the responsibility of the carrying clearing member firm to obtain and submit the requested records of their clients to the Exchange on a timely basis.

538.I. Submission to the Clearing House

Each EFRP transaction shall be submitted to the Clearing House within the time period and in the manner specified by the Exchange and the Clearing House. In all cases, the record submitted to the Clearing House must reflect the correct EFRP transaction type and must reflect the accurate date and time at which the relevant terms of the transaction were agreed upon by the parties to the trade.

An EFRP transaction submitted to the Clearing House shall not be considered accepted by the Clearing House until the transaction has cleared and the first payment of settlement variation and performance bond has been confirmed.

538.J. EFRP Volumes Required to be Reported with Daily Large Trader Positions

Each clearing member, omnibus account and foreign broker responsible for submitting daily large trader positions in accordance with Rule 561 must submit for each reportable account the EFRP volume bought and sold in the reportable instrument. This information must be included in the daily Large Trader report to the Exchange.

538.K. Immediately Offsetting EFPs in Foreign Currency Futures

EFPs in foreign currency futures wherein the parties immediately offset the cash transaction are permitted and the Exchange would expect to see confirmation statements issued by the bank/foreign exchange dealer party to the Transaction. These confirmation statements should be the type normally produced by the bank/foreign exchange dealer for confirmation of currency deals and should indicate, by name, the identity of the counter party principal to the Transaction. However, in circumstances where the EFP Transaction is between a bank/foreign exchange dealer and a CTA, account controller, or other Person acting on behalf of a third party (such as a commodity pool or fund), the cash side confirmation statement must identify, at minimum, the name of the third party's Carrying Clearing Member and the third party's account number (or other account specific designation), but need not identify the third party by name. These transactions are only permissible as EFPs in foreign currency futures and not in any other asset class or in EFRs or EOOs in foreign currency futures.

FAQ Related to Rule 538
<u>Exchange for Related Positions</u>

Q1: What are EFRP transactions?

A1: EFRP is an acronym for Exchange for Related Position, and EFRPs are one of the permitted exceptions to the requirement that futures and options on futures be executed openly and competitively on the Exchange.

An EFRP transaction involves the off-exchange execution of an Exchange futures or options on futures contract and, on the opposite side of the market, the simultaneous execution of an equivalent quantity of the cash product, by-product, related product or OTC derivative instrument corresponding to the asset underlying the Exchange contract.

Q2: What is the difference between EFRP transactions and "Ex-Pit" transactions?

A2: The term "Ex-Pit Transaction" refers broadly to transactions that Exchange rules permit to be executed outside of the Exchange's centralized market. Permissible Ex-Pit transactions include EFRPs, block trades and transfer trades. EFRPs are addressed in Rule 538; block trades are addressed in Rule 526, and transfer trades are addressed in Rule 853.

Q3: What are the different types of EFRPs permitted by CME Group Exchanges?

A3: The following types of Exchange for Related Position ("EFRP") transactions are permitted to be executed outside of the Exchange's centralized market in accordance with the requirements of Rule 538, the application guidance in this advisory, and any applicable CFTC regulations.

Exchange of Futures for Physical ("EFP") – the simultaneous execution of an Exchange futures contract and a corresponding physical transaction or a forward contract on a physical transaction.

Exchange of Futures for Risk ("EFR") – the simultaneous execution of an Exchange futures contract and a corresponding OTC swap transaction or other OTC derivative transaction.

Exchange of Option for Option ("EOO") – the simultaneous execution of an Exchange option contract and a corresponding transaction in an OTC option. No other instrument other than an OTC option is eligible as the related position component of an EOO.

The related position component of an EFRP may not be a futures contract or an option on a futures contract.

Where the related position component of an EFRP is a physical transaction, a forward contract that is not otherwise defined as a swap under federal regulations, an Exchange Traded Fund ("ETF") or an Exchange Traded Note ("ETN"), the transaction should be submitted for clearing as an EFP transaction type.

Where the related position component of an EFRP is an instrument defined as a swap pursuant to federal regulations, or is another OTC derivative transaction, the transaction must be submitted as an EFR or an EOO transaction type, as applicable, and must be reported as required under Parts 43 and 45 of Commodity Futures Trading Commission Regulations. For further information regarding CFTC/SEC product definitions, market participants should reference the August 13, 2012 Federal Register release (77 FR 48207) that defines swaps and the scope of the forward contact exclusion.

A swap that is traded on, or subject to the rules of, a designated contract market ("DCM") or a swap execution facility ("SEF") is ineligible to be the related position component of an EFR or EOO transaction executed pursuant to Rule 538.

The above-referenced exclusion does not apply to swaps that are bilaterally negotiated and submitted for clearing-only to a DCO provided such swaps have a reasonable degree of correlation to the underlying CME Group Exchange product.

Q4: Can EFRPs be executed in any of the CME Group Exchanges' futures and options contracts?

A4: EFRPs may be executed in any of the CME Group Exchanges' futures and futures options contracts provided that the transaction conforms to the requirements of Rule 538 and any associated advisories, as well as with any applicable CFTC regulations.

Q5: Are there specified trading hours during which EFRP transactions may be executed?

A5: EFRPs may be executed at any time. However, an EFRP transaction submitted to the Clearing House shall not be considered to have been accepted by the Clearing House until the transaction has cleared and the first payment of settlement variation and performance bond has been confirmed.

Q6: Can an EFRP be executed after trading has ceased in an expiring contract?

A6: EFRP transactions in certain Exchange contracts may be executed for a defined period of time following the termination of trading only to liquidate Exchange positions and only in accordance with the applicable product rules governing each Exchange contract. The applicable product chapter of the relevant Exchange's rulebook will specify if such transactions are permitted and, if so, the time period following the cessation of trading during which such transactions are eligible to be executed.

Q7: Are there restrictions on who may participate in EFRP transactions?

A7: EFP Transactions – There are no specific eligibility requirements for participation in an EFP transaction.

EFR and EOO Transactions – Participants to EFR and EOO transactions must comply with applicable CFTC requirements governing eligibility to transact the related position component of an EFR or EOO, and participants should consult with counsel as appropriate to determine eligibility. In this regard, market participants should be mindful of all eligibility standards applicable to related positions, including, where applicable, CFTC Regulations Part 32-Regulation of Commodity Option Transactions and Part 35-Swaps In An Agricultural Commodity.

Q8: May EFRPs be executed between affiliated accounts?

A8: The opposing accounts involved in the execution of an EFRP must be:

a) independently controlled accounts with different beneficial ownership; or
b) independently controlled accounts of separate legal entities with common beneficial ownership; or
c) independently controlled accounts of the same legal entity provided that the account controllers operate in separate business units.

Accounts with the same beneficial ownership include accounts owned by the same person or entity, accounts of a parent and its wholly owned subsidiaries, and accounts of subsidiaries that are wholly owned by the same parent. Common beneficial ownership is more inclusive and includes not only accounts with the same beneficial ownership, but also accounts with common beneficial ownership that is less than 100%.

Parties to an EFRP transaction involving the same legal entity or common beneficial owner must be able to demonstrate the independent control of decision making for the respective accounts and that the EFRP had economic substance for each party to the trade.

Q9: Are multi-party EFRP transactions permitted?

A9: Typically, there may be only two parties involved in an EFRP transaction. One party to the EFRP must be the buyer of the Exchange contract and the seller of (or the holder of the short market exposure associated with) the related position; the other party to the EFRP must be the seller of the Exchange contract and the buyer of (or the holder of the long market exposure associated with) the related position. The Exchange contract and corresponding related position of an EFRP must be executed for accounts with the same beneficial ownership.

Any third party may facilitate, as principal, the related position component of an EFRP on behalf of a customer provided that the third party can demonstrate that the related position was passed through to the customer who received the Exchange contract as part of the EFRP.

With respect to the execution of immediately offsetting foreign currency EFPs pursuant to Section K. by CTAs, account controllers, or other Persons acting on behalf of another party, the initiating and offsetting cash legs are not required to be passed through to the customer who received the Exchange contract as part of the EFRP. However, in a circumstance where the futures leg of the transaction fails to clear, the underlying customer must receive the profit or loss, if any, attendant to the offset of the offsetting cash leg.

Q10: Are there restrictions on the price at which an EFRP transaction may be executed?

A10: EFRPs may be transacted at such commercially reasonable prices as are mutually agreed upon by the parties to the transaction, provided that the price conforms to the applicable futures price increments or option premium increments set forth in the product chapter rules for the relevant Exchange contract.

EFRPs may not be priced to facilitate the transfer of funds between parties for any purpose other than as a consequence of legitimate commercial activity. Market participants may be required to demonstrate that EFRPs executed at prices away from prevailing market prices were executed at such prices for legitimate purposes.

Q11: Can EFRPs be average priced?

A11: Yes. EFRP transactions designated for average pricing must conform to the requirements of Rule 553 (“Average Price System”) and Rule 538.

Q12: Are the prices and quantities of EFRP transactions publicly reported?

A12: The price of the Exchange leg of an EFRP transaction is not publicly reported. EFRP volumes are reported daily, by instrument, on the CME Group website.
Parties to an EFR or EOO transaction should consult CFTC regulations regarding the swap reporting requirements associated with their execution of the related position transaction.

Q13: Are transitory EFRPs permitted in any products listed on CME Group exchanges?

A13: No.

Transitory EFRPs are EFRPs in which the execution of an EFRP is contingent upon the execution of another EFRP or related position transaction between the parties and where the transactions result in the offset of the related positions without the incurrence of market risk that is material in the context of the related position transactions.

The time period between the transactions is a factor considered in assessing whether the EFRP is a transitory EFRP; however, the legitimacy of the transactions will be evaluated based on whether the transactions have integrity as independent transactions exposed to market risk that is material in the context of the transactions.

Where economically equivalent futures products trade on a CME Group Exchange and another exchange, the contingent execution between two parties of equal and opposite EFRPs on each exchange where the related position components offset and are not subject to market risk shall be considered a prohibited transitory EFRP at the applicable CME Group Exchange.

Q14: Can a swap be negotiated to settle via an EFR?

A14: Parties to a swap may agree to settle the swap via an EFR provided that the determination of the settlement value of the swap (floating price) is subject to market risk that is material in the context of the transaction. For example, parties may negotiate a swap to settle via EFR on a specific date in the future at the futures settlement price or the average settlement price over a prescribed time period.

Q15: Can an EFRP incorporate multiple legs on the Exchange component of the transaction or incorporate multiple legs on the related position component of the EFRP?

A15: An EFRP may incorporate multiple Exchange components provided that the EFRP is not a prohibited transitory EFRP as defined in Section C. and in the answer to Question 13 of this Advisory Notice. Accordingly, an EFRP with multiple Exchange components where the related position components offset without the incurrence of market risk that is material in the context of the related position transactions would not be permissible. Alternatively, an EFRP with multiple Exchange components where the related position components do not offset and where those related position components incur material market risk are permitted.

An EFRP may incorporate multiple related position components provided that the net exposure of the related position components is approximately equivalent to the quantity of futures exchanged or, in the case of an EOO, the net delta-adjusted quantity of the OTC option components is approximately equivalent to the delta-adjusted quantity of the Exchange-listed option.

Q16: Can EFPs be utilized to facilitate inventory financing in storable non-financial commodities?

A16: EFP transactions entered into for the purpose of obtaining inventory financing for storable agricultural, metals and energy commodities are permitted in accordance with the following: A party providing inventory financing for a storable, non-financial commodity may, through the execution of an EFP, purchase the commodity and sell the equivalent quantity of futures contracts to a counterparty, while simultaneously granting to the counterparty the non-transferable right, but not the obligation, to execute a second EFP that reverses the original EFP during a specified time period in the future.

Q17: What types of instruments are considered acceptable for use as the related position side of EFRPs?

A17: The related position component of the EFRP must involve the product underlying the Exchange contract or a by-product, related product or OTC derivative instrument that is reasonably correlated to the corresponding Exchange instrument.

The related position component of an EFRP may not be a futures contract or an option on a futures contract.

Where the risk characteristics and/or maturities of the related position differ from the instrument underlying the Exchange contract, the parties to the EFRP may be required to demonstrate the correlation between the products and the methodology used in equating the futures to the related position. In all cases, the related position transaction must be comparable with respect to quantity, value or risk exposure of the corresponding Exchange contract.

Each EFRP requires a bona fide transfer of ownership of the cash commodity between the parties or a bona fide, legally binding contract between the parties consistent with relevant market conventions for the particular related position transaction.

Where the related position component of an EFRP is a physical transaction, a forward contract that is not otherwise defined as a swap under federal regulations, an Exchange Traded Fund ("ETF") or an Exchange Traded Note ("ETN"), the transaction should be submitted for clearing as an EFP transaction type.

Where the related position component of an EFRP is an instrument defined as a swap pursuant to federal regulations, or is another OTC derivative transaction, the transaction must be submitted as an EFR or an EOO transaction type, as applicable, and must be reported as required under Parts 43 and 45 of Commodity Futures Trading Commission Regulations. For further information regarding CFTC/SEC product definitions, market participants should reference the August 13, 2012 Federal Register release (77 FR 48207) that defines swaps and the scope of the forward contact exclusion.

Generally acceptable related position instruments for EFRPs in the following product groups include, but are not limited to, the following:

<u>Foreign Exchange Contracts</u>: Instruments acceptable as the related position component of an FX EFRP transaction include spot, forwards, non-deliverable forwards ("NDFs"),swaps and swaptions, cross-currency basis swaps, OTC FX options, non-deliverable options ("NDOs"), currency baskets, ETFs and ETNs.

<u>Interest Rate Contracts</u>: Instruments acceptable as the related position component of an interest rate EFRP include Treasuries, Agencies, investment grade corporates, money market instruments, interest rate swaps and swaptions, forward rate agreements (FRAs), mortgage instruments including collateralized mortgage obligations, OTC interest rate options, ETFs and ETNs.

<u>Equity Index Contracts</u>: Instruments acceptable as the related position component of a stock index EFRP include stock baskets provided the basket is highly correlated to the index and, further, that the basket represents at least 50% of the underlying index by weight or includes at least 50% of the stocks in the underlying index. The notional value of the basket must be approximately equal to the value of the corresponding exchange contract. Other acceptable instruments include equity index swaps and swaptions, OTC equity index options, ETFs and ETNs.

Agricultural Contracts: Instruments acceptable as the related position component of an EFRP in agricultural products include the commodity underlying the futures contract or a by-product or related product that is reasonably correlated to the futures being exchanged, physical forwards, cash-settled forwards, agricultural commodity swaps or swaptions, OTC agricultural options, ETFs and ETNs.

Commodity Index Contracts: Instruments acceptable as the related position component of an EFRP involving an Exchange contracts based on a commodity index (*e.g.*, S&P GSCI, Bloomberg Commodity Index) include a corresponding commodity index swap or swaption, ETFs or ETNs.

Energy Contracts: Instruments acceptable as the related position component of an EFRP in energy products include the commodity underlying the futures contract or a by-product or related product that is reasonably correlated to the futures being exchanged, physical forwards, cash-settled forwards, energy commodity swaps or swaptions, OTC energy options, ETFs and ETNs.

Metals Contracts: Instruments acceptable as the related position component of an EFRP in metals products include related spot transactions, physical forwards, cash-settled forwards, swaps and swaptions, OTC metals options, ETFs and ETNs.

Questions regarding the acceptability of related position instruments may be addressed to the Market Regulation contacts listed in this Advisory Notice.

Q18: What are the recordkeeping requirements for EFRPs?

A18: Parties to an EFRP must maintain all records relevant to the Exchange contract and the corresponding related position transaction, including any records required to be kept pursuant to CFTC Regulation 1.35. Upon request, such records must be provided to Market Regulation in a timely manner.

Records that may be requested include, but are not limited to, the following:

A. All order tickets, trade blotters, e-mails, instant messages, telephone recordings or other records related to the order placement, negotiation, execution and/or confirmation of the EFRP.

B. All cash confirmations and signed contracts corresponding to the cash or derivative component of the EFRP. The documentation must contain all of the relevant terms of the transaction and counterparty information.

C. For EFPs, third party proof of payment evidencing settlement and documentation representing the transfer of ownership of the commodity. For EFPs involving forward contracts, such information may be requested if the forward contract has settled at the time of the request. For EFRs and EOOs, where applicable, proof of payment evidencing settlement between the parties.

D. Futures account statement reflecting confirmation of the EFRP.

E. Records reflecting the booking of the cash or derivative transaction in the firm's internal bookkeeping systems.

Parties who facilitate EFRP transactions must maintain all records corresponding to their facilitation of the transactions.

Q19: Who is responsible for submitting EFRP records when a request for such records is made by the Market Regulation Department?

A19: Upon request, related position documentation for an EFRP must be provided on a timely basis and in the form and manner requested, to the Market Regulation Department. The clearing firm carrying the account shall be responsible for obtaining relevant EFRP records from its client and submitting the records to Market Regulation.

Pursuant to Rule 418 ("Consent to Exchange Jurisdiction"), any party initiating or executing a transaction subject to the rules of the Exchange, or for whose benefit such transaction has been executed, is subject to the jurisdiction of the Exchange and may be required by Market Regulation to produce records and cooperate fully with any investigation.

Failures to provide requested records in a complete or timely manner may result in referral to the Probable Cause Committee for consideration of charges under Rule 432.L. ("General Offenses").

Q20: Must transactions executed as EFRPs be designated as EFRPs on customer account statements?

A20: Account statements must accurately identify EFRP transactions as such. It is not acceptable to designate the trades as "Ex-Pit" or "ClearPort" trades as such terms may reflect transaction types other than EFRPs.

Q21: How are EFRPs submitted to the Clearing House?

A21: EFRPs may be submitted to the Clearing House via Front-End Clearing ("FEC"), via CME ClearPort ("CPC"), or, for EFRPs entered from the NYMEX or COMEX trading floor, via the Clearing System Broker User Interface.

For information regarding the submission of EFRPs using Front End Clearing, please contact Clearing Services at 312.207.2525 or via email at ccs@cmegroup.com.

For information regarding the submission of EFRPs using CME ClearPort, please contact CME ClearPort Market Operations at 1-800-438-8816 or via email at CustCare@cmegroup.com

Q22: How soon after execution must the EFRP be submitted to the Clearing House?

A22: EFRP transactions should be submitted to the Exchange as soon as possible following agreement to the relevant terms by the parties to the trade. The Market Regulation Department expects submission to occur on the same day that the EFRP is executed absent extenuating circumstances.

The relevant terms of the EFRP are considered to have been determined at the time the price and quantity of the Exchange contract and the corresponding related position component of the transaction are agreed upon by the parties to the EFRP. However, where the actual delivery quantity may not be precisely determined by the parties until the time of delivery, the parties may contractually agree to submit the transaction to the Clearing House within the required reporting period following the time at which the actual delivery quantities are determined, rather than reporting the EFRP at the time of pricing. Absent such contractual arrangement, the transaction must be reported at the time of pricing.
Notwithstanding the foregoing, EFRPs may not, under any circumstances, be submitted for clearing later than the end of the permissible posting period for EFRP transactions following the expiration of the underlying futures contract as specified in the relevant product chapter of the applicable Exchange rulebook.

Q23: Must the execution date and time be submitted for EFRPs?

A23: The date and time of execution must be accurately submitted for each EFRP transaction. The execution date and time to be submitted are the date and time at which the relevant terms of the transaction were determined by the parties to the trade as described in Q22.

The execution time for EFRPs entered by members and their employees on the NYMEX/COMEX trading floor via the Clearing System Broker User Interface must be entered in Eastern Time.

The execution time for EFRPs entered into CME ClearPort must be entered in the local time of the party(ies) entering the EFRP.

In all other cases, the execution time for EFRPs must be entered in Central Time.

Q24: Must a broker be specified when submitting EFRPs to the Clearing System?

A24: Direct entry of an EFRP into Front-End Clearing does not require the entry of a broker for the transaction.

Entry of EFRPs through CME ClearPort Clearing by a registered user requires that the “Broker Firm” and “Broker Name” fields be populated.

Entry of EFRPs by members and their employees on the NYMEX trading floor via the Clearing System Broker User Interface require information identifying the party entering the transaction.

Q25: What information regarding EFRPs must be submitted in a reporting firm’s daily Large Trader position file?

A25: A firm’s daily Large Trader position file must include for each reportable account the EFRP volume bought and sold in the reportable instrument.

Q26: What are the responsibilities of firms in connection with EFRPs executed or cleared on behalf of a customer?

A26: Firms that execute or clear EFRPs on behalf of customers are responsible for ensuring that their customers who execute EFRPs are fully informed regarding Exchange EFRP requirements. Upon request by the Market Regulation Department, firms carrying accounts that execute EFRPs are responsible for obtaining and submitting records of their clients’ EFRP transactions in a timely and complete manner.

Firms that execute or clear EFRPs on behalf of customers should exercise due diligence in identifying circumstances in which a customer’s EFRP transactions may be non-bona fide. If a clearing member has notice or knowledge of the execution of non-bona fide EFRPs by its customer and the clearing member fails to take appropriate action, the clearing member will be found to have violated Rule 538.C.

Q27: Is an Immediately Offsetting EFP in Foreign Currency Futures prohibited as a transitory EFRP in Foreign Currency Futures?

A27: No. An immediately offsetting FX EFP as expressly permitted under Rule 538.K. is not prohibited as a transitory EFRP because the offsetting physical transaction is not contingent on the EFP in any way. If, for example, the futures leg of an immediately offsetting EFP in foreign currency is not accepted for clearing, the futures transaction is void ab initio and the counterparties would be left with the stand-alone physical transaction. Nevertheless, Rule 538.K. makes clear that the stand-alone physical and EFP transactions may occur immediately and result in the offset of the physical transactions without being prohibited as a transitory EFRP.