

SUBMISSION COVER SHEET

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Registered Entity Identifier Code (optional): 18-387

Organization: Chicago Mercantile Exchange Inc. (CME)

Filing as a: DCM SEF DCO SDR

Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): 09/25/18 Filing Description: Acceptance of SOFR Denominated Interest Rate Swaps for Clearing

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:

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:

September 25, 2018

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 39.5(b) Submission: Acceptance of SOFR Denominated
Interest Rate Swaps for Clearing.
CME Submission No. 18-387**

Dear Mr. Kirkpatrick:

Chicago Mercantile Exchange Inc. (“CME”), a registered derivatives clearing organization (“DCO”) under the Commodity Exchange Act, as amended (the “Act”), hereby submits to the Commodity Futures Trading Commission (“CFTC” or “Commission”), pursuant to Commission Regulation 39.5(b), its plan to accept Secured Overnight Financial Rate (“SOFR”) denominated interest rate swaps (“SOFR Swaps”), beginning trade date Monday, October 1, 2018.

SOFR is the broadest of the three repo market reference rates produced by the Federal Reserve Bank of New York (“FRBNY”). SOFR has been identified by the Alternative Reference Rate Committee (“ARRC”) as an alternative to the USD-LIBOR benchmark rate. In 2014, the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York convened the ARRC in order to identify best practices for alternative reference rates, identify best practices for rate robustness, develop an adoption plan for usage to support derivatives trading, and create an implementation plan with metrics of success and a timeline for SOFR’s adoption.¹ The rate officially began publishing on April 3, 2018 and is available each day at 8:00 a.m. Eastern Time. The rate quoted in the morning is applied to the previous overnight period.

As shown in Exhibit 2, CME’s cleared OTC IRS product scope will be increased to include SOFR OIS, SOFR/LIBOR Basis Swaps, and SOFR/EFFR Basis Swaps. In general, the structure of all SOFR floating legs will mirror the structure of the Fed Funds leg of current USD OIS. The same daily compounded SOFR floating leg is used in all three product types.

SOFR comprises a broad universe of overnight Treasury repo trade activity, making it a benchmark for all seasons, impervious to future structural shifts in market preferences between bilateral repo versus tri-party repo transactions. It is based firmly on transaction data drawn from multiple and diverse sources: all tri-party Treasury general collateral (“GC”) repo transactions cleared and settled by Bank of New York Mellon (“BNYM”), all tri-party Treasury general collateral repo transactions made through the Fixed Income Clearing Corporation (“FICC”) General Collateral Financing (“GCF”) repo market and bilateral Treasury repo transactions cleared through the FICC Delivery-versus-Payment (“FICC DVP”) service.

Various filters, trims, and inclusion rules are applied to these data sources to isolate overnight Treasury GC repo transactions from other repo market activity, and to ensure that SOFR adheres to the IOSCO Principles for Financial Benchmarks. After editing each of the three sets of source data, FRBNY pools them, then ranks the aggregate of repo trading volumes by their transaction rates, from lowest to highest, then computes the transaction-weighted median repo rate. The transaction-weight median repo rate becomes the day’s SOFR benchmark value.

¹ <https://www.newyorkfed.org/arrc/index.html>.

CME Exchange launched One-Month SOFR futures and Three-Month SOFR futures on May 7, 2018.² These two futures contracts complement one another by facilitating price discovery along different segments of the term structure of money market interest rates. Additionally, they enable intermarket spreading opportunities against the CME Exchange's flagship short-term interest rate futures products, Three-Month Eurodollar (ED) futures and 30-Day Federal Funds ("FF") futures, both of which are supported by long-established, deep, and resilient liquidity pools.

Clearing SOFR Swaps further accrues capital efficiencies as market participants will be able to clear interest rate swaps ("IRS"), swaptions and interest rate futures within a single netting pool.

39.5(b)(3)(i): Eligibility to Clear

Pursuant to CFTC Regulation 39.5(b)(3)(i), CME states that it is eligible to accept SOFR Swaps for clearing. Should the commission determine that such swaps are required to be cleared, CME will be able to maintain compliance with the DCO core principles set forth in Section 5b(c)(2) of the Act and the Regulations promulgated thereunder.

In accordance with CFTC Regulation 39.5(b)(3)(ii)-(viii), we are providing the following information in support of this submission:

39.5(b)(3)(ii)(A): Statement on Outstanding Derivatives Notional Exposure, Trading Liquidity and Pricing Data

Endorsed by the ARRC in June 2017, SOFR is a broad Treasuries overnight repo financing rate published by FRBNY as of April 3, 2018.

As referenced in CME Exchange Submission 18-069 for launching SOFR futures for trading, during the sub-interval from March 1, 2016, through October 17, 2017, the median daily transaction volumes were \$721 billion for SOFR utilized transactions. Additionally, the minimum daily transaction volumes were \$515 billion for SOFR. The median daily transaction volume supporting SOFR during the first week of SOFR publication (April 3-6, 2018) was \$845 billion.

A. SOFR Futures Notional Size

CME Exchange launched SOFR futures in May 2018. Since launch and as of September 5, 2018, \$105 billion in notional open interest has been established (30,181 contracts). SOFR futures have traded \$711 billion in cumulative notional volume (278,000 contracts). The average daily volume reached approximately 6,000 contracts in August.

B. SOFR Swaps

Currently, CME understands that less than one billion in notional value is known to have been executed bilaterally in the last few months, including a small amount of notional value that has been cleared at other clearing houses. Since the SOFR Swaps market is a new market, we expect further development and the availability of liquidity data in the near future.

C. US Dollar IRS Market

SOFR is expected to develop alongside other US Dollar-denominated OTC Interest Rate Swap products which, on a combined basis, represent \$1.3 trillion in average daily notional volume according to the 2016 Triennial Central Bank Survey conducted by the Bank of International Settlements ("BIS") (<http://www.bis.org/publ/rpfx16.htm>)

² https://www.cmegroup.com/content/dam/cmegroup/market-regulation/rule-filings/2018/04/18-069_1.pdf.
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39.5(b)(3)(ii)(B): Rule Framework, Capacity, Operational Expertise and Resources, and Credit Support Infrastructure

The rule framework for SOFR Swaps is the same as all other IRS cleared by CME and is set forth in the CME Rulebook. This CME Rulebook is available at www.cmegroup.com/market-regulation/rulebook.index.html. Furthermore, CME Clearing's "Risk Management and Financial Safeguards" brochure (the Risk Management Brochure), which is available at <http://www.cmegroup.com/clearing/files/financialsafeguards.pdf>, contains information regarding CME's risk management capacity, expertise, resources, and financial safeguard system.

39.5(b)(3)(ii)(C): Statement on the Mitigation of Systemic Risk

As a central counterparty, CME interposes itself between counterparties to the swaps (and other derivatives products) that it clears, becoming the buyer to every seller and the seller to every buyer. For each swap that it clears, CME provides all clearing house services, including a market-to-market function, on a daily basis. Depending upon the particular asset class, CME may standardize contract-critical dates (e.g., start dates, last trade dates, expiry dates) and other contract terms. This may enable customers who hold positions to liquidate or to adjust positional exposures simply by buying back or selling the relevant contracts. The associated benefits are considerable:

- *Centralized clearing.* Clearing SOFR Swaps through CME allows market participants to free up counterparty credit lines. The daily mark-to-market process employed by CME enhances customer risk management opportunities.
- *Operational efficiencies.* Centralized clearing of swaps reduces operational burdens in several ways. Standardization and centralized clearing enables consolidation of collateral management and cash flows and eliminates the need for novation or tear-ups.
- *Ease of position adjustment.* In non-cleared markets, the only means to completely eliminate the risk of a swap is to (i) enter into a tear-up agreement with the swap counterparty, or (ii) enter into a novation (i.e., find another entity willing to assume its side of the swap). In either case, the tear-up or the novation must be approved by the bilateral swap counterparty. For most asset classes, central clearing may be used to offset exposures by a contra trade.

As further described in the Risk Management Brochure, CME has the necessary resources available to clear SOFR Swaps.

39.5(b)(3)(ii)(D): Statement on Competition and Appropriate Fees and Charges

CME does not believe that the clearance of SOFR Swaps will have any negative impact, or impose any burden, on competition. CME's schedule of fees for IRS can be found at <http://www.cmegroup.com/trading/interest-rates/files/cleared-otc-irs-customer-fees.pdf>.

39.5(b)(ii)(E): Statement on Legal Certainty and Insolvency

The bankruptcy of a DCO is governed by subchapter IV of Chapter 7 of the U.S. Bankruptcy Code (11 U.S.C. §§ 761-767), and by Part 190 ("Bankruptcy") of the Commission's Regulations. Also relevant in the event that CME were to enter into bankruptcy proceedings is CME Rule 818. ("Close-Out Netting") included in Chapter 8 ("Clearing House and Performance Bonds") of the CME Rulebook.

The bankruptcy of a clearing member that is a U.S. futures commission merchant ("FCM") would be governed by subchapter IV of Chapter 7 of the U.S. Bankruptcy Code (11 U.S.C. §§ 761-767) and Part 190 (Bankruptcy) of the Commission's Regulations. If an FCM is registered as a broker-dealer, certain aspects of its insolvency proceeding may also be governed by the Securities Investor Protection Act.

39.5(b)(3)(iii): Product Specification

Attached as Exhibit 2 are the product-specifications for SOFR Swaps. These specifications will be added, without the conditional statement of being subject to further regulatory review upon the effectiveness of this submission, to CME's IRS product scope slate at www.cmegroup.com/irs. SOFR Swaps will settle in USD.

39.5(b)(3)(iv): Participant Eligibility Standards

CME Rule 8G04. ("IRS Clearing Member Obligations and Qualifications") specifies the requirements for IRS Clearing Members.

39.5(b)(3)(v): Pricing Sources

We have concurrently submitted in CME Submission 18-387S, a document, marked for confidential treatment, describing the curve building for cleared SOFR Swaps.

A. SOFR Swap Rate

The SOFR Swaps references the USD-SOFR ("SOFR Rate"). The SOFR is computed, and is published daily at approximately 8:00 a.m. Eastern Time, by the FRBNY. It is a fully transactions-based interest rate benchmark incorporating data on transactions in overnight repurchase agreements collateralized by Treasury securities (repo) drawn from three sources:

- all tri-party Treasury general collateral repo transactions settled on the books of Bank of New York Mellon. The FRBNY collects such trade-by-trade data directly from Bank of New York Mellon, pursuant to the supervisory authority of the Board of Governors of the Federal Reserve System.
- all tri-party Treasury general collateral repo transactions mediated through GCF repo market of FICC. FRBNY has entered into an agreement with DTCC Solutions LLC ("DTCC"), an affiliate of the Depository Trust & Clearing Corporation, to obtain these transaction data.
- bilateral Treasury repo transactions cleared through the FICC DVP service. Here too, FRBNY has entered into an agreement with DTCC to obtain these transaction data.

39.5(b)(3)(vi): Risk Management Procedures

The Risk Management Brochure summarizes CME's risk management procedures applicable to the clearing of SOFR Swaps.

39.5(b)(3)(vii): Rules, Manuals, Policies, or Procedures

The product rules for SOFR Swaps are being added to Chapters 901 of the CME Rulebook and are enclosed in Exhibit 1 which is attached hereto. The product rules and attendant non-substantive conforming revisions (i) add USD-SOFR-COMPOUND as a new Rate Option to Rule 90102.E.1 ("Rate Options"). Additions to existing rules are underscored.

39.5(b)(3)(viii): Notice of Submission

Notice of this submission has been concurrently posted on CME Group's 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 via e-mail at CMEGSubmissionInquiry@cmegroup.com.

Sincerely,

Christopher Bowen
Managing Director and Chief Regulatory Counsel

Attachments:

Exhibit 1 – CME Rulebook Amendments, SOFR Swaps Product Rules
Exhibit 2 – SOFR Swaps Product Specifications

EXHIBIT 1

CME RULEBOOK SOFR Product Rules

(Additions underlined)

Chapter 901 Interest Rate Swaps Contract Terms

90102.E. Rate Options

90102.E.1 Rate Options

With respect to an IRS Contract, the Rate Option elected by the IRS Clearing Participant in accordance with Rule 90002.F from the following Rate Options or combination of Rate Options:

1. USD-LIBOR-BBA
2. USD-Federal Funds-H.15-OIS-COMPOUND
3. USD-Federal Funds-H. 15-LIBOR-BBA
4. EUR-EURIBOR-Reuters
5. EUR-EURIBOR-Telerate (as defined in the 2000 ISDA Definitions, as published by ISDA)
6. EUR-EONIA-OIS-COMPOUND
7. GBP-LIBOR-BBA
8. GBP-WMBA-SONIA-COMPOUND
9. JPY-LIBOR-BBA
10. JPY-TONA-OIS-COMPOUND
11. CHF-LIBOR-BBA
12. CAD-BA-CDOR
13. CAD-CORRA-OIS-COMPOUND
14. AUD-BBR-BBSW
15. AUD-LIBOR-BBA
16. AUD-AONIA-OIS-COMP
17. SEK-STIBOR-SIDE
18. DKK-CIBOR-DKNA13
19. DKK-CIBOR2-DKNA13
20. NOK-NIBOR-NIBR
21. HKD-HIBOR-HKAB
22. NZD-BBR-FRA
23. SGD-SOR-VWAP
24. HUF-BUBOR-Reuters
25. PLN-WIBOR-WIBO
26. CZK-PRIBOR-PRBO
27. ZAR-JIBAR-SAFEX
28. MXN-TIIE-Banxico
29. USD-SOFR-COMPOUND

EXHIBIT 2

SOFR Swaps Product Specifications

Secured Overnight Financing Rate Data

| | |
|--|--|
| Product Type | <u>OIS:</u> Fixed versus SOFR <u>Basis:</u> USD LIBOR versus SOFR EFFR versus SOFR |
| Floating Rate Index | USD-SOFR-COMPOUND |
| Maximum Maturity | 30 Years |
| Settlement Convention | USD will be settled on a next day (T+1) basis |
| Forecasting and Discounting Curve | USD SOFR Curve |
| Price Alignment Rate | USD SOFR |
| Reset Calendar | US Gov Securities |
| Payment Calendar | New York (USNY) |

SOFR OIS (SOFR vs. fixed)

| | |
|-----------------------------|---------------------------------------|
| Product Type | OIS |
| Currency | USD |
| Floating Rate Index | USD-SOFR-COMPOUND |
| Floating Index Tenor | 1D |
| Maximum Maturity | 30 Years |
| Payment Offset | 2D on SOFR Leg, 0D or 2D on Fixed Leg |

SOFR vs. USD-LIBOR Basis Swap

| | |
|-----------------------------|---------------------------------------|
| Product Type | Basis |
| Currency | USD |
| Floating Rate Index | USD-LIBOR-BBA vs USD-SOFR-COMPOUND |
| Floating Index Tenor | LIBOR = 1M, 3M, 6M |
| Maximum Maturity | 30 Years |
| Payment Offset | 2D on SOFR Leg, 0D or 2D on Fixed Leg |

SOFR vs Fed Funds Basis Swap

| | |
|-----------------------------|--|
| Product Type | Basis |
| Currency | USD |
| Floating Rate Index | USD-Federal Funds H.15-OIS-COMPOUND vs USD-SOFR-COMPOUND |
| Floating Index Tenor | 1D |
| Maximum Maturity | 30 Years |
| Payment Offset | 2D on SOFR Leg, 2D on EFR Leg |