

## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34–61164; File No. S7–06–09]

### Order Extending and Modifying Temporary Exemptions Under the Securities Exchange Act of 1934 in Connection With Request of Chicago Mercantile Exchange Inc. Related to Central Clearing of Credit Default Swaps, and Request for Comments

December 14, 2009.

#### I. Introduction

Over the past year, the Securities and Exchange Commission (“Commission”) has taken multiple actions to protect investors and ensure the integrity of the nation’s securities markets, including actions<sup>1</sup> designed to address concerns related to the market in credit default swaps (“CDS”).<sup>2</sup> The over-the-counter

<sup>1</sup> See generally Securities Exchange Act Release No. 60372 (Jul. 23, 2009), 74 FR 37748 (Jul. 29, 2009) (temporary exemptions in connection with CDS clearing by ICE Clear Europe Limited), Securities Exchange Act Release No. 60373 (Jul. 23, 2009), 74 FR 37740 (Jul. 29, 2009) (temporary exemptions in connection with CDS clearing by Eurex Clearing AG), Securities Exchange Act Release No. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009) (temporary exemptions in connection with CDS clearing by Chicago Mercantile Exchange Inc.) (“CME Exemptive Order”), Securities Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009) (temporary exemptions in connection with CDS clearing by ICE US Trust LLC (now “ICE Trust U.S. LLC”)), Securities Exchange Act Release No. 59164 (Dec. 24, 2008), 74 FR 139 (Jan. 2, 2009) (temporary exemptions in connection with CDS clearing by LIFFE A&M and LCH.Clearnet Ltd.) and other Commission actions discussed therein.

In addition, we have issued interim final temporary rules that provide exemptions under the Securities Act of 1933 and the Securities Exchange Act of 1934 for CDS to facilitate the operation of one or more central counterparties for the CDS market. See Securities Act Release No. 8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009) (initial approval); Securities Act Release No. 9063 (Sep. 14, 2009), 74 FR 47719 (Sep. 17, 2009) (extension until Nov. 30, 2010).

Further, the Commission has provided temporary exemptions in connection with Sections 5 and 6 of the Securities Exchange Act of 1934 for transactions in CDS. See Securities Exchange Act Release No. 59165 (Dec. 24, 2008), 74 FR 133 (Jan. 2, 2009) (initial exemption); Securities Exchange Act Release No. 60718 (Sep. 25, 2009), 74 FR 50862 (Oct. 1, 2009) (extension until Mar. 24, 2010).

<sup>2</sup> A CDS is a bilateral contract between two parties, known as counterparties. The value of this financial contract is based on underlying obligations of a single entity (“reference entity”) or on a particular security or other debt obligation, or an index of several such entities, securities, or obligations. The obligation of a seller to make payments under a CDS contract is triggered by a default or other credit event as to such entity or entities or such security or securities. Investors may use CDS for a variety of reasons, including to offset or insure against risk in their fixed-income portfolios, to take positions in bonds or in segments of the debt market as represented by an index, or to take positions on the volatility in credit spreads during times of economic uncertainty.

(“OTC”) market for CDS has been a source of concern to us and other financial regulators, and we have recognized that facilitating the establishment of central counterparties (“CCPs”) for CDS can play an important role in reducing the counterparty risks inherent in the CDS market, and thus can help mitigate potential systemic impacts. We have therefore found that taking action to help foster the prompt development of CCPs, including granting temporary conditional exemptions from certain provisions of the Federal securities laws, is in the public interest.<sup>3</sup>

The Commission’s authority over the OTC market for CDS is limited. Specifically, Section 3A of the Securities Exchange Act of 1934 (“Exchange Act”) limits the Commission’s authority over swap agreements, as defined in Section 206A of the Gramm-Leach-Bliley Act.<sup>4</sup> For those CDS that are swap agreements, the exclusion from the definition of security in Section 3A of the Exchange Act, and related provisions, will continue to apply. The Commission’s action today does not affect these CDS, and this Order does not apply to them. For those CDS that are not swap agreements (“non-excluded CDS”), the Commission’s action today provides conditional exemptions from certain requirements of the Exchange Act.

The Commission believes that using well-regulated CCPs to clear transactions in CDS provides a number of benefits, by helping to promote efficiency and reduce risk in the CDS market and among its participants, contributing generally to the goal of market stability, and by requiring maintenance of records of CDS transactions that would aid the Commission’s efforts to prevent and

Growth in the CDS market has coincided with a significant rise in the types and number of entities participating in the CDS market. CDS were initially created to meet the demand of banking institutions looking to hedge and diversify the credit risk attendant to their lending activities. However, financial institutions such as insurance companies, pension funds, securities firms, and hedge funds have entered the CDS market.

<sup>3</sup> See generally actions referenced in note 1, *supra*.

<sup>4</sup> 15 U.S.C. 78c–1. Section 3A excludes both a non-security-based and a security-based swap agreement from the definition of “security” under Section 3(a)(10) of the Exchange Act, 15 U.S.C. 78c(a)(10). Section 206A of the Gramm-Leach-Bliley Act defines a “swap agreement” as “any agreement, contract, or transaction between eligible contract participants (as defined in section 1a(12) of the Commodity Exchange Act \* \* \*) \* \* \* the material terms of which (other than price and quantity) are subject to individual negotiation.” 15 U.S.C. 78c note.

detect fraud and other abusive market practices.<sup>5</sup>

Earlier this year, the Commission granted temporary conditional exemptions to the Chicago Mercantile Exchange Inc. (“CME”) and Citadel Investment Group, L.L.C. (“Citadel”) from certain requirements under the Exchange Act with respect to their proposed activities in clearing and settling certain CDS,<sup>6</sup> as well as the proposed activities of certain other persons.<sup>7</sup> Those exemptions are scheduled to expire on December 14, 2009. CME has requested that the Commission extend the exemptions, and expand them to address the calculation of settlement prices for non-excluded CDS.<sup>8</sup>

Based on the facts presented and the representations made by CME,<sup>9</sup> and for the reasons discussed in this Order, and

<sup>5</sup> See generally actions referenced in note 1, *supra*.

<sup>6</sup> For purposes of this Order, “Cleared CDS” means a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to CME, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act (“CEA”) as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which: (i) The reference entity, the issuer of the reference security, or the reference security is one of the following: (A) An entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available; (B) a foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States; (C) a foreign sovereign debt security; (D) an asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or (E) an asset-backed security issued or guaranteed by the Federal National Mortgage Association (“Fannie Mae”), the Federal Home Loan Mortgage Corporation (“Freddie Mac”), or the Government National Mortgage Association (“Ginnie Mae”); or (ii) the reference index is an index in which 80 percent or more of the index’s weighting is comprised of the entities or securities described in subparagraph (i). As discussed above, the Commission’s action today does not affect CDS that are swap agreements under Section 206A of the Gramm-Leach-Bliley Act. See text at note 4, *supra*.

<sup>7</sup> See CME Exemptive Order, *supra* note 1.

<sup>8</sup> See Letter from Ann K. Shuman, Managing Director and Deputy General Counsel, CME, to Elizabeth Murphy, Secretary, Commission, Dec. 14, 2009 (“December 2009 request”).

<sup>9</sup> See *id.* The exemptions we are granting today are based on all of the representations made in the December 2009 request by CME. We recognize, however, that there could be legal uncertainty in the event that one or more of the underlying representations were to become inaccurate. Accordingly, if any of these exemptions were to become unavailable by reason of an underlying representation no longer being materially accurate, the legal status of existing open positions in non-excluded CDS that previously had been cleared pursuant to the exemptions would remain unchanged, but no new positions could be established pursuant to the exemptions until all of the underlying representations were again accurate.

subject to certain conditions, the Commission is extending temporarily the exemptions granted in the CME Exemptive Order, and is expanding them to accommodate CME's proposed settlement price calculation methodology for non-excluded CDS. Specifically, the Commission is extending the temporary conditional exemption granted to CME from clearing agency registration under Section 17A of the Exchange Act solely to perform the functions of a clearing agency for certain non-excluded CDS transactions. The Commission also is extending the temporary exemption for eligible contract participants and others from certain Exchange Act requirements with respect to non-excluded CDS cleared by CME. In addition, this order conditionally exempts on a temporary basis CME and certain of its clearing members from the registration requirements of Sections 5 and 6 of the Exchange Act solely in connection with the calculation of settlement prices for non-excluded CDS cleared by CME. These exemptions are temporary, subject to certain conditions, and will expire on March 31, 2010.

## II. Discussion

### A. Description of CME Proposal

The exemptive request by CME describes how its proposed arrangements for central clearing of CDS would operate, and makes representations about the safeguards associated with those arrangements, as described below:

#### 1. CME Organization

CME Group Inc. ("CME Group"), a Delaware stock corporation, is the holding company for CME, as well as Board of Trade of the City of Chicago, Inc., New York Mercantile Exchange, Inc., Commodity Exchange, Inc., and their subsidiaries.

CME is a designated contract market ("DCM"), regulated by the Commodity Futures Trading Commission ("CFTC"), for the trading of futures and options on futures contracts. In addition, CME Group operates its own clearing house, which is a division of CME. The CME clearing house is a derivatives clearing organization ("DCO") regulated by the CFTC. The clearing house clears, settles, and guarantees the performance of all transactions matched through the execution facilities and on third party exchanges for which CME Group provides clearing services. The clearing house operates with the oversight of the Clearing House Risk Committee ("CHRC"). The CHRC is made up of a group of clearing member

representatives who represent the interests of the clearing house as well as clearing members of CME Group. With respect to CDS clearing services, CME is establishing three additional committees:<sup>10</sup> (i) A CDS Advisory Board, which will have oversight for certain aspects of CME's CDS clearing services; (ii) a CDS Determinations Committee, which will be responsible for issuing determinations related to CDS contract terms; and (iii) a CDS Default Management Committee, which will advise the clearing house on matters relating to managing CDS portfolio positions in the event of an actual or threatened default involving CDS cleared contracts.

CME is required to comply with the eighteen CFTC Core Principles applicable to registered DCMs and the fourteen CFTC Core Principles applicable to DCOs.<sup>11</sup> The CFTC conducts regular audits or risk reviews of CME with respect to these Core Principles. CME is registered and in good standing with the CFTC. In addition, CME is notice registered with the Commission as a special purpose national securities exchange for the purpose of trading security futures products. In the U.K., CME is a Recognised Overseas Investment Exchange and a Recognised Overseas Clearing House, subject to regulation by the U.K. Financial Services Authority.

#### 2. CME Central Counterparty Services for CDS

CME as part of its clearing services will be interposed as central counterparty for transactions in Cleared CDS. CME will provide clearing and settlement services for multiple platforms, including an electronic trade booking and migration platform operated by CME.<sup>12</sup> Specifically, CME

<sup>10</sup> These committees will generally have equal authority to the CHRC, but with narrower mandates and oversight that is specific to CDS. In some cases, the approval of the new CDS Advisory Board will be required, in addition to the approval of the CHRC, with respect to certain changes to CME's risk management of CDS. The CDS Advisory Board will also have approval rights with respect to certain other matters, such as the launch of clearing services for a new CDS product using the existing CDS financial safeguards package.

<sup>11</sup> The DCM and DCO Core Principles are set forth in 7 U.S.C. 7(b), 7a-1(c)(2)(A).

<sup>12</sup> CME's clearing services would be available only to persons that satisfy the definition of an "eligible contract participant" in Section 1a(12) of the CEA (other than paragraph (C) thereof). In addition, each participant 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, CME would offer CDS that mirror as closely as possible the terms of existing OTC CDS. The coupons and maturities would be standardized to the extent necessary to permit centralized clearing.

will accept for clearing both (i) pre-existing non-standard trades that are submitted to clearing through CME's migration utility, a platform that provides data for converting non-standard terms to standard terms, allowing parties to non-standard transactions to substitute standard transactions for non-standard and submit the standard for clearing,<sup>13</sup> and (ii) transactions executed on standardized terms, which can be submitted to CME for clearing using CME's trade booking facility or a confirmation service.<sup>14</sup>

CME has no rule requiring an executing dealer to be a clearing member. In addition, CME will adopt a rule to confirm that there will be open access to its CDS clearing services for any execution venue or trade processing or confirmation service that desires to facilitate the submission of CDS transactions to CME for clearing, subject to CME's normal operational requirements applied to all such third-party services, including the requirement for a CME clearing member guaranty of all transactions submitted to clearing.

CME clearing and settlement of Cleared CDS will operate using the established systems, procedures, and financial safeguards that stand behind trading in CME's primary futures market, and such activities will be subject to CFTC oversight of risk management and collateralization procedures. CME Rulebook Chapter 8-F sets forth the rules governing clearing and settlement of all products, instruments, and contracts in OTC derivatives, including but not limited to CDS contracts, swaps, and forward rate agreements that the CME clearinghouse has designated as eligible for clearing.

#### 3. CME Risk Management

CME clearing members that are broker-dealers or futures commission merchants ("FCMs") maintain capital and liquidity in accordance with relevant SEC and CFTC rules and

<sup>13</sup> Non-standard trades that are migrated to CME would ultimately be converted to a standard, centrally cleared contract. Migration may only occur if both counterparties to a trade agree to the process and both are clearing members or have the appropriate relationship with a clearing member. To facilitate operational efficiency, CME would also supply participants a data file of the original bilateral positions that were accepted into clearing via the migration process, so that participants may send appropriate exit records to the DTCC Trade Information Warehouse.

<sup>14</sup> Trades may be submitted using Bloomberg's VCON confirmation service as of the initial launch date. CME is also working with other confirmation services to connect to CME clearing for submission of CDS transactions. See December 2009 request, *supra* note 8.

regulations, respectively. In addition, CME has requirements for minimum capital contribution, contribution to the guaranty fund based on risk factors, maintenance margin, and mark to market with immediate payment of losses applicable to clearing member firms.

CME has adopted a risk-based capital requirement. Capital requirements are monitored by CME's Audit Department and vary to reflect the risk of each clearing member's positions as well as CME's assessment of each clearing member's internal controls, risk management policies, and back office operations. CME has established additional capital and guaranty fund contribution requirements for clearing members authorized to clear CDS. To clear CDS, whether for proprietary or customer accounts, a clearing member must maintain \$500 million in adjusted net capital.<sup>15</sup> CDS clearing members must also make initial guaranty fund contributions with respect to CDS that will be a minimum of \$50 million each.<sup>16</sup> Those CDS clearing members with adjusted net capital of less than \$1 billion must also maintain excess margin with the clearing house that is equal to their guaranty fund contributions; CDS clearing members with less than \$5 billion in adjusted net capital are also subject to daily capital reporting.

Clearing members also have to manage appropriate requirements with respect to their customers. CME Rule 982 requires clearing members to establish written risk management policies and procedures, including monitoring the risks assumed by specific customers. To facilitate such controls with respect to CDS transactions, CME's clearing systems includes functionality that permits clearing members to register customer accounts and specify customer credit limits.

Customer account reporting will allow CME to view the positions held by individual accounts. Clearing members

<sup>15</sup> CDS clearing members that are structured as hedge funds must also have a minimum of \$5 billion in net assets under management.

<sup>16</sup> During an initial phase starting as early as December 15, 2009, a limited number of CDS clearing members and customers that have been engaged in active testing with CME will be eligible to participate, and participating clearing members will make guaranty fund contributions of \$50 million each. Clearing will be restricted to a small set of index products, and CME will carefully limit risk exposures. Thereafter, participation will be open to all eligible clearing members and market participants. At that time, the minimum initial or additional guaranty fund contribution per CDS clearing member will be equal to the greater of \$50 million or \$500 million divided by the total number of CDS clearing members.

will be required to register their proprietary and customer accounts in CME's EDB system, and report new customer positions through EDB on an ongoing basis. Changes in positions of each account will be analyzed throughout the day, and compared to intraday price movements, to monitor any accounts that may develop significant losses due to market moves. In addition, significant changes in positions from day to day will be analyzed and reported to CME clearing house senior management.

In designing its margining methodology for CDS, CME conducted extensive testing of historical CDS data, stress testing the different CDS margin factors to capture moves beyond the 99% standard on its multi-factor risk model. The overall financial safeguards package for CDS has also been designed using concentration types of margining and routine stress testing. On an ongoing basis, CME will daily back-test the CDS margin factor parameters to ensure that they are providing the desired level of coverage. CME will also review on a daily basis the margin collected by CME on CDS portfolios and compare those amounts to next-day market moves so that actual portfolio effects can be determined and gauged against the margin coverage. In addition, CME will evaluate the concentration of CDS positions beyond the margin factors and compare them against overall open interest and liquidity in the CDS market.

CME will extend its scenario-based stress testing techniques for concentration margining to Cleared CDS. The concentration stress test results will be evaluated relative to excess adjusted net capital for each segregated pool. If the hypothetical losses exceed the excess adjusted net capital for a clearing member's segregated pool, then an additional margin charge will be applied to the clearing member's position. The additional margin charge will be calculated based on the magnitude of the hypothetical losses in excess of the clearing member's excess adjusted net capital.

CME determines the acceptability of different collateral types and determines appropriate haircuts.<sup>17</sup> Collateral requirements for Cleared CDS will appropriately reflect the specific risks of Cleared CDS, including jump-to-default and the consequences of a liquidity event caused by the defaults.

<sup>17</sup> A list of acceptable collateral and applicable haircuts is available at <http://www.cme.com>.

#### 4. Settlement Prices

CME will determine settlement prices each business day for each eligible product based upon pricing data from multiple origins. Sources of pricing data will include: (1) Prices of OTC transactions submitted to CME for clearing; (2) indicative settlement prices contributed by CME CDS clearing members; and (3) pricing information licensed by CME from other third-party sources. The pricing data will be processed using standard validation, aggregation, and valuation analytics. Updated settlement prices will be made available to clearing members on their open positions on a regular basis (at least once a day, or more frequently in case of sudden market moves). As part of the CDS clearing process, CME will periodically require CDS clearing members to trade at prices generated by their indicative settlement prices where those indicative settlement prices generate crossed bids and offers, pursuant to CME's price quality auction methodology.<sup>18</sup>

#### 5. Member Default

If a clearing member is troubled (*i.e.*, if it fails to meet minimum financial requirements or its financial or operational condition may jeopardize the integrity of the CME, or negatively impact the financial markets), CME may take action pursuant to CME Rule 974 (Failure to Meet Minimum Financial Requirements) or 975 (Emergency Financial Conditions). In the event of a default by a clearing member of CME, the process would be governed by applicable CME rules.<sup>19</sup>

In the event of a member default, CME may access its financial safeguards package as necessary. CME's financial safeguard package is a combination of each clearing member's collateral on deposit to support its positions, the collateral of its customers to support their positions, CME surplus funds,

<sup>18</sup> Each trading day CME will randomly select 5% of its CDS product available for clearing (but at least one product) and will randomly select one tenor for each such product to evaluate for crossed bids and offers pursuant to CME's price quality auction methodology.

<sup>19</sup> See, *e.g.*, CME Rulebook Chapter 8-F (Over-the-Counter Derivative Clearing), including but not limited to Rules 8F06 (Clearing Member Default), 8F07 (Guaranty Fund Deposit), 8F13 (Insolvency and Liquidation), and 8F25 (Default Management Committee). Chapter 8-F further incorporates the general CME Rules relating to defaults, including but not limited to Rules 802 (Protection of Clearing House), 913 (Withdrawal From Clearing Membership), 974 (Failure to Meet Minimum Financial Requirements), 975 (Emergency Financial Conditions), 976 (Suspension of Clearing Members), 978 (Open Trades of Suspended Clearing Members), and 979 (Suspended or Expelled Clearing Members).

security deposits, and CME's assessment powers.<sup>20</sup>

#### 6. Customer Rules and Other Requirements

Prior to any issuance of an order from the CFTC under Section 4d of the CEA ("4d order"), described below, all Cleared CDS submitted to CME for clearing for the account of a clearing member's customer must be assigned and held in an account subject to CFTC Regulation 30.7.<sup>21</sup> Regulation 30.7 requires customer positions and property to be separately held and accounted for from the positions and property of the FCM, and customer property to be deposited under an account name that clearly identifies it as customer property. CME Rule 8F03 also provides that "[a]ll collateral deposited as performance bond to support positions in such Regulation § 30.7 account and all positions, collateral or cash in such account shall be segregated from the Clearing Member's proprietary account."<sup>22</sup> CME notes, however, that "[n]either the CFTC nor the courts have issued an interpretation with regard to the bankruptcy protections that would be afforded to customers clearing OTC positions in 30.7 accounts, and it is therefore unclear whether they would receive the same protections as foreign futures customers."<sup>23</sup>

In the event the CFTC issues a 4d order,<sup>24</sup> the segregation and protection of customer funds and property would be controlled by Section 4d of the CEA

<sup>20</sup> CME indicates that, excluding performance bond collateral supporting open positions, which totals approximately \$85 billion, the total financial safeguards package is greater than \$7.5 billion, comprised of: (1) CME surplus funds of \$177 million; (2) clearing member security deposits of approximately \$1.973 billion; and (3) assessment powers of approximately \$5.426 billion (as of September 30, 2009). Clearing members that clear Cleared CDS would be subject to additional guaranty fund deposit requirements. Furthermore, the calculation of that portion of a clearing member's security deposit that is related to the risk of its CDS position would be scaled upward by a factor of four.

<sup>21</sup> 17 CFR 30.7.

<sup>22</sup> As discussed below, the exemptions related to CDS customer clearing require CME clearing members to satisfy additional conditions, including conditions specific to the use of a 30.7 account.

<sup>23</sup> December 2009 request, *supra* note 8.

<sup>24</sup> CME petitioned the CFTC on June 15, 2009 for a 4d order covering cleared CDS transactions. See December 2009 request, *supra* note 8. More specifically, CME's petition requested that the CFTC issue an Order pursuant to Section 4d that would permit CME and its clearing members that are FCMs to commingle customer funds used to margin, secure, or guarantee CDS cleared by CME with other funds held in segregated accounts maintained in accordance with Section 4d of the CEA and CFTC regulations. See <http://www.cftc.gov/stellent/groups/public/@requestsandactions/documents/ifdocs/cme4drequestcds.pdf>.

and the related regulations; all funds and property received from customers of FCMs in connection with purchasing, selling, or holding CDS positions would be subject to the requirements of CFTC Regulation 1.20, *et seq.* promulgated under Section 4d. This regulation requires that customer positions and property be separately accounted for and segregated from the positions and property of the FCM. Customer property would be deposited under an account name that clearly identifies it as such and shows it is appropriately segregated as required by the CEA and Regulation 1.20, *et seq.*

In addition, customer margin requirements for a broker-dealer are generally set by the broker-dealer's self-regulatory organizations (*e.g.*, the Financial Industry Regulatory Authority, or FINRA). One purpose for customer margin requirements is to assure that broker-dealers collect sufficient margin from customers to protect the broker-dealer in the event that an adverse price move causes a customer default, leaving the broker-dealer with responsibility for the transaction. FINRA has amended its customer margin rule to implement an interim pilot program with respect to margin requirements for transactions in CDS.<sup>25</sup>

#### B. Extended Temporary Conditional Exemption From Clearing Agency Registration Requirement

On March 13, 2009, in connection with its efforts to facilitate the establishment of one or more CCPs for Cleared CDS, the Commission issued the CME Exemptive Order, conditionally exempting CME from clearing agency registration under Section 17A of the Exchange Act on a temporary basis.<sup>26</sup> Subject to the conditions in that Order, CME is permitted to act as a CCP for Cleared CDS by novating trades of non-excluded CDS that are securities and generating money and settlement obligations for participants without having to register with the Commission as a clearing agency. The CME Exemptive Order expires on December 14, 2009. Pursuant to its authority under Section 36 of the Exchange Act,<sup>27</sup> for the reasons

<sup>25</sup> See Securities Exchange Act No. 60722 (Sept. 25, 2009), 74 FR 50856 (Oct. 1, 2009) (File No. SR-FINRA-2009-063) (extending the implementation of FINRA Rule 4240, Margin Requirements for Credit Default Swaps, to Nov. 30, 2010).

<sup>26</sup> See *supra*, note 1.

<sup>27</sup> 15 U.S.C. 78mm. Section 36 of the Exchange Act authorizes the Commission to conditionally or unconditionally exempt any person, security, or transaction, or any class or classes of persons, securities, or transactions, from any provision or provisions of the Exchange Act or any rule or

described herein, the Commission is extending the exemption granted in that order until March 31, 2010, subject to certain conditions.

In the CME Exemptive Order, the Commission recognized the need to ensure the prompt establishment of CME as a CCP for CDS transactions. The Commission also recognized the need to ensure that important elements of Section 17A of the Exchange Act, which sets forth the framework for the regulation and operation of the U.S. clearance and settlement system for securities, apply to the non-excluded CDS market. Accordingly, the temporary exemption in the CME Exemptive Order was subject to a number of conditions designed to enable Commission staff to monitor CME's clearance and settlement of CDS transactions.<sup>28</sup>

The temporary exemption was based, in part, on CME's representation that it met the standards set forth in the Committee on Payment and Settlement Systems ("CPSS") and International Organization of Securities Commissions ("IOSCO") report entitled: *Recommendation for Central Counterparties* ("RCCP").<sup>29</sup> The RCCP establishes a framework that requires a CCP to have: (i) The ability to facilitate the prompt and accurate clearance and settlement of CDS transactions and to safeguard its users' assets; and (ii) sound risk management, including the ability to appropriately determine and collect clearing fund and monitor its users' trading. This framework is generally consistent with the requirements of Section 17A of the Exchange Act.

The Commission believes that continuing to facilitate the central clearing of CDS transactions—including customer CDS transactions—through a temporary conditional exemption from Section 17A would provide important risk management and systemic benefits by facilitating the prompt establishment of CCP clearance and settlement services. Accordingly, and consistent with our findings in the CME Exemptive Order, we find pursuant to Section 36 of the Exchange Act that it is necessary and appropriate in the public interest

regulation thereunder, by rule, regulation, or order, to the extent that such exemption is necessary or appropriate in the public interest, and is consistent with the protection of investors.

<sup>28</sup> See Securities Exchange Act Release No. 59527 (Mar. 6, 2009), 74 FR 10791 (Mar. 12, 2009).

<sup>29</sup> The RCCP was drafted by a joint task force ("Task Force") composed of representative members of IOSCO and CPSS and published in November 2004. The Task Force consisted of securities regulators and central bankers from 19 countries and the European Union. The U.S. representatives on the Task Force included staff from the Commission, the Federal Reserve Board, and the CFTC.

and is consistent with the protection of investors for the Commission to extend, until March 31, 2010, CME's exemption provided from the clearing agency registration requirements of Section 17A, subject to certain conditions.

In granting this exemption, we are balancing the aim of facilitating CME's service as a CCP for non-excluded CDS transactions with ensuring that important elements of Commission oversight are applied to the non-excluded CDS market. The continued use of temporary exemptions will permit the Commission to continue to develop direct experience with the non-excluded CDS market. During the extended exemptive period, the Commission will continue to monitor closely the impact of the CCPs on this market. In particular, the Commission will seek to assure itself that CME has sufficient risk management controls in place and does not act in an anticompetitive manner or indirectly facilitate anticompetitive behavior with respect to fees charged to members, the dissemination of market data, and the access to clearing services by independent CDS exchanges or CDS trading platforms.

This temporary extension of the CME Exemptive Order also is designed to assure that—as CME has represented—information will be available to market participants about the terms of the CDS cleared by CME, the creditworthiness of CME or any guarantor, and the clearance and settlement process for the CDS.<sup>30</sup> The Commission believes operation of the Order will facilitate the availability to market participants of information that should enable them to make better informed investment decisions and better value and evaluate their Cleared CDS and counterparty exposures relative to a market that is not centrally cleared.

This temporary extension of the CME Exemptive Order is subject to a number of conditions that are designed to enable Commission staff to monitor CME's clearance and settlement of CDS transactions and help reduce risk in the CDS market. These conditions require that CME: (i) Make available on its Web site its annual audited financial

statements; (ii) preserve records related to the conduct of its Cleared CDS clearance and settlement services for at least five years (in an easily accessible place for the first two years); (iii) provide information relating to its Cleared CDS clearance and settlement services to the Commission and provide access to the Commission to conduct on-site inspections of facilities, records, and personnel related to its Cleared CDS clearance and settlement services; (iv) notify the Commission on a monthly basis about material disciplinary actions taken against any of its members utilizing its Cleared CDS clearance and settlement services, and about the involuntary termination of the membership of an entity that is utilizing CME's Cleared CDS clearance and settlement services; (v) provide the Commission with changes to rules, procedures, and any other material events affecting its Cleared CDS clearance and settlement services not less than one day prior to effectiveness or implementation of such rule changes, or in exigent circumstances, as promptly as reasonably practicable under the circumstances; (vi) provide the Commission with reports prepared by independent audit personnel that are generated in accordance with risk assessment of the areas set forth in the Commission's Automation Review Policy Statements<sup>31</sup> and its annual audited financial statements prepared by independent audit personnel; and (vii) report all significant systems outages to the Commission within specified timeframes.

In addition, this temporary extension of the CME Exemptive Order is conditioned on CME, directly or indirectly, making available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (i) All end-of-day settlement prices and any other prices with respect to Cleared CDS that CME may establish to calculate settlement variation or margin requirements for CME clearing members; and (ii) any other pricing or valuation information with respect to Cleared CDS as is published or distributed by CME.

As a CCP, CME will collect and process information about CDS transactions, prices, and positions from all of its participants. With this information, it will calculate and disseminate current values for open positions for the purpose of setting

appropriate margin levels. The availability of such information can improve fairness, efficiency, and competitiveness of the market—all of which enhance investor protection and facilitate capital formation. Moreover, with pricing and valuation information relating to Cleared CDS, market participants would be able to derive information about underlying securities and indexes. This may improve the efficiency and effectiveness of the securities markets by allowing investors to better understand credit conditions generally.

### *C. Temporary Conditional Exemption From Exchange Registration Requirements*

CME has requested that the Commission expand its exemptive relief to include a temporary conditional exemption for CME from the requirements of Sections 5 and 6 of the Exchange Act, and the rules and regulations thereunder, in connection with CME's methodology for determining CDS settlement prices, including its price quality auction methodology. Section 5 of the Exchange Act contains certain restrictions relating to the registration of national securities exchanges,<sup>32</sup> while Section 6 provides the procedures for registering as a national securities exchange.<sup>33</sup>

The temporary exemption would facilitate the establishment of CME's settlement price process. CME represents that updated settlement prices will be made available to clearing members on their open positions on a regular basis (at least once a day, or more frequently in case of sudden market moves). As part of the CDS clearing process, CME will periodically require CDS clearing members to trade at prices generated by their indicative settlement prices where those indicative settlement prices generate crossed bids and offers, pursuant to CME's price quality auction methodology.<sup>34</sup>

As discussed above, we have found in general that it is necessary or appropriate in the public interest, and is

<sup>32</sup> In particular, Section 5 provides:

It shall be unlawful for any broker, dealer, or exchange, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce for the purpose of using any facility of an exchange \* \* \* to effect any transaction in a security, or to report any such transactions, unless such exchange (1) is registered as a national securities exchange under section 6 of [the Exchange Act], or (2) is exempted from such registration \* \* \* by reason of the limited volume of transactions effected on such exchange \* \* \* 15 U.S.C. 78e.

<sup>33</sup> 15 U.S.C. 78f. Section 6 of the Exchange Act also sets forth various requirements to which a national securities exchange is subject.

<sup>34</sup> See note 18, *supra*.

<sup>30</sup> The Commission believes that it is important in the CDS market, as in the securities market generally, that parties to transactions have access to financial information that would allow them to evaluate appropriately the risks relating to a particular investment and make more informed investment decisions. See generally Policy Statement on Financial Market Developments, The President's Working Group on Financial Markets, March 13, 2008, available at: [http://www.treas.gov/press/releases/reports/pwgpolicystatementkturmoil\\_03122008.pdf](http://www.treas.gov/press/releases/reports/pwgpolicystatementkturmoil_03122008.pdf).

<sup>31</sup> See Automated Systems of Self-Regulatory Organization, Exchange Act Release No. 27445 (Nov. 16, 1989), File No. S7-29-89, and Automated Systems of Self-Regulatory Organization (II), Exchange Act Release No. 29185 (May 9, 1991), File No. S7-12-91.

consistent with the protection of investors, to facilitate CDS clearing by CME. Consistent with that finding—and in reliance on CME's representation that the settlement pricing process, including the periodically required trading, is part of its clearing process—we further find that it is necessary or appropriate in the public interest, and is consistent with the protection of investors to grant, pursuant to Section 36 of the Exchange Act, a temporary exemption until March 31, 2010, to CME from Sections 5 and 6 of the Exchange Act in connection with its calculation of settlement variation prices for open positions in Cleared CDS, and a temporary exemption to CME clearing members from Section 5 with respect to such trading activity, subject to certain conditions.

The temporary exemption for CME is subject to three conditions. First, CME must report the following information with respect to its determination of daily settlement prices for cleared CDS to the Commission within 30 days of the end of each quarter, and preserve such reports for as long as CME offers CDS clearing services and for a period of at least five years thereafter:

- The total dollar volume of CDS transactions executed during the quarter pursuant to CME's price quality auction methodology, broken down by reference entity, security, or index; and
- The total unit volume or notional amount executed during the quarter pursuant to CME's price quality auction methodology, broken down by reference entity, security, or index.

Reporting of this information will assist the Commission in carrying out its responsibility to supervise and regulate the securities markets.

Second, CME must establish and maintain adequate safeguards and procedures to protect participants' confidential trading information related to Cleared CDS. Such safeguards and procedures shall include: (a) Limiting access to the confidential trading information of participants to those CME employees who have a need to access such information in connection with the provision of CME CDS clearing services or who are responsible for compliance with this exemption or any other applicable rules; and (b) implementing policies and procedures for CME employees with access to such information with respect to trading for their own accounts. CME must adopt and implement adequate oversight procedures to ensure that the policies and procedures established pursuant to this condition are followed. This condition is designed to prevent any

misuse of CME clearing member trading information that may be available to CME in connection with the daily settlement variation of open positions in Cleared CDS. This should strengthen confidence in CME as a CCP for CDS, thus promoting participation in central clearing of CDS.

Third, CME must comply with the conditions to the temporary exemption from Section 17A of the Exchange Act in this Order. This exemption from exchange registration is granted in the context of our goal of facilitating CME's ability to act as a CCP for non-excluded CDS. We note that CME has represented that given the requirement for CDS clearing members periodically to trade at prices generated by their indicative settlement prices where those indicative settlement prices generate crossed bids and offers, pursuant to CME's price quality auction methodology, its price auction methodology will be part of its CDS clearing process.

#### *D. Extended Temporary Conditional General Exemption for CME and Certain Eligible Contract Participants*

As we recognized when we initially provided temporary conditional exemptions in connection with CDS clearing by CME, applying the full panoply of Exchange Act requirements to participants in transactions in non-excluded CDS likely would deter some participants from using CCPs to clear CDS transactions. We also recognized that it is important that the antifraud provisions of the Exchange Act apply to transactions in non-excluded CDS, particularly given that OTC transactions subject to individual negotiation that qualify as security-based swap agreements already are subject to those provisions.<sup>35</sup>

<sup>35</sup> While Section 3A of the Exchange Act excludes "swap agreements" from the definition of "security," certain antifraud and insider trading provisions under the Exchange Act explicitly apply to security-based swap agreements. See (a) paragraphs (2) through (5) of Section 9(a), 15 U.S.C. 78i(a), prohibiting the manipulation of security prices; (b) Section 10(b), 15 U.S.C. 78j(b), and underlying rules prohibiting fraud, manipulation or insider trading (but not prophylactic reporting or recordkeeping requirements); (c) Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices; (d) Sections 16(a) and (b), 15 U.S.C. 78p(a) and (b), which address disclosure by directors, officers and principal stockholders, and short-swing trading by those persons, and rules with respect to reporting requirements under Section 16(a); (e) Section 20(d), 15 U.S.C. 78t(d), providing for antifraud liability in connection with certain derivative transactions; and (f) Section 21A(a)(1), 15 U.S.C. 78u-1(a)(1), related to the Commission's authority to impose civil penalties for insider trading violations.

"Security-based swap agreement" is defined in Section 206B of the Gramm-Leach-Bliley Act as a swap agreement in which a material term is based

As a result, we concluded that it is appropriate in the public interest and consistent with the protection of investors temporarily to apply substantially the same framework to transactions by market participants in non-excluded CDS that applies to transactions in security-based swap agreements. Consistent with that conclusion, we temporarily exempted CME and certain eligible contract participants from a number of Exchange Act requirements, while excluding certain enforcement-related and other provisions from the scope of the exemption.

We believe that continuing to facilitate the central clearing of CDS transactions by CME through this type of temporary conditional exemption will provide important risk management and systemic benefits. We also believe that facilitating the central clearing of customer CDS transactions, subject to the conditions in this Order, will provide an opportunity for the customers of CME clearing members to control counterparty risk.

Accordingly, pursuant to Section 36 of the Exchange Act, the Commission finds that it is necessary or appropriate in the public interest and is consistent with the protection of investors to grant an exemption until March 31, 2010, from the requirements of the Exchange Act discussed below, subject to certain conditions. This temporary exemption applies to CME and to eligible contract participants<sup>36</sup> other than: Eligible contract participants that receive or hold funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons;<sup>37</sup> eligible contract

on the price, yield, value, or volatility of any security or any group or index of securities, or any interest therein.

<sup>36</sup> This exemption in general applies to eligible contract participants, as defined in Section 1a(12) of the CEA as in effect on the date of this Order, other than persons that are eligible contract participants under paragraph (C) of that section.

<sup>37</sup> Solely for purposes of this requirement, an eligible contract participant would not be viewed as receiving or holding funds or securities for purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons, if the other persons involved in the transaction would not be considered "customers" of the eligible contract participant in a parallel manner when certain persons would not be considered "customers" of a broker-dealer under Exchange Act Rule 15c3-3(a)(1). For these purposes, and for the purpose of the definition of "Cleared CDS," the terms "purchasing" and "selling" mean the execution, termination (prior to its scheduled maturity date), assignment, exchange, or similar transfer or conveyance of, or extinguishing the rights or obligations under, a Cleared CDS, as the context may require. This is consistent with the meaning of the terms "purchase" or "sale" under the Exchange Act in the context of security-based swap

participants that are self-regulatory organizations; or eligible contract participants that are registered brokers or dealers.<sup>38</sup>

As before, under this temporary exemption, and solely with respect to Cleared CDS, those persons generally are exempt from the provisions of the Exchange Act and the rules and regulations thereunder that do not apply to security-based swap agreements. Thus, those persons will still be subject to those Exchange Act requirements that explicitly are applicable in connection with security-based swap agreements.<sup>39</sup> In addition, all provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions remain applicable.<sup>40</sup> In this way, the temporary exemption applies the same Exchange Act requirements in connection with non-excluded CDS as apply in connection with OTC credit default swaps that are security-based swap agreements.

Consistent with our earlier exemptions, and for the same reasons, this temporary exemption also does not extend to: the exchange registration requirements of Exchange Act Sections 5 and 6;<sup>41</sup> the clearing agency registration requirements of Exchange Act Section 17A; the requirements of

agreements. See Exchange Act Section 3A(b)(4). A separate temporary conditional exemption addresses members of CME that hold funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons. See Part I.E, *infra*.

<sup>38</sup> A separate temporary exemption addresses the Cleared CDS activities of registered-broker-dealers. See Part I.F, *infra*. Solely for purposes of this Order, a registered broker-dealer, or a broker or dealer registered under Section 15(b) of the Exchange Act, does not refer to someone that would otherwise be required to register as a broker or dealer solely as a result of activities in Cleared CDS in compliance with this Order.

<sup>39</sup> See note 35, *supra*.

<sup>40</sup> Thus, for example, the Commission retains the ability to investigate potential violations and bring enforcement actions in the Federal courts as well as in administrative proceedings, and to seek the full panoply of remedies available in such cases.

<sup>41</sup> These are subject to a separate temporary class exemption. See note 1, *supra*. A national securities exchange that effects transactions in Cleared CDS would continue to be required to comply with all requirements under the Exchange Act applicable to such transactions. A national securities exchange could form subsidiaries or affiliates that operate exchanges exempt under that order. Any subsidiary or affiliate of a registered exchange could not integrate, or otherwise link, the exempt CDS exchange with the registered exchange including the premises or property of such exchange for effecting or reporting a transaction without being considered a "facility of the exchange." See Section 3(a)(2), 15 U.S.C. 78c(a)(2).

This Order also includes a separate temporary exemption from Sections 5 and 6 in connection with the settlement price calculation methodology of CME, discussed above. See Part I.C, *supra*.

Exchange Act Sections 12, 13, 14, 15(d), and 16;<sup>42</sup> the Commission's administrative proceeding authority under Sections 15(b)(4) and (b)(6);<sup>43</sup> or certain provisions related to government securities.<sup>44</sup> CME clearing members relying on this temporary exemption must be in material compliance with CME rules.

#### *E. Conditional Temporary Exemption for Certain Clearing Members of CME*

In the CME Exemptive Order, we granted a conditional temporary exemption from particular Exchange Act requirements to certain clearing members of CME that hold funds and securities of others in connection with Cleared CDS transactions. Absent an exception or exemption, persons that effect transactions in non-excluded CDS that are securities may be required to register as broker-dealers pursuant to Section 15(a)(1) of the Exchange Act.<sup>45</sup>

<sup>42</sup> 15 U.S.C. 78j, 78m, 78n, 78o(d), 78p. Eligible contract participants and other persons instead should refer to the interim final temporary rules issued by the Commission. See note 1, *supra*.

<sup>43</sup> Exchange Act Sections 15(b)(4) and 15(b)(6), 15 U.S.C. 78o(b)(4) and (b)(6), grant the Commission authority to take action against broker-dealers and associated persons in certain situations. Accordingly, while this exemption generally extends to persons that act as inter-dealer brokers in the market for Cleared CDS and do not hold funds or securities for others, such inter-dealer brokers may be subject to actions under Sections 15(b)(4) and (b)(6) of the Exchange Act. In addition, such inter-dealer brokers may be subject to actions under Exchange Act Section 15(c)(1), 15 U.S.C. 78o(c)(1), which prohibits brokers and dealers from using manipulative or deceptive devices. As noted above, Section 15(c)(1) explicitly applies to security-based swap agreements. Sections 15(b)(4), 15(b)(6), and 15(c)(1), of course, would not apply to persons subject to this exemption who do not act as broker-dealers or associated persons of broker-dealers.

<sup>44</sup> This exemption specifically does not extend to the Exchange Act provisions applicable to government securities, as set forth in Section 15C, 15 U.S.C. 78o-5, and its underlying rules and regulations; nor does the exemption extend to related definitions found at paragraphs (42) through (45) of Section 3(a), 15 U.S.C. 78c(a). The Commission does not have authority under Section 36 to issue exemptions in connection with those provisions. See Exchange Act Section 36(b), 15 U.S.C. 78mm(b).

<sup>45</sup> 15 U.S.C. 78o(a)(1). This section generally provides that, absent an exception or exemption, a broker or dealer that uses the mails or any means of interstate commerce to effect transactions in, or to induce or attempt to induce the purchase or sale of, any security must register with the Commission.

Section 3(a)(4) of the Exchange Act generally defines a "broker" as "any person engaged in the business of effecting transactions in securities for the account of others," but provides 11 exceptions for certain bank securities activities. 15 U.S.C. 78c(a)(4). Section 3(a)(5) of the Exchange Act generally defines a "dealer" as "any person engaged in the business of buying and selling securities for his own account," but includes exceptions for certain bank activities. 15 U.S.C. 78c(a)(5). Exchange Act Section 3(a)(6) defines a "bank" as a bank or savings association that is directly supervised and examined by state or Federal

Certain reporting and other requirements of the Exchange Act may also apply to such persons, as broker-dealers, regardless of whether they are registered with the Commission.

In granting that exemption, we noted that it is consistent with our investor protection mandate to require securities intermediaries that receive or hold funds and securities on behalf of others to comply with standards that safeguard the interests of their customers.<sup>46</sup> We also recognized, however, that requiring intermediaries that receive or hold funds and securities on behalf of customers in connection with transactions in non-excluded CDS to register as broker-dealers may deter the use of CCPs in CDS transactions, to the detriment of the markets and market participants generally. We concluded that those factors, along with certain representations by CME, argued in favor of flexibility in applying the requirements of the Exchange Act to these intermediaries. As a result, we provided a temporary conditional exemption to any CME clearing member registered as an FCM pursuant to Section 4f(a)(1) of the CEA (but not registered as a broker-dealer under Section 15(b) of the Exchange Act (other than paragraph (11) thereof)) that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons. Solely with respect to Cleared CDS, those members generally were exempted from provisions of the Exchange Act and the underlying rules and regulations that do not apply to security-based swap agreements.

When CME requested the exemptions that we granted in March, it stated that pending a receipt of an order from the CFTC pursuant to Section 4d of the CEA and related regulations, to permit CME

banking authorities (with certain additional requirements for banks and savings associations that are not chartered by a Federal authority or a member of the Federal Reserve System). 15 U.S.C. 78c(a)(6).

<sup>46</sup> Registered broker-dealers are required to segregate assets held on behalf of customers from proprietary assets, because segregation will assist customers in recovering assets in the event the intermediary fails. Absent such segregation, collateral could be used by an intermediary to fund its own business, and could be attached to satisfy the intermediary's debts were it to fail. Moreover, the maintenance of adequate capital and liquidity protects customers, CCPs, and other market participants. Adequate books and records (including both transactional and position records) are necessary to facilitate day to day operations as well as to help resolve situations in which an intermediary fails and either a regulatory authority or receiver is forced to liquidate the firm. Appropriate records also are necessary to allow examiners to review for improper activities, such as insider trading or fraud.

and its members to establish segregated accounts for holding collateral posted by cleared CDS customers, FCMs would hold customer collateral within accounts established pursuant to CFTC Rule 30.7. Rule 30.7 provides a mechanism for establishing accounts for holding collateral posted by foreign futures customers.

We understand that the protections associated with using CFTC Rule 30.7 to segregate collateral associated with over-the-counter derivatives is untested,<sup>47</sup> and thus less certain than the protections that would be afforded to collateral protected by Section 4d. Also, we note that the CFTC has proposed a rule—not yet adopted—that would provide for the establishment of an account class, with respect to the bankruptcy of a commodity broker that is an FCM, that would be applicable to positions in cleared over-the-counter derivatives and collateral securing such positions.<sup>48</sup>

In light of the risk management and systemic benefits in continuing to facilitate CDS clearing by CME, while promoting customer protection in connection with those CDS transactions, the Commission finds pursuant to Section 36 of the Exchange Act that it is necessary or appropriate in the public interest and is consistent with the protection of investors to extend this temporary conditional exemption for certain CME clearing members from certain requirements of the Exchange Act in connection with Cleared CDS until March 31, 2010. As discussed below, this exemption has been modified in certain respects from the exemption that we previously granted to CME clearing members that receive or hold customer funds or securities in connection with Cleared CDS.

As before, this revised exemption will be available to any CME clearing member that is also an FCM (other than one that either is registered pursuant to Section 4f(a)(2) or is registered as a broker or dealer under Section 15(b) of the Exchange Act (other than paragraph (11) thereof)) that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons. Solely with respect to Cleared CDS, those members generally will be exempt from those provisions of the Exchange Act and the underlying rules and regulations that do not apply to security-based swap agreements. As with the exemption discussed above that is applicable to CME and certain eligible contract participants, and for

the same reasons, this exemption for CME clearing members that receive or hold funds and securities does not extend to Exchange Act provisions that explicitly apply in connection with security-based swap agreements,<sup>49</sup> or to related enforcement authority provisions.<sup>50</sup> As with the exemption discussed above, we also are not exempting those members from Sections 5, 6, 12(a) and (g), 13, 14, 15(b)(4), 15(b)(6), 15(d), 16, and 17A of the Exchange Act.<sup>51</sup>

This temporary exemption is subject to the member complying with conditions that are important for protecting customer funds and securities. Any CME clearing member relying on this exemption must be in material compliance with the rules of CME (including Rules 971 and 973 relating to Segregation and Secured Requirements and Customer Accounts with the Clearing House). Such clearing members also must be in material compliance with applicable laws and regulations relating to capital, liquidity, and segregation of customers' <sup>52</sup> funds and securities (and related books and records provisions) with respect to Cleared CDS.<sup>53</sup>

Such CME clearing members must also comply with certain additional conditions—not in the earlier Order—with respect to such activities. The customers for whom the clearing member receives or holds such funds or securities may not be natural persons. In addition, the clearing member must make certain risk disclosures to those customers.<sup>54</sup>

This exemption is further conditioned on funds or securities received or held by the clearing member for the purpose of purchasing, selling, clearing, settling, or holding cleared CDS positions for those customers being held in one of three manners. First, such funds and securities may be held in an account

established in accordance with Section 4d of the CEA and CFTC Rules 1.20 through 1.30 and 1.32 thereunder.

Alternatively, in the absence of a 4d order from the CFTC, those funds and securities may be held in an account that is part of a separate account class, specified by CFTC Bankruptcy Rules,<sup>55</sup> established for an FCM to hold its customers' positions in cleared OTC derivatives (and funds and securities posted to margin, guarantee, or secure such positions).

Finally, if neither of those other accounts is available, those funds and securities must be held in an account established in accordance with CFTC Rule 30.7.<sup>56</sup> In that situation, the clearing member must disclose to Cleared CDS customers that uncertainty exists as to whether they would receive priority in bankruptcy (*vis-à-vis* other customers) with respect to any funds or securities held by the clearing member to collateralize Cleared CDS positions.

To facilitate compliance with the segregation practices that are required as a condition to this temporary exemption, the clearing member—regardless of the type of account discussed above that it uses—also must annually provide CME with a self-assessment that it is in compliance with the requirements, along with a report by the clearing member's independent third-party auditor that attests to that assessment. The report must be dated the same date as the clearing member's annual audit report (but may be separate from it), and must be produced in accordance with the standards that the auditor follows in auditing the clearing member's financial statements.<sup>57</sup>

Finally, consistent with the CME Exemptive Order, a CME clearing member that receives or holds funds or securities of customers for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions shall segregate such funds and securities of customers from the CME clearing member's own assets (*i.e.*, the member may not permit the customers to “opt out” of applicable segregation requirements for such funds and securities even if regulations or laws

<sup>49</sup> See note 35, *supra*.

<sup>50</sup> See note 40, *supra*.

<sup>51</sup> See notes 41 through 43, *supra*, and accompanying text. Nor are we exempting those members from provisions related to government securities, as discussed above. See note 44, *supra*.

<sup>52</sup> The term “customer,” solely for purposes of Part III(d) and (e), *infra*, and corresponding references in this Order, means a “customer” as defined under CFTC Regulation 1.3(k). 17 CFR 1.3(k).

<sup>53</sup> This condition is similar to a condition in the earlier Order.

<sup>54</sup> The clearing member must disclose that it is not regulated by the Commission, that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the clearing member to collateralize Cleared CDS, and that the applicable insolvency law may affect such customers' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding.

<sup>55</sup> 17 CFR 190.01 *et seq.*

<sup>56</sup> The conditions in this Order require that any FCM that holds Cleared CDS customer funds and securities in a 30.7 account must segregate *all* such customer funds and securities in a 30.7 account. It is our understanding that this is consistent with CME Rule 8F03.

<sup>57</sup> This condition requiring the clearing member to convey a third-party audit report to CME as a repository for regulators does not impose upon CME any independent duty to audit or otherwise review that information. This condition also does not impose on CME any independent fiduciary or other obligation to any customer of a clearing member.

<sup>47</sup> See text at note 23, *supra*.

<sup>48</sup> See 74 FR 40794 (Aug. 13, 2009).

would permit the customer to “opt out”).

*F. Extended Temporary Conditional General Exemption for Certain Registered Broker-Dealers Including Certain Broker-Dealer-FCMs*

The CME Exemptive Order granted temporary limited exemptions from Exchange Act requirements to registered broker-dealers in connection with their activities involving Cleared CDS. In crafting these temporary exemptions, we balanced the need to avoid creating disincentives to the prompt use of CCPs against the critical role that certain broker-dealers play in promoting market integrity and protecting customers (including broker-dealer customers that are not involved with CDS transactions).

In light of the risk management and systemic benefits in continuing to facilitate CDS clearing by CME through targeted conditional exemptions to registered broker-dealers, the Commission finds pursuant to Section 36 of the Exchange Act that it is necessary or appropriate in the public interest and is consistent with the protection of investors to exercise its authority to extend this temporary conditional registered broker-dealer exemption from certain Exchange Act requirements until March 31, 2010.<sup>58</sup>

Consistent with the temporary exemptions discussed above, and solely with respect to Cleared CDS, we are temporarily exempting registered broker-dealers (including registered broker-dealers that are also FCMs (“BD-FCMs”)) from provisions of the Exchange Act and the rules and regulations thereunder that do not apply to security-based swap agreements, subject to certain conditions. As discussed above, we are not excluding registered broker-dealers, including BD-FCMs, from Exchange Act provisions that explicitly apply in connection with security-based swap agreements or from related enforcement authority provisions.<sup>59</sup> As above, and for similar

<sup>58</sup> The temporary exemptions addressed above—with regard to CME, certain clearing members, and certain eligible contract participants—are not available to persons that are registered as broker-dealers with the Commission (other than those that are notice registered pursuant to Exchange Act Section 15(b)(11)). Exchange Act Section 15(b)(11) provides for notice registration of certain persons that effect transactions in security futures products. 15 U.S.C. 78o(b)(11).

<sup>59</sup> See notes 35 and 40, *supra*. As noted above, broker-dealers also would be subject to Section 15(c)(1) of the Exchange Act, which prohibits brokers and dealers from using manipulative or deceptive devices, because that provision explicitly applies in connection with security-based swap agreements. In addition, to the extent the Exchange Act and any rule or regulation thereunder imposes any other requirement on a broker-dealer with

reasons, we are not exempting registered broker-dealers, including BD-FCMs, from: Sections 5, 6, 12(a) and (g), 13, 14, 15(b)(4), 15(b)(6), 15(d), 16 and 17A of the Exchange Act.<sup>60</sup>

Further, we are not exempting registered broker-dealers from the following additional provisions under the Exchange Act: (1) Section 7(c),<sup>61</sup> regarding the unlawful extension of credit by broker-dealers; (2) Section 15(c)(3),<sup>62</sup> regarding the use of unlawful or manipulative devices by broker-dealers; (3) Section 17(a),<sup>63</sup> regarding broker-dealer obligations to make, keep, and furnish information; (4) Section 17(b),<sup>64</sup> regarding broker-dealer records subject to examination; (5) Regulation T,<sup>65</sup> a Federal Reserve Board regulation regarding extension of credit by broker-dealers; (6) Exchange Act Rule 15c3-1,<sup>66</sup> regarding broker-dealer net capital; (7) Exchange Act Rule 15c3-3,<sup>67</sup> regarding broker-dealer reserves and custody of securities; (8) Exchange Act Rules 17a-3 through 17a-5,<sup>68</sup> regarding records to be made and preserved by broker-dealers and reports to be made by broker-dealers; and (9) Exchange Act Rule 17a-13,<sup>69</sup> regarding quarterly security counts to be made by certain exchange members and broker-dealers.<sup>70</sup> Registered broker-dealers must comply with these provisions in connection with their activities involving non-excluded CDS because these provisions are especially important to helping protect customer funds and securities, ensure proper credit practices, and safeguard against fraud and abuse.<sup>71</sup>

respect to security-based swap agreements (e.g., requirements under Rule 17h-1T to maintain and preserve written policies, procedures, or systems concerning the broker or dealer’s trading positions and risks, such as policies relating to restrictions or limitations on trading financial instruments or products), these requirements would continue to apply to broker-dealers’ activities with respect to Cleared CDS.

<sup>60</sup> See notes 41 through 43, *supra*, and accompanying text. We also are not exempting those members from provisions related to government securities, as discussed above. See note 44, *supra*.

<sup>61</sup> 15 U.S.C. 78g(c).

<sup>62</sup> 15 U.S.C. 78o(c)(3).

<sup>63</sup> 15 U.S.C. 78q(a).

<sup>64</sup> 15 U.S.C. 78q(b).

<sup>65</sup> 12 CFR 220.1 *et seq.*

<sup>66</sup> 17 CFR 240.15c3-1.

<sup>67</sup> 17 CFR 240.15c3-3.

<sup>68</sup> 17 CFR 240.17a-3 through 240.17a-5.

<sup>69</sup> 17 CFR 240.17a-13.

<sup>70</sup> Solely for purposes of this temporary exemption, in addition to the general requirements under the referenced Exchange Act sections, registered broker-dealers shall only be subject to the enumerated rules under the referenced Exchange Act sections.

<sup>71</sup> Indeed, Congress directed the Commission to promulgate broker-dealer financial responsibility rules, including rules relating to custody, the use

of customer securities, the use of customers’ deposits or credit balances, and the establishment of minimum financial requirements. See Exchange Act Section 15(c)(3).

However, CME clearing members that are BD-FCMs and that receive or hold customer funds or securities for the purpose of purchasing, selling, clearing, settling, or holding CDS positions cleared by CME in a futures account (as that term is defined in Rule 15c3-3(a)(15)<sup>72</sup>) also shall be exempt from Exchange Act Rule 15c3-3, subject to conditions that are similar to those—discussed above—that are applicable to CME that are not broker-dealers and that hold customer funds and securities in connection with Cleared CDS transactions. Thus, such BD-FCMs must be in material compliance with CME rules, as well as and applicable laws and regulations relating to capital, liquidity, and segregation of customers’ funds and securities (and related books and records provisions) with respect to Cleared CDS. A BD-FCM may not receive or hold funds or securities relating to Cleared CDS transactions and positions for customers who are natural persons. In addition, the BD-FCM must make certain risk disclosures to each such customer.<sup>73</sup> Further, the BD-FCM must hold the customer funds or securities in the same type of account (e.g., in a 4d account) as is required for other clearing members that hold customer funds and securities in connection with Cleared CDS transactions.<sup>74</sup> The BD-FCM also must

of customer securities, the use of customers’ deposits or credit balances, and the establishment of minimum financial requirements. See Exchange Act Section 15(c)(3).

<sup>72</sup> 17 CFR 240.15c3-3(a)(15).

<sup>73</sup> The BD-FCM must disclose that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the clearing member to collateralize Cleared CDS positions, and that the applicable insolvency law may affect such customers’ ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding.

This BD-FCM condition differs from the analogous disclosure condition related to other CME clearing members that hold customer funds and securities, in that the other condition also requires disclosure that the clearing member is not regulated by the Commission.

<sup>74</sup> As with the exemption applicable to those other CME clearing members, in the absence of a 4d order from the CFTC, the BD-FCM may hold the funds and securities in an account that is part of a separate account class, specified by CFTC Bankruptcy Rules, established for an FCM to hold its customers’ positions in cleared OTC derivatives (and funds and securities posted to margin, guarantee, or secure such positions). See Part II.E, *supra*.

If that alternative also is not available, the BD-FCM must hold the funds and securities in an account established in accordance with CFTC Rule 30.7. In that situation, the clearing member must disclose to Cleared CDS customers that uncertainty exists as to whether they would receive priority in bankruptcy (vis-à-vis other customers) with respect to any funds or securities held by the clearing member to collateralize Cleared CDS positions.

segregate the funds and securities of customers from the CME clearing member's own assets (*i.e.*, the member may not permit the 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 addition, the BD-FCM also must annually provide CME with a self-assessment that it is in compliance with the requirements, along with a report by the clearing member's independent third-party auditor that attests to that assessment.<sup>75</sup>

Finally—and in addition to the conditions that are applicable to CME that are not broker-dealers and that hold customer funds and securities in connection with Cleared CDS transactions—the CME clearing member must comply with the margin rules for Cleared CDS of the self-regulatory organization that is its designated examining authority<sup>76</sup> (*e.g.*, FINRA).

### G. Solicitation of Comments

When we granted our initial temporary conditional exemptions in connection with CDS clearing by CME, we solicited comment on all aspects of the exemptions, and specifically requested comment as to the duration of the temporary exemptions, the appropriateness of the exemptive conditions, and whether CME should be required to register as a clearing agency under the Exchange Act. We received no comments in response to this request.

In connection with this Order extending the temporary conditional exemptions granted in connection with CDS clearing by CME, and expanding that relief to accommodate CME's settlement price calculation methodology, we reiterate our request for comments on all aspects of the exemptions. We particularly request comments as to the exemption we are granting in connection with the calculation of settlement prices, including whether the conditions on the exemption promote fair and accurate settlement prices and include adequate safeguards and procedures to protect clearing members' confidential trading information. We also request comment

on the adequacy of the proposed conditions for the protection of customer assets, including whether it is appropriate to permit such assets to be protected in an account that is subject to the framework provided by CFTC Rule 30.7, and, if so, whether the conditions associated with the use of that account are adequate. In addition, we request comment on whether additional conditions or requirements are appropriate to promote compliance with the requirements of the temporary conditional exemptions, and what, if any, additional conditions would be appropriate.

Comments may be submitted by any of the following methods:

#### Electronic Comments

- Use the Commission's Internet comment form (<http://www.sec.gov/rules/other.shtml>); or
- Send an e-mail to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File Number S7-06-09 on the subject line; or
- Use the Federal eRulemaking Portal (<http://www.regulations.gov/>). Follow the instructions for submitting comments.

#### Paper Comments

- Send paper comments in triplicate to Secretary, Securities and Exchange Commission, 100 F Street, NE., Washington, DC 20549-1090. All submissions should refer to File Number S7-06-09. This file number should be included on the subject line if e-mail is used. To help us process and review your comments more efficiently, please use only one method. We will post all comments on the Commission's Internet Web site (<http://www.sec.gov/rules/other.shtml>). Comments are also available for public inspection and copying in the Commission's Public Reference Room, 100 F Street, NE., Washington, DC 20549, on official business days between the hours of 10 a.m. and 3 p.m. All comments received will be posted without change; we do not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly.

### III. Conclusion

*It is hereby ordered*, pursuant to Section 36(a) of the Exchange Act, that, until March 31, 2010:

(a) Exemption from Section 17A of the Exchange Act.

The Chicago Mercantile Exchange Inc. ("CME") shall be exempt from Section 17A of the Exchange Act solely to perform the functions of a clearing agent for Cleared CDS (as defined in

paragraph (f) of this Order), subject to the following conditions:

(1) CME shall make available on its Web site its annual audited financial statements.

(2) CME shall keep and preserve records of all activities related to the business of CME as a central counterparty for Cleared CDS. These records shall be kept for at least five years and for the first two years shall be held in an easily accessible place.

(3) CME shall supply such information and periodic reports relating to its Cleared CDS clearance and settlement services as may be reasonably requested by the Commission. CME shall also provide access to the Commission to conduct on-site inspections of all facilities (including automated systems and systems environment), and records related to its Cleared CDS clearance and settlement services. CME will provide the Commission with access to its personnel to answer reasonable questions during any such inspections related to its Cleared CDS clearance and settlement services.

(4) CME shall notify the Commission, on a monthly basis, of any material disciplinary actions taken against any CME clearing members utilizing its Cleared CDS clearance and settlement services, including the denial of services, fines, or penalties. CME shall notify the Commission promptly when CME involuntarily terminates the membership of an entity that is utilizing CME's Cleared CDS clearance and settlement services. Both notifications shall describe the facts and circumstances that led to CME's disciplinary action.

(5) CME shall notify the Commission of all changes to rules as defined under the CFTC rules, fees, and any other material events affecting its Cleared CDS clearance and settlement services, including material changes to risk management models. In addition, CME will post any rule or fee changes on the CME Web site. CME shall provide the Commission with notice of all changes to its rules not less than one day prior to effectiveness or implementation of such rule changes or, in exigent circumstances, as promptly as reasonably practicable under the circumstances. Such notifications will not be deemed rule filings that require Commission approval.

(6) CME shall provide the Commission with annual reports and any associated field work concerning its Cleared CDS clearance and settlement services prepared by independent audit personnel that are generated in accordance with risk assessment of the

As above, the conditions in this Order require that BD-FCM (as well as any other FCM) that holds Cleared CDS customer funds and securities in a 30.7 account must segregate *all* such customer funds and securities in a 30.7 account.

<sup>75</sup> The report must be dated the same date as the clearing member's annual audit report (but may be separate from it), and must be produced in accordance with the standards that the auditor follows in auditing the clearing member's financial statements. See text accompanying note 57, *supra*.

<sup>76</sup> See 17 CFR 240.17d-1 for a description of a designated examining authority.

areas set forth in the Commission's Automation Review Policy Statements. CME shall provide the Commission (beginning in its first year of operation) with its annual audited financial statements prepared by independent audit personnel for CME.

(7) CME shall report to the Commission all significant outages of clearing systems having a material impact on its Cleared CDS clearance and settlement services. If it appears that the outage may extend for 30 minutes or longer, CME shall report the systems outage immediately. If it appears that the outage will be resolved in less than 30 minutes, CME shall report the systems outage within a reasonable time after the outage has been resolved.

(8) CME, directly or indirectly, shall make available to the public on terms that are fair and reasonable and not unreasonably discriminatory: (i) All end-of-day settlement prices and any other prices with respect to Cleared CDS that CME may establish to calculate settlement variation or margin requirements for CME clearing members; and (ii) any other pricing or valuation information with respect to Cleared CDS as is published or distributed by CME.

(9) CME shall not materially change its methodology for determining Cleared CDS margin levels without prior written approval from the Commission, and from FINRA with respect to customer margin requirements that would apply to broker-dealers.

(b) Exemption from Sections 5 and 6 of the Exchange Act

(1) CME shall be exempt from the requirements of Sections 5 and 6 of the Exchange Act and the rules and regulations thereunder in connection with its calculation of settlement prices for Cleared CDS, subject to the following conditions:

(i) CME shall report the following information with respect to its determination of daily settlement prices for Cleared CDS to the Commission within 30 days of the end of each quarter, and preserve such reports for as long as CME offers CDS clearing services and for a period of at least five years thereafter:

(A) The total dollar volume of CDS transactions executed during the quarter pursuant to CME's price quality auction methodology, broken down by reference entity, security, or index; and

(B) The total unit volume or notional amount executed during the quarter pursuant to CME's price quality auction methodology, broken down by reference entity, security, or index;

(ii) CME shall establish and maintain adequate safeguards and procedures to

protect participants' confidential trading information related to Cleared CDS. Such safeguards and procedures shall include:

(A) Limiting access to the confidential trading information of participants to those CME employees who have a need to access such information in connection with the provision of CME CDS clearing services or who are responsible for compliance with this exemption or any other applicable rules; and

(B) Implementing policies and procedures for CME employees with access to such information with respect to trading for their own accounts. CME shall adopt and implement adequate oversight procedures to ensure that the policies and procedures established pursuant to this condition are followed; and

(iii) CME shall satisfy the conditions of the temporary exemption from Section 17A of the Exchange Act set forth in paragraphs (a)(1)—(9) of this Order.

(2) Any CME clearing member shall be exempt from the requirements of Section 5 of the Exchange Act to the extent such CME clearing member uses any facility of CME to effect any transaction in Cleared CDS, or to report any such transaction, in connection with CME's clearance and risk management process for Cleared CDS.

(c) Exemption for CME and certain eligible contract participants.

(1) Persons eligible. The exemption in paragraph (c)(2) is available to:

(i) CME; and

(ii) Any eligible contract participant (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), other than:

(A) An eligible contract participant that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for other persons;

(B) An eligible contract participant that is a self-regulatory organization, as that term is defined in Section 3(a)(26) of the Exchange Act; or

(C) A broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof).

(2) Scope of exemption.

(i) In general. Subject to the condition specified in paragraph (c)(3), such persons generally shall, solely with respect to Cleared CDS, be exempt from the provisions of the Exchange Act and the rules and regulations thereunder that do not apply in connection with security-based swap agreements.

Accordingly, under this exemption, those persons would remain subject to those Exchange Act requirements that explicitly are applicable in connection with security-based swap agreements (*i.e.*, paragraphs (2) through (5) of Section 9(a), Section 10(b), Section 15(c)(1), subsections (a) and (b) of Section 16, Section 20(d), and Section 21A(a)(1), and the rules thereunder that explicitly are applicable to security-based swap agreements). All provisions of the Exchange Act related to the Commission's enforcement authority in connection with violations or potential violations of such provisions also remain applicable.

(ii) Exclusions from exemption. The exemption in paragraph (c)(2)(i), however, does not extend to the following provisions under the Exchange Act:

(A) Paragraphs (42), (43), (44), and (45) of Section 3(a);

(B) Section 5;

(C) Section 6;

(D) Section 12 and the rules and regulations thereunder;

(E) Section 13 and the rules and regulations thereunder;

(F) Section 14 and the rules and regulations thereunder;

(G) Paragraphs (4) and (6) of Section 15(b);

(H) Section 15(d) and the rules and regulations thereunder;

(I) Section 15C and the rules and regulations thereunder;

(J) Section 16 and the rules and regulations thereunder; and

(K) Section 17A (other than as provided in paragraph (a)).

(3) Condition for CME clearing members. Any CME clearing member relying on this exemption must be in material compliance with the rules of CME.

(d) Exemption for certain CME clearing members.

Any CME clearing member registered as a futures commission merchant pursuant to Section 4f(a)(1) of the Commodity Exchange Act (but that is not registered as a broker or dealer under Section 15(b) of the Exchange Act (other than paragraph (11) thereof)) that receives or holds funds or securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS for other persons shall be exempt from the provisions of the Exchange Act and the rules and regulations thereunder specified in paragraph (c)(2), solely with respect to Cleared CDS, subject to the following conditions:

(1) The clearing member shall be in material compliance with the rules of CME (including Rules 971 and 973 relating to Segregation and Secured

Requirements and Customer Accounts with the Clearing House), and also shall be in material compliance with applicable laws and regulations, relating to capital, liquidity, and segregation of customers' funds and securities (and related books and records provisions) with respect to Cleared CDS;

(2) The customers for whom the clearing member receives or holds such funds or securities shall not be natural persons;

(3) The clearing member shall disclose to such customers that the clearing member is not regulated by the Commission, that U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to any funds or securities held by the clearing member to collateralize Cleared CDS positions, and that the applicable insolvency law may affect such customers' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding;

(4) Customer funds and securities received or held by the clearing member for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions for such customers shall be held in one of the following manners:

(i) In an account established in accordance with section 4d of the Commodity Exchange Act and CFTC Rules 1.20 through 1.30 and 1.32 [17 CFR 1.20 through 1.30 and 1.32] thereunder;

(ii) In the absence of an Order from the Commodity Futures Trading Commission ("CFTC") permitting the use of an account specified in subparagraph (d)(4)(i) for holding such funds and securities, in an account that is part of a separate account class, specified by CFTC Bankruptcy Rules [17 CFR 190.01 *et seq.*], established for a futures commission merchant to hold its customers' positions in cleared OTC derivatives (and funds and securities posted to margin, guarantee, or secure such positions); or

(iii) If the clearing member is unable to hold such funds and securities as specified in subparagraph (d)(4)(i) or (ii), the clearing member shall:

(A) Hold such funds and securities in a separate account that is established in accordance with CFTC Rule 30.7 [17 CFR 30.7], and

(B) Disclose to such customers that uncertainty exists as to whether they would receive priority in bankruptcy (vis-à-vis other customers) with respect to any funds or securities held by the clearing member to collateralize Cleared CDS positions.

(5) The clearing member annually shall provide CME with

(i) An assessment by the clearing member that it is in compliance with all the provisions of subparagraphs (d)(4)(i) through (iii) in connection with such activities, and

(ii) A report by the clearing member's independent third-party auditor that attests to, and reports on, the clearing member's assessment described in subparagraph (d)(5)(i) and that is:

(A) Dated as of the same date as, but which may be separate and distinct from, the clearing member's annual audit report;

(B) Produced in accordance with the auditing standards followed by the independent third-party auditor in its audit of the clearing member's financial statements.

(6) To the extent that the clearing member receives or holds funds or securities of customers for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS positions, the clearing member shall segregate such funds and securities of customers from the clearing member's own assets (*i.e.*, the member may not permit such 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").

(e) Exemption for certain registered broker-dealers.

(1) In general. A broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) shall be exempt from the provisions of the Exchange Act and the rules and regulations thereunder specified in paragraph (c)(2), solely with respect to Cleared CDS, except:

- (i) Section 7(c);
- (ii) Section 15(c)(3);
- (iii) Section 17(a);
- (iv) Section 17(b);
- (v) Regulation T, 12 CFR 200.1 *et seq.*;
- (vi) Rule 15c3-1;
- (vii) Rule 15c3-3;
- (viii) Rule 17a-3;
- (ix) Rule 17a-4;
- (x) Rule 17a-5; and
- (xi) Rule 17a-13.

(2) Broker-dealers that also are futures commission merchants. A CME clearing member that is a broker or dealer registered under Section 15(b) of the Exchange Act (other than paragraph (11) thereof) and that is also registered as a futures commission merchant pursuant to Section 4f(a)(1) of the Commodity Exchange Act and that receives or holds customer funds and securities for the purpose of purchasing, selling, clearing, settling, or holding Cleared CDS in a futures account (as that term is defined in Rule 15c3-3(a)(15) [17 CFR 240.15c3-3(a)(15)]) also shall be exempt

from Exchange Act Rule 15c3-3, subject to the following conditions:

(i) The clearing member shall comply with the conditions set forth in paragraphs (d)(1), (2), (4), (5), and (6) above;

(ii) The clearing member shall disclose to Cleared CDS customers that the U.S. broker-dealer segregation requirements and protections under the Securities Investor Protection Act will not apply to funds or securities held by the clearing member to collateralize Cleared CDS positions, and that the applicable insolvency law may affect such customers' ability to recover funds and securities, or the speed of any such recovery, in an insolvency proceeding; and

(iii) The CME clearing member shall collect from each customer the amount of margin that is not less than the amount required for Cleared CDS under the margin rule of the self-regulatory organization that is its designated examining authority.

(f) For purposes of this Order, "Cleared CDS" shall mean a credit default swap that is submitted (or offered, purchased, or sold on terms providing for submission) to CME, that is offered only to, purchased only by, and sold only to eligible contract participants (as defined in Section 1a(12) of the Commodity Exchange Act as in effect on the date of this Order (other than a person that is an eligible contract participant under paragraph (C) of that section)), and in which:

(1) The reference entity, the issuer of the reference security, or the reference security is one of the following:

(i) An entity reporting under the Exchange Act, providing Securities Act Rule 144A(d)(4) information, or about which financial information is otherwise publicly available;

(ii) A foreign private issuer whose securities are listed outside the United States and that has its principal trading market outside the United States;

(iii) A foreign sovereign debt security;

(iv) An asset-backed security, as defined in Regulation AB, issued in a registered transaction with publicly available distribution reports; or

(v) An asset-backed security issued or guaranteed by Fannie Mae, Freddie Mac, or Ginnie Mae; or

(2) The reference index is an index in which 80 percent or more of the index's weighting is comprised of the entities or securities described in subparagraph (1).

By the Commission.

**Florence E. Harmon,**

*Deputy Secretary.*

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