

November 26, 2010

David Stawick
Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: CME Clearing Europe Limited – Application for Registration as a Derivatives Clearing Organization Pursuant to Part 39 of the Regulations of the Commission

Dear Mr. Stawick:

CME Clearing Europe Limited (“CMECE”) hereby submits this Application for Registration as a Derivatives Clearing Organization (“DCO”) pursuant to Section 5b of the Commodity Exchange Act (the “Act”) and Part 39 of the Regulations promulgated under the Act (the “CFTC Regulations”) by the Commodity Futures Trading Commission (the “Commission”).

CMECE respectfully requests that the Commission issue an order granting CMECE registration as a DCO for clearing over-the-counter derivatives, such as swaps, forwards, and options, on energy products. CMECE hereby requests pursuant to CFTC Regulation 39.3(a)(3) that this Application be reviewed on an expedited basis and that CMECE be registered as a DCO not later than 90 days after the receipt of this Application.

This Application demonstrates how CMECE is able to comply with the “core principles” for DCOs set forth in Section 5b(c)(2) of the Act and to fulfill each of the various representations made in connection with this Application. In addition to demonstrating compliance with the existing core principles, CMECE is voluntarily demonstrating compliance with the core principles, as amended by the Wall Street Transparency and Accountability Act of 2010 (the “Core Principles”).¹ CMECE represents that it will operate in accordance with the definition of “derivatives clearing organization” contained in Section 1a(15) of the Act.

Pursuant to the requirements of Part 39 of the CFTC Regulations, this Application also includes, as Exhibits hereto, a copy of the rules of CMECE (the “CMECE Rules”) as CMECE intends to be in effect upon registration as a DCO,² and copies of certain agreements entered into or to be entered into between or among CMECE, its affiliates, and its technology and banking service providers and/or its Clearing Members, that will enable CMECE to comply with the Core Principles.

Schedule I sets forth the index of exhibits that support CMECE’s ability to comply with the Core Principles. In addition to the documents referred to herein and the exhibits, CMECE is submitting herewith a regulatory chart that describes the manner in which it complies

¹ The Commission has not yet released its final guidance or rules for compliance with the Core Principles as recently amended; however, CMECE has attempted to anticipate the application of the amended Core Principles to its operation as a DCO. Once such Commission guidance or rules are finalized, CMECE will undertake to adopt amendments to its procedures and rules as are necessary for it to continue to comply with the Core Principles.

² A copy of the CMECE Rules is attached as Exhibit A.

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with each of the Core Principles. CMECE has requested confidential treatment for each exhibit to this Application identified as a “Confidential Exhibit.”

I. CMECE

CMECE is a private limited company incorporated and registered under the laws of England on June 3, 2009.³ CMECE is headquartered at Watling House, 33 Cannon Street London, England and presently does not intend to maintain an office in the United States. CMECE is a wholly owned subsidiary of Chicago Mercantile Exchange Luxembourg S.à r.l, a Luxembourg-based wholly owned subsidiary of CME Group Inc. (“CME Group”). CMECE has applied to the Financial Services Authority (the “FSA”) for designation as a Recognised Clearing House (“RCH”) in the United Kingdom and expects to receive such designation later this year. CMECE will appoint CME Group as its agent for service of process in the United States prior to its designation as a DCO.

A. Operational and Managerial Resources

The Board of Directors of CMECE presently consists of eight members: three independent non-executive directors, three non-executive directors appointed by CME Group, and two executive directors (the CEO of CMECE and the COO of CMECE).⁴ The name and biographical information of each director also is available to the public on the CMECE website.

The Board of Directors governance arrangements are set forth in the Articles of Association, which is filed with this Application and publicly available. CMECE’s governance arrangements are transparent and fulfill public interest requirements. Prior to commencement of operations as a registered DCO, CMECE will ensure that the composition of its governing board or committee includes market participants. Public interest considerations are addressed by including three independent non-executive directors who act as the chairpersons of the Board of Directors, the Audit Committee, and the Risk Committee.⁵ Transparency is addressed through access to CMECE’s governance arrangements and director information.

CMECE will obtain a certification from each director regarding his/her potential conflicts of interest and certifying that he/she does not have a history of serious disciplinary offenses, such as those that would be disqualifying under Section 1.63(b)(1)-(6) of the CFTC Regulations.⁶

³ The Articles of Association and Memorandum of Association of CMECE are attached as Exhibit B.

⁴ A list of the directors of CMECE and the biographical information of each director are attached as Exhibit C.

⁵ CMECE acknowledges the proposed definition of “public director” in the Commission’s proposal rulemaking Requirements for Derivatives Clearing Organizations, Designated Contract Markets, and Swap Execution Facilities Regarding the Mitigation of Conflicts of Interest (75 FR 63732) (the “Proposed Conflicts of Interest Rules”), and anticipates that each independent director will be found to have no “material relationship” with CMECE.

⁶ A form of certification of the CMECE directors and employees is attached as Confidential Exhibit D. A form of Certificate of CMECE regarding director qualifications is attached as Confidential Exhibit E. A form of Certificate of CMECE certifying the determination of director independence is attached as

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One of the three independent non-executive directors serves as Chairman of the Board of Directors and the other two serve, respectively, as Chairman of the Audit Committee and Chairman of the Risk Committee. Of the three non-executive directors appointed by CME Group, one is currently in charge of CME's clearing house division, and another previously occupied that position.

CMECE presently has 13 full-time, dedicated employees (and one outsourced, dedicated internal auditor) covering the following functions: Operations, IT, and Clearing Member Support; Risk and Membership; Banking and Settlement; Regulatory Compliance and Internal Audit; and Clearing Strategy and Development.⁷ Each of these employees is based at CMECE's office in London. Under the terms of an Agreement for the Provision of Clearing Services, (the "Services Agreement") to be entered into between CMECE and Chicago Mercantile Exchange Inc. ("CME"),⁸ CMECE receives legal, accounting, human resources, and marketing support from CME staff working at CMECE's office in London. U.S.-based staff of CME supply support in these and other areas to CMECE. CMECE will obtain a certification from each of its employees regarding his/her potential conflicts of interest and certifying that he/she does not have a history of serious disciplinary offenses, such as those that would be disqualifying under Section 1.63(b)(1)-(6) of the CFTC Regulations, in line with CME Group policies.⁹

Pursuant to the Services Agreement, CME, a DCO registered with the Commission, will perform certain core clearing services for CMECE. The Services Agreement is described in paragraph E. below.

Based on the prior experience of CME in conducting clearing operations, and CMECE Management's experience at other clearing organizations, CMECE believes that its current staffing levels, in conjunction with the services provided by CME under the Services Agreement, are sufficient for its initial projected operations. CMECE will reassess its staffing needs from time to time based on the level of business and product types being cleared.

B. Financial Resources

As set forth in the attached financial projections, CMECE currently has, and will maintain, financial resources that, at a minimum, enable CMECE to cover its projected operational expenses on a rolling one-year basis.¹⁰ The sources of these assets are a contribution of capital by CME Group (through its Luxembourg subsidiary) and a long-term

Confidential Exhibit F. CMECE anticipates obtaining such certifications once the Commission adopts final rules arising from the Proposed Conflicts of Interest Rules.

⁷ An organizational chart for CMECE is attached as Confidential Exhibit G. The biographical information of the primary CMECE employees and the outsourced auditor are attached as Confidential Exhibit H.

⁸ A draft of the Services Agreement is attached as Confidential Exhibit I. CMECE will provide to the Commission a final, fully executed version of the Services Agreement prior to its operation as a DCO.

⁹ The form of certification of CMECE directors and employees is attached as Confidential Exhibit D. CMECE anticipates obtaining such certifications once the Commission adopts final rules arising from the Proposed Conflicts of Interest Rules.

¹⁰ The financial projections for CMECE are attached as Confidential Exhibit J.

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intercompany loan from CME Group to CMECE.¹¹ These assets presently are held by CMECE in the form of bank deposits. In early 2011, however, CMECE intends to begin holding these assets in highly liquid money market funds. Additionally, CME Group has provided CMECE a comfort letter to ensure that CMECE will have sufficient equity and working capital to meet its financial resources requirements under the Act.¹² CMECE's primary operating expenses will be direct staff costs, the costs of the clearing services received from CME under the Services Agreement, and other operating expenses (such as office premises, depreciation, legal and regulatory fees, and marketing costs).

C. Conflicts of Interest

The Board of Directors is responsible for ensuring that adequate systems and controls are in place to identify and manage conflicts of interest. All directors and employees of CMECE are required by their employment relationship with CMECE to read and agree to the Conflicts of Interest Policy,¹³ which requires the prompt disclosure of a conflict of interest to the Regulatory Compliance Officer or to the relevant Board or Committee Chairman, as appropriate. The Regulatory Compliance Officer is responsible for identifying and addressing the conflict and setting out procedures by which the conflict will be managed. The Regulatory Compliance Officer will liaise as appropriate with the CEO, COO, and the CME legal department.

The Conflicts of Interest Policy sets forth examples of conflicts involving CMECE directors, managers, or employees that could arise in the course of CMECE's operation as a DCO and describes procedures for the mitigation and management of such conflicts.

The inclusion of independent directors and market participants on the Board of Directors helps to mitigate CMECE's potential conflict of interest regarding (i) whether a contract is capable of being cleared, (ii) the minimum criteria that an entity must meet in order to become a clearing member, (iii) whether a particular entity satisfies such criteria, and (iv) the advancement of commercial interest and fulfillment of self-regulatory responsibilities.

D. Regulatory Compliance Officer

CMECE has appointed a Regulatory Compliance Officer who reports directly to the CEO of CMECE.¹⁴ The Regulatory Compliance Officer is responsible for reviewing the compliance by CMECE with the Core Principles, resolving any conflicts of interest, ensuring compliance with the Act and CFTC Regulations, establishing policies and procedures for addressing non-compliance, and addressing non-compliance.

As required by the Act, the Regulatory Compliance Officer annually will prepare and sign a report that contains a description of (i) the compliance of the CMECE with the Act and the CFTC Regulations, and (ii) each policy and procedure of CMECE (including the code of

¹¹ A copy of the Intercompany Note is attached as Confidential Exhibit K.

¹² The CME Group Comfort Letter is attached as Confidential Exhibit L. CMECE will provide to the Commission a final, fully executed version of the Comfort Letter prior to its operation as a DCO.

¹³ A copy of the Conflicts of Interest Policy is attached as Confidential Exhibit M.

¹⁴ The Regulatory Compliance Officer will fulfill the responsibilities of the "Chief Compliance Officer" set forth in Section 5b(i) of the Act.

ethics and conflicts of interest policies of CMECE). The Regulatory Compliance Officer will file this compliance report with the Commission along with the CMECE's annual financial report, and will include a certification, under penalty of law, that the compliance report is accurate and complete.

E. Services Agreement

CME will provide certain core clearing services CMECE pursuant to the Services Agreement, which describes the services provided by CME to CMECE, together with service levels and notification obligations. The primary services provided by CME to CMECE under the Services Agreement are:

- operation of the clearing system, including operation of its margining, banking and settlement modules;
- operation of risk management monitoring systems;
- provision of IT disaster recovery and other IT facilities and services, including business recovery;
- assistance with risk management and the calculation of margin requirements;
- assistance with the end of day settlement and banking cycle;
- assistance with the processing of Clearing Member applications;
- assistance with the auditing of Clearing Members;
- assistance with regulatory and monitoring services;
- recordkeeping services (described in Section X.B. below);
- general services including accounts and tax, legal, and human resources; and
- the provision of certain internal audit services to support CMECE's Head of Internal Audit.

The Service Agreement requires that CME provide the services in a manner which is consistent with that in which CME provides equivalent services, including where such services are provided to itself in its capacity as a DCO in terms of each aspect of the service provision, including quality and timing; and with due skill, care, and diligence.

The Board of Directors will have ultimate oversight of the services provided by CME through regular reports from management. On a day-to-day basis, satisfactory performance of the outsourcing arrangements will be overseen by the relevant CMECE staff, who will be in frequent contact with their counterparts at CME and will receive regular notices and reports on the provision of the services to supplement their direct observations of the

performance of the services provided by CME.¹⁵ The oversight procedure put in place by CMECE comprises CMECE operational staff, for example, those in the risk management department, reporting all breaches of service standards to the Regulatory Compliance Officer, the Chief Executive Officer, and the Chief Operating Officer. Corrective action in respect of persistent problems will be escalated to CME at a senior level and the internal CMECE reports and escalation actions and agreed consequential changes will form the basis of management reports from the Regulatory Compliance Officer to the Board of CMECE.

II. CLEARING MEMBERS

A. Clearing Member Admission and Eligibility Standards

The membership requirements of CMECE are objective, publicly disclosed and permit fair and open access. The CMECE Membership Procedure¹⁶ and Chapter 3 of the CMECE Rules, both of which will be publicly available on the CMECE website, set forth the admission and eligibility standards that applicants for clearing membership must satisfy to become a clearing member of CMECE (a “Clearing Member”). Among other requirements, these standards require that the applicants to be a Clearing Member must:

- have all necessary licenses to become a Clearing Member (which includes, for any applicant located in the U.S. clearing for customers, or any applicant that intends to clear for U.S. domiciled customers, that it be registered with the Commission as a “futures commission merchant” (an “FCM”) and be an “eligible contract participant” (an “ECP”);¹⁷
- meet minimum capital requirements of £10 million (presently, approximately \$15.6 million);
- have made a contribution to the Guarantee Fund (currently a minimum of \$2.5 million);¹⁸
- satisfy CMECE as to its fitness and propriety, financial, operational, technical, and risk management capacity and competence; and
- satisfy CMECE that it has written anti-money laundering, risk management, disaster recovery, and business continuity policies.

¹⁵ A copy of the CMECE Organizational Chart, which illustrates the CMECE employees with oversight of certain CME services, is attached as Confidential Exhibit G.

¹⁶ The CMECE Membership Procedure is set forth in the Clearing Procedures, attached as Confidential Exhibit N.

¹⁷ The term “futures commission merchant” is defined in Section 1a(28) of the Act and the term “eligible contract participant” is defined in Section 1a(18) of the Act.

¹⁸ As described in Section IV.C.2., however, CMECE will not require a Clearing Member to make a contribution to the Guarantee Fund during CMECE’s first year of operation as an RCH, except in certain circumstances.

All of CMECE's Clearing Membership requirements are designed to permit fair and open access while protecting the CMECE and its Clearing Members. CMECE does not intend to deny an applicant membership in CMECE if it satisfies all of the Clearing Membership requirements.

B. Clearing Member Admission Process

To apply for Clearing Membership, an applicant must complete a Clearing Member Application and submit it with the required documentation to CMECE. The Risk and Membership Department of CMECE will initially review the submitted application and request additional information from the applicant, if necessary. After the Risk and Membership Department determines that the application is complete, it will submit the application for review and consideration by the Risk Committee, which will make a determination for CMECE. CMECE anticipates that the Risk Committee review will take place within six weeks of receipt of the completed application. The Risk Committee will notify the applicant in writing of its decision. An applicant whose application is denied may appeal to the Board of Directors only on the basis that the Risk Committee's determination was arbitrary, capricious, or an abuse of its discretion. Once approved as a Clearing Member, an applicant must enter into the Clearing Member Agreement with CMECE.¹⁹

C. Monitoring of Clearing Members

The CMECE Risk and Membership Department also is responsible for verifying, on an ongoing basis, the compliance of Clearing Members with the CMECE admission and eligibility standards and monitoring compliance with the CMECE Rules (as described in Section VIII). In accordance with the Membership Procedure, each Clearing Member is required to submit audited financial statements, which must demonstrate compliance with CMECE's minimum capital requirements. The Risk and Membership Department will review these financial statements for such compliance. Additionally, the CMECE Rules require that a Clearing Member notify CMECE immediately (i) if it ceases to be able to satisfy any of the Membership Criteria or reasonably believes it may cease to be able to do so, (ii) of any material changes that are made to the information previously provided to CMECE, (iii) if it has been notified that its regulator intends to investigate it or take disciplinary or formal action against it, and (iv) of anything relating to the Clearing Member of which CMECE would reasonably expect notice.

The CMECE Rules permit CMECE to conduct audits on each Clearing Member's compliance with the CMECE Rules. Clearing Members are required to provide such information, books and records as CMECE may request and to cooperate with CMECE in its audit.

D. Clients of Clearing Members

A Clearing Member may clear transactions that meet the relevant contract specifications (each, a "Transaction") through CMECE on behalf of other persons, each of

¹⁹ A copy of the Clearing Member Application is attached as Confidential Exhibit O and a copy of the Clearing Member Agreement is attached as Confidential Exhibit P.

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whom is referred to as a “Client.” Any Clearing Member that clears Transactions for U.S. Clients must be registered as an FCM with the Commission and must be an ECP.²⁰ As required by the Act, each Client of a Clearing Member that is registered as an FCM must be an ECP.

In the Clearing Member Agreement, the Clearing Member is required to ensure that a written agreement is at all times in place with each Client (if any) pursuant to which each such Client agrees that (i) the Clearing Member acts as principal at all times to each Contract; (ii) the Client has no contractual relationship with CMECE; and (iii) the Client shall not have any rights or benefits under the Clearing Member Agreement, the CMECE Rules, any Contract (i.e., a novated transaction between CMECE and the Clearing Member), or otherwise except for any liability which by law may not be excluded.

Clients are not subject to the CMECE Rules directly, although any Clearing Member that wishes to clear Transactions for a Client must comply with CMECE Rule 3.3 (Clearing for Clients), which is designed to ensure that CMECE is aware of the identities of the Clients and that the Clearing Members impose sufficiently robust obligations on their Clients to ensure that the financial integrity of CMECE is not undermined. Additionally, when a Clearing Member submits a Transaction to CMECE on behalf of a Client, the Clearing Member must require the Client to provide it with not less than the amount of Eligible Collateral (as described in Section IV.C.3.) that the Client would be required to provide to CMECE in respect of such transaction if it were itself a Clearing Member. CMECE will monitor risk at the Clearing Member level and has the capability to monitor risk at the Client level; however, each Clearing Member is responsible for any risk arising at the level of its own Clients.

Clearing Members may hold Eligible Collateral of Clients in three types of accounts: (i) a Sequestered Client Account, (ii) a Segregated Client Account, or (iii) a Non-Segregated Client Account, each of which are described in detail in Section V.

III. ELIGIBLE CONTRACTS

CMECE intends to clear derivatives, such as swaps, forwards, and options, on energy products. In assessing which instruments it will clear, CMECE will focus on how best to manage the risks associated with its role as central counterparty, taking into account *inter alia*: market size; distribution of trading interest—dispersal/concentration; liquidity; and price certainty and sources. CMECE will consult with its Clearing Members to assist it in determining the instruments that can and should be cleared, and the related valuation and risk management policies and practices. Clearing activities and risk policies with respect to a new product must be endorsed and recommended by CMECE’s Risk Committee, and confirmed by the Board of Directors, before the new product is introduced and implemented. CMECE will submit each contract that it intends to clear to the Commission for review and/or approval in accordance with Section 5c(c) of the Act and the procedures to be adopted by the Commission in the CFTC Regulations.

²⁰ Such Clearing Member is referred to as a “Cleared OTC Derivatives Clearing Member” in the CMECE Rules.

IV. RISK MANAGEMENT

A. AUDIT COMMITTEE

The Audit Committee currently consists of the independent non-executive directors of CMECE (other than the Chairman of the Board of Directors), one of whom shall serve as Chairman of the Audit Committee. In the absence of the Chairman of the Audit Committee, the Chairman of the Risk Committee will act as Chairman of the Audit Committee, and the Chairman of the Board of Directors will participate in the meeting to ensure a quorum.²¹

The purpose of the Audit Committee is to assist the Board of Directors in ensuring the financial integrity of CMECE and the soundness of its internal risk controls and procedures. The Audit Committee is responsible for reviewing the effectiveness of CMECE's internal operational risk controls, monitoring and reviewing the effectiveness of CMECE's internal audit function in the context of CMECE's overall risk controls, monitoring and overseeing the internal audit arrangements under the Services Agreement, managing and overseeing the relationship with CMECE's external auditor, monitoring the integrity of CMECE's financial statements, and monitoring CMECE's procedures for whistle-blowing, detecting fraud, financial crime, and market abuse.

B. RISK COMMITTEE

The Risk Committee will consist of: the Chairman, who is an independent non-executive director of the Board of Directors; the CEO; at least three risk management specialists from Clearing Members;²² at least one representative from other parties with a direct interest in the risk management of CMECE; and the Chairman of the CME Clearing House Risk Committee, *ex officio*.²³ The inclusion of risk management specialists from Clearing Members is a means by which CMECE is able to consider the views of its Clearing Members, who have a direct financial interest in the risk management of CMECE.

The purpose of the Risk Committee is to provide, on behalf of the Board of Directors, oversight of the major risk management policies of CMECE relating to counterparty and market risk in relation to Clearing Members and to banking and custodial counterparties. The work of the Risk Committee is complementary to that of the Audit Committee. The Risk Committee makes recommendations for endorsement by the Board of Directors.

The Risk Committee is required to review annually the requirements of clearing membership, the policies and practices related to valuation and margining, including Eligible Collateral and haircuts from market value, security of CMECE and Clearing Member assets, and CMECE's other counterparty and market risk policies in relation to Clearing Members and banking and custodial counterparties, and to make recommendations for change, as appropriate, to the Board of Directors.

²¹ The Terms of Reference of the Audit Committee are attached as Confidential Exhibit Q.

²² Clearing Members and client firms may propose risk specialists to sit on the Risk Committee.

²³ The Terms of Reference of the Risk Committee are attached as Confidential Exhibit R.

The Risk Committee is required to review, on at least a semi-annual basis, the continued adequacy of CMECE's default resources based on the stress test results presented to it by CMECE staff, and to make recommendations for change, as appropriate, to the Board of Directors.

The Risk Committee also is responsible for (i) reviewing proposals for risk management of new markets or product types with novel risk characteristics and making recommendations to the Board of Directors, (ii) reviewing proposals for cross-margining and clearing linkages with other clearing houses, (iii) reviewing applications for clearing membership, (iv) reviewing all material amendments to the CMECE Rules and making recommendations to the Board of Directors, and (v) acting as the disciplinary panel, as necessary, for purposes of disciplinary proceedings against a Clearing Member.

The members of the Risk Committee are required to disclose the existence of any conflicts of interest and to abstain from any decisions in which they are conflicted.

C. FINANCIAL SAFEGUARDS

Through the collection of Margin under its Risk Management Procedures and the maintenance of Guarantee Fund (including CMECE's commitment to the Guarantee Fund), CMECE will possess financial resources that, at a minimum, exceed the total amount that would enable CMECE to meet its financial obligations to its Clearing Members, notwithstanding a default by the Clearing Member creating the largest financial exposure for CMECE in extreme but plausible market conditions. The adequacy of CMECE's default resources are stress tested on a daily basis.

1. Margin and Variation Requirements

CMECE manages its counterparty and market risk by margining each Clearing Member's Contracts on a daily and intra-day basis according to the Risk Management Procedure.²⁴ Risk is further mitigated through CMECE's payment to and collection from Clearing Members of profits and losses determined through the variation settlement process. The CME SPAN model is used to calculate a Clearing Member's "Margin Requirement" for energy products. The CME SPAN model simulates the effects of changing market conditions and uses tailored options pricing models to determine a portfolio's overall risk. CME SPAN constructs scenarios of price and volatility changes to estimate the potential loss arising if an entire portfolio must be closed out over a one-day time horizon. The resulting Margin Requirement is designed to cover this potential loss at a 99% confidence level.²⁵

CMECE calculates on a net basis the Margin Requirement in respect of each Client whose Contracts are reflected in the Sequestered Client Account and the Segregated Client Account, and it calls for amounts required to be deposited with CMECE based on the aggregate of those amounts across all Clients in these two account types. Therefore, the long and short positions between different Clients of a Clearing Member do not cancel each other out

²⁴ The Risk Management Procedure is set forth in the Clearing Procedures, attached as Confidential Exhibit N.

²⁵ A paper describing CMECE's implementation of CME SPAN is attached as Confidential Exhibit S.

in the calculation of the Clearing Member's overall (gross) Margin Requirement in respect of those accounts.

CMECE calculates on a net omnibus basis the Margin Requirement in respect of Clients in the Non-Segregated Client Account. Therefore, the long and short positions between Non-Segregated Clients of a Clearing Member will cancel each other out in the calculation of the Clearing Member's overall Margin Requirement in respect of that account.

Clearing Members must identify and report the gross position relating to each Client whose Contracts are reflected in each of the Sequestered Client Account, the Segregated Client Account, or the Non-Segregated Client Account.

CMECE calculates on a net basis the Margin Requirement for all Contracts reflected in the house account opened for the Clearing Member in the books and records of CMECE (the "House Account"). Therefore, Contracts capable of being offset in the House Account are recognized for the purposes of calculating the Margin Requirement for the House Account.

CMECE calculates the "Variation Requirement" for Contracts at least twice daily. The Variation Requirement consists of a mark-to-market revaluation of Contracts based on current market prices. CMECE uses the Margin Requirement and the Variation Requirement to calculate the "Net Settlement Amount" for the settlement cycle. The settlement cycle is described below in Section V.B.

CMECE does not currently participate in any cross-margining programs with other clearing organizations. However, CMECE may in the future seek to enter into cross-margining programs in order to be able to offer margin offsets to Clearing Members.

2. Guarantee Fund

CMECE will maintain a Guarantee Fund, which is an important element of the financial safeguards for the protection of CMECE and the Clearing Members. CMECE will maintain the Guarantee Fund in accordance with the Guarantee Fund Procedure and the Guarantee Fund Policy.²⁶ In the event that the Guarantee Fund is depleted, CMECE has an assessment power against non-defaulting Clearing Members for 275% of the original Guarantee Fund contribution of the Clearing Members with respect to the Guarantee Fund.

The Guarantee Fund is comprised of Guarantee Fund contributions from Clearing Members and a contribution by CMECE of at least \$20 million.²⁷ Each Clearing Member will be required to contribute the higher of \$2.5 million and its *pro rata* portion of the total Guarantee Fund, based on its proportion of the average daily margin requirement for all Clearing Members in the previous quarter, weighted to a factor of 85% and its proportion of gross volume in the previous quarter, weighted to a factor of 15%.

²⁶ The Guarantee Fund Procedure is set forth in the Clearing Procedures, attached as Confidential Exhibit N, and the Guarantee Fund Policy is attached as Confidential Exhibit T.

²⁷ CMECE's contribution to the Guarantee Fund will be funded by an intercompany transfer of cash from CME Group to CMECE, which amount will then be contributed by CMECE to the Guarantee Fund.

During CMECE's first year of operation as an RCH, CMECE's contribution to the Guarantee Fund will be \$60 million, and CMECE generally will not require Clearing Members to make a contribution to the Guarantee Fund, except in the following circumstances. If CMECE determines pursuant to the Guarantee Fund Policy that the total Guarantee Fund should be greater than \$60 million, then Clearing Members will be required to contribute to the Guarantee Fund the amount in excess of \$60 million. Each Clearing Member will be required to contribute *pro rata*, based on its required Guarantee Fund contribution determined as if CMECE had only contributed \$20 million to the Guarantee Fund. If there is an Event of Default that requires application of the Guarantee Fund, CMECE will replenish the Guarantee Fund, up to \$20 million, and Clearing Members will be required to make the remaining contributions to the Guarantee Fund to bring it up to its required size. After CMECE's first year of operation as an RCH, it will withdraw \$40 million from the Guarantee Fund (leaving its \$20 million contribution) and each Clearing Member will be required to make its contribution to the Guarantee Fund as described in the preceding paragraph.²⁸

Contributions to the Guarantee Fund may be made in Eligible Cash and Eligible Securities (each as defined below), each of which will be subject to applicable haircuts.

The adequacy of the size of the Guarantee Fund will be formally assessed at least quarterly in accordance with the Guarantee Fund Policy. CMECE also will re-calculate a Clearing Member's required contributions to the Guarantee Fund to reflect adjustments to the size of the Guarantee Fund and changes to the proportion of such Clearing Member's contribution. If there is a shortfall, a Clearing Member is required to contribute additional funds to the Guarantee Fund within two business days of the recalculation. Additionally, CMECE will require a Clearing Member to make an incremental contribution to the Guarantee Fund if the market value of its contribution, less any haircut, has dropped below its required contribution. Such incremental contributions must be received by CMECE within one business day of notification by CMECE.

Distributions related to a Clearing Member's Eligible Securities and interest payments related to Eligible Cash will be paid to the Clearing Member by CMECE within five business days of the receipt of such amounts by the custodian at the end of each calendar quarter.

3. Eligible Collateral

Clearing Members will be required to make their Guarantee Fund contributions and Margin deposits in "Eligible Collateral," which includes the following "Eligible Securities" and "Eligible Cash". The list of Eligible Collateral will be made available to Clearing Members from time to time and will initially include:

Eligible Securities

- French and German Government Bills, Notes, and Bonds;

²⁸CMECE's Notice to Clearing Members relating to the transitional period for Guarantee Fund contributions is attached as Confidential Exhibit U.

- UK Government Bills and Gilts; and
- US Treasury Bills, Bonds, and Notes.

Eligible Cash

- EUR, GBP, and USD

Haircuts from current market value are applied when recognizing the value of Eligible Collateral. As described in the CMECE Collateral Policy, haircuts will be based on a minimum of the 99% confidence level over 12 months of 1-day moves.²⁹ The haircuts are established and reviewed based on volatility using several VaR methodologies and historical observations for varying periods of time and confidence intervals. In addition to using the quantitative data from these methodologies, qualitative information is also incorporated into the analysis.

D. STRESS TESTING

CMECE has implemented a Stress Testing Policy, the purpose of which is to set forth the policy goals, procedures and responsibilities for CMECE's stress testing process.³⁰ CMECE runs a comprehensive suite of risk-based stress testing analysis on a daily basis to inform decisions on margin and Guarantee Fund adequacy, determine the need for additional margin requirements, and for general Clearing Member monitoring.³¹

CMECE employs four separate stress-testing models to assess potential Clearing Member exposures across all markets, each of which is currently used by CME.

A summary of the stress testing results in Clearing Member anonymous format will be presented to the Risk Committee on a quarterly basis for the regular evaluation of the adequacy of the default resources.

On an annual basis, CMECE's Risk and Membership Department will conduct a full validation of all stress testing models, parameters, and assumptions and will reconsider the appropriateness of all stress test scenarios. Adjustments to parameters and the use of additional scenarios, informed by observed market developments, will be made as necessary, independent of the annual review. The results of the review and any recommendations for amendments will be presented to the Risk Committee.

The Risk Committee will review the Stress Testing Policy on an annual basis and at any other time at its initiative or on the initiative of the COO. The Risk Committee will recommend amendments to the prevailing policy for approval by the Board of Directors. CMECE Internal Audit will also review the implementation of the policy on an annual basis.

²⁹ The CMECE Collateral Policy is attached as Confidential Exhibit V.

³⁰ The Stress Testing Policy is attached as Confidential Exhibit W.

³¹ CMECE has performed hypothetical stress tests for its proposed energy products in order to establish the initial size of the Guarantee Fund. A paper analyzing the tests and explaining the reasoning behind the chosen initial size, and the data used, is attached as Confidential Exhibit X.

1. Largest Net Debtor Stress Testing

Largest Net Debtor Stress Testing is conducted on a daily basis by applying price and volatility stresses that reflect the largest historical absolute moves in each market. Price moves used are the largest historical price moves observed over the timeframe of the product or market's existence and the scenarios are updated when new moves are observed by CMECE's Risk and Membership Department. New products with little or no data history are stressed using proxy data. Each market is stressed up and down individually and the largest hypothetical loss in each market is added together to arrive at the largest hypothetical loss for each Clearing Member account. Stress-test scenarios (either up or down) in each Clearing Member loss are then applied to all other Clearing Member portfolios to assess the next largest hypothetical loss under the same combination of market scenarios. The Largest Net Debtor results are then used to assess the adequacy of the Guarantee Fund.

2. Concentration Margin Stress Testing

On a daily basis, all Clearing Member portfolios are subject to a Concentration Margin Stress Test that includes market moves equal to 150% of the price move covered by the product margin, attempting to identify Clearing Members with excessive directional risk. Each market is stressed up and down by 150% and the largest hypothetical loss in the market is compared to several thresholds for the Clearing Member, per account, in order to determine whether any additional margin is required to cover the risk of concentrated positions.

3. Liquidity Stress Testing

Liquidity Stress Testing is designed to assess operational risk associated with a Clearing Member's ability to satisfy settlement variation payments within CMECE's settlement cycle deadlines given a significant but reasonable market move. On a daily basis, all Clearing Member portfolios are subject to a liquidity stress test that includes market moves equal to the price move covered by the product margin. Each market is stressed up and down individually and the largest hypothetical loss in each market is added together to arrive at the largest hypothetical loss for each Clearing Member. This loss is then compared to several internal thresholds based on the respective Clearing Member's financial resources and reported to the COO; Clearing Member-specific action is then taken if required.

4. Trend Analysis Stress Testing

Multiple levels of stress tests for all markets cleared by CMECE are applied to all Clearing Member portfolios on a daily basis and measured over time. Scenarios are established based on standard deviations: the first level represents moves equal to half of the largest historical moves in terms of standard deviations for each market; the second level represents the largest historical moves in terms of standard deviations for each market. The CMECE Risk and Membership Department will review these stress-test results daily to identify any changes in Clearing Member potential exposures over time, seeking to identify changes in behavior or risk profile that warrant additional investigation. Results will be summarized on a weekly basis for the COO.

V. TREATMENT OF FUNDS

CMECE intends to designate several banks to act as “Settlement Banks,” which will maintain accounts and settle and hold funds on behalf of Clearing Members and which also will maintain accounts and settle and hold funds for CMECE. The current Settlement Banks are Barclays Bank plc and JPMorgan N.A. (acting through its London branch). CMECE will designate a settlement bank in the United States with respect to CMECE’s Sequestered Client Account.³² Each Clearing Member must maintain accounts at a Settlement Bank.³³

CMECE will maintain the following accounts at each Settlement Bank: (i) CMECE Segregated Client Account, (ii) CMECE Non-Segregated Client Account, (iii) CMECE house, (iv) CMECE Guarantee Fund, and (v) fees and charges. Additionally, CMECE will maintain a CMECE Sequestered Client Account at a settlement bank located in the United States. Funds in the CMECE Sequestered Client Account, the CMECE Segregated Client Account and the CMECE Non-Segregated Client Account may not be comingled with each other, or with the other CMECE accounts.

Clearing Members will hold Eligible Collateral for their proprietary account in a house account and may hold Eligible Collateral of Clients in three types of accounts at the Settlement Banks:

- *Sequestered Client Account.* A Clearing Member that is an FCM (i.e., a Cleared OTC Derivatives Clearing Member) must hold Eligible Collateral of all Clients (U.S. and non-U.S.) in a Sequestered Client Account at any Settlement Bank subject to applicable CFTC Regulations.³⁴ A Clearing Member that is not an FCM may not hold Eligible Collateral of a Client in the Sequestered Client Account.
- *Segregated Client Account.* A Clearing Member that is not an FCM must hold Eligible Collateral of Clients (non-U.S.) whose cash the Clearing Member is required to hold as “client money” in accordance with the “client money rules” (as

³² A copy of the draft Settlement Bank Agreement with Barclays Bank is attached as Confidential Exhibit Y. CMECE anticipates executing this agreement upon the receipt of its designation as an RCH. A copy of the Settlement Bank Agreement with JPMorgan N.A. (acting through its London branch) is attached as Confidential Exhibit Z.

³³ Prior to its operation as a DCO, CMECE will enter into a settlement banking agreement with a bank located in the United States that requires the bank to hold customer funds in accordance with CFTC Regulations and also will obtain a segregated funds acknowledgement letter in the form prescribed by CFTC Regulations, once such regulations have been adopted for customer cleared OTC derivatives accounts. See also CMECE Rules 3.3.3 and 4.2.7.

³⁴ The Sequestered Client Account is a “cleared OTC derivatives account” as defined in CFTC Regulation 190.1(a). See also Commission Final Rules amending CFTC Regulation 190 (75 Fed. Reg. 17297 (April 6, 2010)). If the Commission has not adopted final CFTC Regulations relating to the treatment of funds held in the cleared OTC derivatives account class prior to CMECE becoming a DCO, CMECE will adopt CMECE Rules relating to the Sequestered Client Account that parallel the Commission’s Customer Segregation requirements set forth in CFTC Regulation 1.20, et seq.

defined in the rules of the FSA) in the Segregated Client Account.³⁵ The Clearing Member's Segregated Client Account may be held at any Settlement Bank.

- *Non-Segregated Client Account.* A Clearing Member that is not an FCM may hold Eligible Collateral of Clients (non-U.S.) whose cash the Clearing Member is not required to hold as "client money" in accordance with the "client money rules" in the Non-Segregated Client Account. The Clearing Member's Segregated Client Account may be held at any Settlement Bank.

Funds in the Sequestered Client Account, the Segregated Client Account and the Non-Segregated Client Account may not be comingled with each other, or with the Clearing Member's house account.

CMECE uses JPMorgan N.A. (acting through its London branch) and, solely with respect to CMECE's Sequestered Client Account, a custodian located in the United States, as custodian for the safekeeping of all Eligible Securities accepted as margin and as contributions to the Guarantee Fund.³⁶ Legal title to such Eligible Securities passes to CMECE and the Eligible Securities are held in accounts under CMECE's name. CMECE maintains six accounts with its custodian banks: (i) CMECE Sequestered Client Account (holding Eligible Securities linked to Sequestered Client Account margin liabilities), which account will be domiciled in the United States, (ii) CMECE Segregated Client Account (holding Eligible Securities linked to Segregated Client Account margin liabilities), which account is held in London, (iii) CMECE Non-Segregated Client Account (holding Eligible Securities linked to Non-Segregated Client Account margin liabilities), which account is held in London, (iv) CMECE house (holding Eligible Securities linked to house account margin liabilities), which account is held in London, (v) CMECE Guarantee Fund (holding Eligible Securities representing contributions to the Guarantee Fund), which account is held in London, and (vi) fees and charges, which account is held in London.

CMECE selected the custodian on the basis of its experience as a custodian, its documentation, procedures, safeguards and legal responsibilities as a custodian, and its credit rating and capitalization. CMECE must authorize all movements of Eligible Securities in the Custodial accounts.

Cash transferred to the bank acting as investment agent for CMECE is deposited in the corresponding six CMECE accounts, and investments are reported in respect of the six account types. The investment agent bank invests in accordance with CMECE's investment and liquidity policy.³⁷ CMECE's investment policy limits both counterparty risk and concentrations of counterparty risk in respect of investments. CMECE's investment policy with respect to Client funds includes only the investments permitted by CFTC Regulation 1.25.

³⁵ The use of the term "Segregated" in this Application does not refer to segregation under the Act, but rather to segregation under the FSA's "client money rules."

³⁶ A copy of the draft Custody Agreement is attached as Confidential Exhibit AA. CMECE anticipates executing these agreements upon the receipt of its designation as a Recognised Clearing House.

³⁷ A copy of CMECE's investment policy is attached as Confidential Exhibit BB.

VI. CLEARING AND SETTLEMENT PROCEDURES

CMECE's procedures for clearing and settlement are set forth Chapter 5 of the CMECE Rules and in the Clearing and Settlement Procedures, which are contained in the Clearing Procedures, attached as Confidential Exhibit N.

A. Clearing Procedures

Transactions may be submitted to the CMECE clearing system through the ClearPort API or GUI, from other broker or trade negotiation platforms (such as an unaffiliated designated contract market or swap execution facility), or directly from Clearing Members by API or GUI. Transactions may be submitted to the clearing system at any time. The clearing system will operate from 6:00 p.m. on Sunday to 2:00 a.m. on Saturday every week (London time), but excluding Christmas Day and New Year's Day. Transactions submitted outside these times will be processed when the clearing system next commences operations.

CMECE may only accept a Transaction:

- (a) that satisfies the relevant contract specification;
- (b) that is included in CMECE's product referential file and conforms to CMECE's specified fluctuation increments;
- (c) in respect of which each party is a Clearing Member or is authorized by a Clearing Member to submit the Transaction to CMECE; and
- (d) which satisfies CMECE's credit checks and does not cause the Clearing Member's position limit to be exceeded.

The CMECE Rules also set forth circumstances in which CMECE may decline to accept a Transaction, including if the Transaction appears to be incomplete or erroneous, breaches the CMECE Rules or conflicts with information received from another source, if so requested by a regulatory authority, or if CMECE determines the Transaction would be inadvisable.

A Transaction submitted to CMECE is novated upon (i) receipt by CMECE, (ii) successful completion of credit checks on each Clearing Member that is, or is acting on behalf of, a party to the Transaction, and (iii) storage of the Transaction in the CMECE clearing system. Upon novation, a "Contract" is created and CMECE assumes the position of the seller to the buyer and the buyer to the seller of the original Transaction. CMECE has all the rights and is subject to all the liabilities of each Clearing Member that was party to the original Transaction with respect to such Contract. Each Clearing Member that has any rights or obligations in relation to the original Transaction is released and discharged from all rights and liabilities. Clients do not have any rights or benefits from CMECE under such Contract.

Each Clearing Member acts as principal (and not as agent) to each Contract to which it is a party. CMECE treats each Clearing Member as being fully, legally, and beneficially

entitled to the rights pursuant to the Contract and each Contract as being free from encumbrances in favor of any person other than CMECE.

Each Contract will remain in force and will continue to be binding on CMECE and the Clearing Member until it expires, is settled, is transferred to another Clearing Member, or is closed out or otherwise liquidated.

B. Settlement Procedures

Once accepted by CMECE, Contracts are transmitted to CMECE's financial settlement and performance bond (initial margin) modules. The performance bond module calculates the value of the Eligible Collateral and Margin Requirement for Clearing Members, using the relevant margining methodology.

The functions of the financial settlement module include:

- aggregation of cumulative financial settlement requirements from individual positions;
- determining variation and premium amounts to be banked by netting these aggregate financial requirements, and performing rules-based processing against these net amounts, taking into account amounts already banked for the current business day;
- revaluation of Eligible Collateral on deposit (mark-to-market and application of haircuts);
- aggregation of calculated Collateral requirements; and
- comparison of Collateral requirements to Eligible Collateral on deposit using a complex rules-based engine, ultimately determining whether Collateral excess or deficits exist, and if necessary, generating cash calls to cure any deficits.

The settlement price of CMECE Contracts will be determined by CME pursuant to the Services Agreement, subject to CMECE calculating an alternative settlement price on the basis of risk assessment, as described below.³⁸ The CME staff responsible for determining settlement prices will follow a three-tiered process for determining settlement prices, as follows:

- Front or active month settlement prices will be derived from a combination of data received from relevant publications (i.e., Platt's, Bloomberg, Argus), exchange data, and broker quotes. For the deferred months, CMECE will rely on the same data, and where necessary, may use information that is publicly available from other exchanges (i.e., ICE, ECX) to generate settlement prices.
- For products where data is not available on a consistent basis, CMECE will employ models and/or analytical concepts to derive prices; for example, using

³⁸ A description of the settlement price procedures is attached as Confidential Exhibit CC.

spread differential or correlation relationships between the liquid and illiquid products to generate settlement prices. OTC products that have no open interest will not be priced.

- In the case of inaccurate or unavailable settlement prices, or if a settlement price creates risk management concerns for CMECE, CMECE reserves the right to calculate settlement variation using an alternate price determined by CMECE.

CMECE operates two “Settlement Cycles” each clearing day (intra-day and end-of-day), but generally only will call Collateral in the end-of-day cycle. CMECE may call Collateral in respect of a particular Clearing Member (or Clearing Members) at the intra-day Settlement Cycle if CMECE believes that CMECE or the Clearing Member(s) are particularly exposed. The timings of the routine end-of-day Settlement Cycle will be published on the CMECE website.

To call Collateral from a Clearing Member, CMECE sends SWIFT instructions to each Settlement Bank for the amounts that will be transferred from each Clearing Member's account at the relevant Settlement Bank to CMECE's account to at the relevant Settlement Bank. CMECE's banking module works together with the CMECE financial settlement module to execute funds movements associated with Settlement Cycles. The Settlement Banks are then required to confirm payments to CMECE by 9:00 a.m. the following business day for the end-of-day Settlement Cycle. Clearing Members must make all settlement payments in Eligible Cash but, once the Eligible Cash is received by CMECE, Clearing Members are permitted to substitute such Eligible Cash with other types of Eligible Collateral. Eligible Collateral, other than Eligible Cash, must be transferred by a Clearing Member to CMECE's securities custodian. CMECE only will accept Eligible Cash as payment for Net Settlement Amounts because it is the most liquid form of Collateral and the quickest to transfer, therefore reducing the counterparty and market risk to which CMECE is exposed.

In response to payment instructions from CMECE, Settlement Banks will confirm payments to CMECE on behalf of their Clearing Member clients by legally binding and final SWIFT messages, before making book entry transfers to CMECE's account and then transferring the funds to the Settlement Bank for the account of CMECE. Payments from CMECE to Clearing Members will be effected through the same process.

CMECE will know if a Settlement Bank has not settled on behalf of a Clearing Member at any particular Settlement Cycle because CMECE will have neither received confirmation of payment nor payment itself by the deadlines referred to above.

CMECE will communicate with each Settlement Bank on a daily basis and is likely to know about any potential problems earlier than the end of the relevant cycle because CMECE will contact any Clearing Member and its Settlement Bank before the Settlement Cycle if the Clearing Member exceeds CMECE's internal tolerance levels. These tolerance levels are set by CMECE and are based on historic data and the Clearing Member's credit rating. Any new Clearing Member is given a fairly low tolerance level so that CMECE can become familiar with its clearing activities. Monitoring of Clearing Member positions is carried out in real time. Any concerns in relation to settlement will be reported immediately by Banking and Settlement staff to the COO (or the CEO if the COO is not available).

CMECE will monitor and keep a record of non- or delayed settlement by each Clearing Member and (as necessary) Settlement Bank so that CMECE can monitor such event over time. Settlement activity is reviewed on a daily basis. In addition to close day-to-day contact, CMECE intends to hold a monthly formal call or meeting with each Settlement Bank to review performance of its obligations and to identify any necessary adjustments that need to be made to the arrangements.

CMECE currently has no linkages with other clearing organizations. CMECE is currently investigating an intra-group linkage with CME. The approach to that linkage will draw on that adopted by CME in its mutual offset and cross-margining programs, taking account of the full scope of risk management, legal, and operational issues that must be addressed in secure linkages between clearing organizations, while recognizing that certain aspects of risk are reduced or eliminated in the case of intra-group arrangements.

VII. CLEARING MEMBER DEFAULT

A. Event of Default

A Clearing Member "Event of Default" includes:

- the failure of a Clearing Member to discharge any obligation to CMECE;
- the Clearing Member notifying CMECE that it is, or is likely to be, unable to discharge any obligation to CMECE;
- if CMECE believes that the Clearing Member is, or is likely to be, unable to discharge any obligation to the Clearinghouse;
- if the Clearing Member is subject to an insolvency event; or
- if CMECE reasonably considers that the financial or operational condition of the Clearing Member or any of its affiliates is such that to allow the Clearing Member to continue its operation as such would jeopardize the integrity of CMECE or otherwise introduce an unacceptable level of risk to CMECE or its Clearing Members.

The CEO of CMECE has absolute discretion whether to conclude that an Event of Default exists and, if so, whether to apply CMECE's default rules. The CEO may consult with the "Emergency Committee," which is not a standing committee, but if convened would consist of the CEO, the COO, or another executive director if one were appointed, and one independent non-executive director. The role of the Emergency Committee is to provide advice and assistance to the CEO in determining whether an Event of Default exists in respect of a Clearing Member and if so, whether to apply the default rules.

Upon an Event of Default, CMECE will notify the defaulting Clearing Member in writing and provide a copy of such notice to the Commission. A defaulting Clearing Member is required to cease taking any action in respect of its Contracts, to not enter into any new Contracts, and to comply with any directions of CMECE. Upon the issuance of the default

notice, the direct access of the Clearing Member to CMECE systems (for the presentation of trades for clearing) will be withdrawn, and CMECE will assume legal responsibility for the registered (cleared) positions.

For the purposes of discharging a defaulting Clearing Member's rights and obligations and calculating a single net sum, CMECE may take any of the following actions (or any combination thereof) with respect to the defaulting Clearing Member's rights and obligations under the CMECE Rules and each Contract to which it is a party (each, an "Affected Contract"):

- (a) closing out or settling any Affected Contract, including the application of Collateral or transferring to or reopening with another Clearing Member or other Clearing Members any of the defaulting Clearing Member's open positions under any Affected Contracts;
- (b) auctioning any of the defaulting Clearing Member's open positions under any Affected Contracts;
- (c) transferring any Affected Contract to, or re-opening any new Contract that relates to an Affected Contract with any non-defaulting Clearing Member and transferring any Eligible Cash or Eligible Securities constituting Collateral relating to an open position under any such Affected Contract to the relevant account or accounts relating to such non-defaulting Clearing Member;
- (d) effecting corresponding Contracts to any Affected Contracts;
- (e) exercising any option granted by an Affected Contract; and
- (f) entering into hedging transactions in relation to any Affected Contracts.

Additionally, CMECE may require any Clearing Member to buy or accept the transfer of any such Affected Contract and/or to enter into a corresponding contract, or a hedging contract, to any such Affected Contract in proportion to the Clearing Member's share of all Contracts of the same type as the Affected Contract compared to the share of other Clearing Members of all Contracts of the same type.

After CMECE has finalized default management, it must provide a factual description of its actions, and financial accounts, to those responsible for the affairs of the defaulter (e.g., an insolvency practitioner) and to the FSA, returning net assets, identifying their links to house and Client and other accounts at CMECE as appropriate, to the insolvency practitioner. CMECE also will provide this factual description to the Commission.

B. Application of CMECE Default Resources

CMECE's policies on the financial resources available to cover potential shortfalls arising in the event of Clearing Member default and CMECE's investment and liquidity policies are designed to ensure that CMECE will be able to continue to meet obligations to the non-defaulting Clearing Members (and, by extension, their Clients) while also absorbing the financial consequences of default.

CMECE's default rules, supported by the provisions of English law under amendments to Part VII of the UK Companies Act 1989, permit CMECE to apply any surplus assets (a net sum under terms used in the legislation and in the default rules) available after it has finalized the default management of a defaulter's house account positions to meet any shortfall in relation to the defaulting Clearing Member's Client account positions. CMECE is not permitted to apply a net sum related to the Sequestered Client Account or CMECE Segregated Client Account of a defaulting Clearing Member to cover a shortfall in the defaulting Clearing Member's house account. In that context, Client accounts have a priority over house accounts. CMECE is able to use the Guarantee Fund (including the contribution from CME Group and contributions of non-defaulting Clearing Members) to cover shortfalls in relation to a defaulting Clearing Member's Client accounts, house account, or both.

In the event of a Clearing Member default, the following available resources would be applied in the following order to offset the costs to CMECE associated with the transfer and close-out of the defaulting Clearing Member's positions:

- (a) The defaulting Clearing Member's margin deposits, *provided* that the Clearing Member's proprietary margin may be used to satisfy a shortfall in a Client account, but Client margin may not be used to satisfy a shortfall in the Clearing Member's house account;
- (b) The defaulting Clearing Member's Guarantee Fund contribution;
- (c) The CME Group commitment to the Guarantee Fund (presently at least \$20 million);
- (d) The non-defaulting Clearing Members' contributions to the Guarantee Fund; and
- (e) The exercise of contractual obligations under the CMECE Rules, accepted by Clearing Members as a condition of membership, under which CMECE can call for additional funds from non-defaulting Clearing Members equivalent to 275% of the original Guarantee Fund contributions of Clearing Members.

VIII. RULE ENFORCEMENT

CMECE has adequate arrangements to monitor and enforce compliance with the CMECE Rules, and to resolve disputes among Clearing Members, and will have the authority and ability to discipline, limit, and suspend a Clearing Member for violations of the CMECE Rules.

A. Applicability of CMECE Rules

CMECE's Rules apply only to its Clearing Members. Clients are not subject to the CMECE Rules directly, although any Clearing Member that wishes to clear Transactions for a Client must comply with CMECE Rule 3.3 (Clearing for Clients), which is designed to ensure that CMECE is aware of the identities of the Clients and that the Clearing Members impose sufficiently robust obligations on their Clients to ensure that the financial integrity of CMECE is not undermined.

B. Surveillance

The detection and assessment of any non-compliance with the relevant CMECE Rules by Clearing Members is the responsibility of CMECE's personnel in Risk and Membership, Operations, and Banking and Settlement, supplemented in certain cases by the CME Market Regulation Department and the CME Audit and Membership Department under the Services Agreement. All cases of non-compliance will be reported to the COO, the CEO, and to the Regulatory Compliance Officer.

CMECE will decide whether to conduct a formal investigation or disciplinary proceeding on the basis of the factual record and the gravity of the non-compliance.

C. Enforcement

CMECE's disciplinary procedures have two stages – investigations and disciplinary proceedings – and the powers available to CMECE in respect of each reflect the magnitude of the breach of the CMECE Rules. If CMECE believes a breach to be particularly serious, CMECE need not undertake an investigation before launching Disciplinary Proceedings.

CMECE may investigate breaches or alleged breaches of the CMECE Rules, whether or not such breaches or alleged breaches have been identified as a result of a Clearing Member Complaint (described below) or as a result of CMECE's own investigation. Clearing Members are required to cooperate fully with all investigations, including by providing CMECE with requested information, access to premises, personnel, documents, files, and electronic information.

CMECE will report disciplinary actions to the FSA, the Commission, and other relevant regulatory authorities, where appropriate.

D. Disciplinary Proceedings

CMECE may commence disciplinary proceedings if it is reasonably satisfied that a Clearing Member has breached the CMECE Rules. This may be as a result of a complaint, an investigation or otherwise. To commence a disciplinary proceeding, CMECE will send the Clearing Member a written notice setting out details of the alleged breach of the CMECE Rules and sufficient information to enable the Clearing Member to understand and respond to the allegations.

The Clearing Member will have 20 business days from receipt of such notice to provide a statement of defense in respect of the allegations to CMECE, setting out its plea and any admissions of fact. After due consideration of the defense, CMECE may decide either to proceed with or terminate the Disciplinary Proceedings or, subject to the limitations in CMECE Rule 9.4.7, amend the disciplinary notice.

In the event that Disciplinary Proceedings were to continue, the Risk Committee will act as the Disciplinary Panel under the CMECE Rules. The Disciplinary Panel will, however,

be constituted so as to avoid any conflicts of interest, in accordance with the Conflicts of Interest Policy.

The Disciplinary Panel will hear submissions on the matter of the alleged breach of the CMECE Rules, will determine whether there has been a breach of the CMECE Rules and, if so, which sanctions should be imposed. In carrying out this function, the Disciplinary Panel has a certain degree of flexibility in how to conduct proceedings. The Disciplinary Panel may:

- order the disclosure by CMECE or the Clearing Member of such further information, documents, or other evidence as may be necessary;
- issue directions and take such other steps as it considers appropriate to clarify the facts and issues and determine the case;
- decide to determine the case upon written submissions and evidence placed before it (although this requires the express agreement of CMECE and the Clearing Member concerned);
- in all other cases, give the opportunity to, or require, CMECE and the Clearing Member to attend hearings before the Disciplinary Panel (CMECE and the Clearing Member may call witnesses to give evidence and be questioned);
- allow the Clearing Member and CMECE to be assisted or represented by any person, whether or not legally qualified;
- require hearings to be held in private unless the Clearing Member or CMECE requests otherwise and the other party consents; and
- appoint its own legal advisers.

The Disciplinary Panel will apply the civil standard of proof on the balance of probabilities (i.e., more likely than not to have occurred), with the cogency of evidence required being commensurate with the seriousness of the alleged breach (i.e., the less likely the event is to have occurred, the stronger the evidence required).

The Disciplinary Panel will communicate its findings in writing and any particulars of any sanction determined to the Clearing Member and to CMECE. Such findings and sanction shall be deemed conclusive and binding upon expiration of the time permitted for appeal.

The Disciplinary Panel may impose one or more of the following sanctions:

- issue a private written warning to the Clearing Member;
- issue of a public notice of censure (in the CMECE Monthly Update to Clearing Members);

- impose a fine of any amount;
- disgorge any gain made by the Clearing Member or its representatives in connection with the breach of the CMECE Rules;
- recommend to CMECE to suspend or terminate the membership of the Clearing Member with immediate effect; or
- issue an order requiring the Clearing Member to take such steps including making an order for compensation, as the Disciplinary Panel may direct, to remedy the situation caused by the breach of the CMECE Rules.

Within ten business days of receiving notice of a decision of the Disciplinary Panel, a Clearing Member or CMECE may appeal by lodging a notice of appeal with CMECE and delivering a copy to the other party to the proceeding. CMECE will refer the appeal to the appeals body, which will consist of one or more persons nominated by the Centre for Effective Dispute Resolution in London. The decision of the appeals body is final and binding.

E. Complaints Procedure

The Complaints Procedure is designed to ensure that all Complaints received from Clearing Members are dealt with fairly and in an objective and prompt way.³⁹ A Clearing Member may file a Clearing House Complaint, which is a complaint made by a Clearing Member that arises in connection with the performance by CMECE of its functions as a clearing house, or a failure by CMECE to perform any of its regulatory functions relating to the obligations to which it is subject under or by virtue of the U.K. Financial Services and Markets Act 2000 or the Act or to matters arising out of such obligations. A Clearing Member also may file a Clearing Member Complaint, which is a complaint made by a Clearing Member that relates to the conduct or behavior or other actions of another Clearing Member in relation to that Clearing Member's clearing activities with CMECE.

A Clearing House Complaint and a Clearing Member Complaint must be made in writing and specify the full details of the substance of the complaint, including the date(s) and place(s) that it occurred and the names of the persons involved. The complaint also must set forth the outcome sought by the complainant and contain any other details or documentation that the complainant considers that CMECE would require in order to investigate the complaint. A complaint may not be made more than three months after the conduct which is the subject of the complaint occurred.

A Clearing House Complaint will be addressed in the manner set forth in the Complaints Procedure. CMECE must acknowledge the complaint within ten business days and, if the complaint meets the above requirements, refer the complaint to the Risk Committee, which will carry out an objective and thorough internal investigation and review of the Clearing House Complaint and issue a report to the complainant and the Board of Directors within seventy days of the date on which the Clearing House Complaint was referred to the Risk

³⁹ The Complaints Procedure is set forth in the Clearing Procedures, attached as Confidential Exhibit N.

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Committee. If the complainant is not satisfied with the outcome of the internal investigation or does not receive the Risk Committee's report within the required timeframe, the complainant may request that the Clearing House Complaint be referred to an independent complaints investigator nominated for this purpose by the Centre for Effective Dispute Resolution. At the conclusion of the independent investigator's investigation, the independent investigator will produce a written report setting forth its findings, conclusions, and reasons for its conclusions. The independent investigator may make such binding recommendations as it deems fit in the circumstances, including a recommendation that CMECE make a compensatory payment to the complainant and/or take remedial action to remedy the cause of the Clearing House Complaint.

CMECE will commence an investigation and may commence Disciplinary Proceedings, as described above, in response to a Clearing Member Complaint.

IX. SYSTEM SAFEGUARDS

CMECE uses information technology ("IT") systems provided and supported by CME at all levels of its operations, including those key to the daily processing and risk assessment of a DCO. CMECE's rights and CME's obligations in respect of those IT systems are set forth in the Services Agreement. The core systems standards and procedures that underpin performance and resilience are those established and reviewed by CME. CMECE's separate internal audit function, which will draw on IT audit experts from Deloitte, will rely on CME Group Internal Audit work or undertake complementary work, as appropriate.

All automated systems employed by CMECE will meet the International Organization of Securities Commissions (IOSCO) Principles for the Oversight of Screen-Based Trading Systems issued in 1990, as adopted by the Commission and as supplemented in October 2000, including those involving physical security, environmental controls, network management, capacity, and systems testing.

The CMECE clearing system, a dedicated, separate instance of CME's clearing system, has been configured initially to handle 10,000 Transactions per day. The type of product cleared has no impact on system capacity. CMECE believes this is a suitable and prudent capacity for initial activity, with considerable excess capacity, and will be kept under periodic review.

The CME Clearing IT Department includes a dedicated Quality Assurance Team responsible for manual and automated testing of all clearing systems. The team provides test coverage for each of the systems described above. It has developed a large suite of regression test cases that cover all existing functionality and continues to add new test cases to cover new functionality added to the various systems. It executes various types of tests, including testing individual systems in isolation as well as end-to-end integration tests that exercise the functions of the clearing systems.

In addition, the CME Clearing IT Department includes a dedicated performance and reliability testing team responsible for executing tests that stress the clearing systems with large numbers of transactions to ensure that the systems are sized to support at least twice the last known transaction volume peak. Additional hardware will be added as necessary to meet increasing transaction volumes. The Quality Assurance Team also executes tests that simulate

various types of system failure and ensures that these scenarios are handled predictably and can be recovered with no impact on data integrity.

CMECE has defined business-critical IT systems with appropriate redundancy, including immediate recovery time objectives for core components and up to four hours recovery for certain ancillary systems. In practice, the business could withstand a system outage of up to eight hours.

The CMECE Operations and IT Team will be responsible for overall monitoring of the operation of the CMECE IT systems and the provision of IT services by CME under the Services Agreement. Monitoring will include system performance, availability, and integrity of the relevant systems. The Operations and IT Team will in turn report to the CEO and the Board of Directors pursuant to the CMECE internal reporting line structure.

The end-of-day reports that will be provided by CME to the Operations and IT Team in this respect include:

- Settlement price file;
- Bank deposit/withdrawal file;
- Margin file;
- Trade register file;
- Ending position file; and
- Volume and open interest file.

Monitoring of IT system performance will also take place within CME with reporting lines to the CMECE Operations and IT Team.

CME and CMECE have both implemented disaster recovery plans in the event of a failure of their systems.⁴⁰ While these plans are designed to ensure that business operations can continue in the event of a wide range of disaster situations, IT failure is at their core. Since most of the IT systems will be operated by CME on CMECE's behalf pursuant to the Services Agreement, the CME disaster recovery plan is key to CMECE. However, CMECE also has its own disaster recovery plan to set out back-up arrangements for CMECE staff and their connections with the services being provided on an outsourced basis by CME. The CMECE disaster recovery plan is parallel to CME's disaster recovery plan and extensive work has been carried out by CMECE and CME to ensure that the two plans are coordinated and operate effectively together.

⁴⁰ A copy of the CME Disaster Recovery Plan is attached as Confidential Exhibit DD and a copy of the CMECE Disaster Recovery Plan is attached as Confidential Exhibit EE.

X. REPORTING AND RECORDKEEPING

A. Reporting

CMECE will provide to the Commission on request all information necessary for the Commission to conduct its oversight function of CMECE under the Act with respect to its activities as a registered DCO, including the reporting of transaction information to a registered swap data repository.

B. Recordkeeping

In accordance with the Act and CFTC Regulations, CMECE will maintain records of all activities related to its business as a DCO in a form and manner, and for the time period, set forth in CFTC Regulation 1.31.

CMECE will maintain records showing, among other things, for each contract: the contract date, time, quantity, underlying transaction, settlement or delivery month, price, the Clearing Member buying, and selling, whether the transaction was for house account, non-segregated client account or segregated client account and the time of clearing, and the source indicator code (indicating the submission route by which the transaction entered the system). All record-keeping systems will ensure segregation of records of CMECE from those of other CME Group entities.

All cleared Contract information will be stored in multiple locations. First, a copy of the cleared Contract information will be stored in archive files at each of the primary CME Group data storage sites in Chicago and a further copy at the CME Group back-up storage site. These copies of records will be retained for a minimum of 5 years. Second, a copy of the cleared Contract information will be entered into a CME Group database, which will allow CMECE to view the data electronically for a period of at least two years from the date of clearing of the Contract by CMECE.

Under the Services Agreement, CME provides the following record-keeping services:

- back-up and storage of copies of contracts in archive files at each of its primary data storage sites for a minimum period of five years and the entry of further copies of contracts into a database available to CMECE, which may be viewed electronically for a period of at least two years from the date of clearing of contracts by CMECE;
- storage of copies of the daily Trade Register file listing contracts and transactions by Clearing Member in archive files and saving of such reports into Axis Point (an electronic database that provides storage of all reports sent to Clearing Members) where all such reports will be stored for a minimum of five years from the date of creation, to be accessed by CMECE electronically;
- maintenance of the following information in its original hard-copy format on site at CME's primary site in Chicago for a minimum of one year: audit work papers;

financial statement reviews; correspondence with Clearing Members (including any requests for information, disciplinary actions, etc.); and

- maintenance of an electronic database of the hard copy materials mentioned above and any other requested items to be accessed by CMECE electronically.

Ensuring that appropriate records of contracts are maintained and an internal audit trail in relation to matters of regulation, compliance, disciplinary matters, and complaints is available will be the responsibility of the Regulatory Compliance Officer.

The CMECE Rules provide that CMECE will make information available to regulators in the discharge of their duties. Under this provision and CMECE's prospective status as a DCO, the Commission and Department of Justice staff will have full access to the books and records of CMECE related to its operation as a DCO.

XI. PUBLIC INFORMATION

The CMECE Rules, including default and settlement finality rules, will be available on the CMECE website (<http://www.cmeclearingeuropa.co.uk/>), without access restrictions. CMECE's detailed operating procedures will also be available on its website, with access restricted to market participants.

Additionally, CMECE will publicly disclose information concerning:

- (a) the terms and conditions of each contract cleared and settled by CMECE;
- (b) each clearing and other fee that CMECE charges its Clearing Members;
- (c) the margin-setting methodology, and the size and composition of the financial resource package of CMECE;
- (d) daily settlement prices, volume, and open interest for each contract settled or cleared by CMECE; and
- (e) other matters relevant to participation in the settlement and clearing activities of CMECE.

XII. INFORMATION SHARING

CMECE will, as appropriate, enter into and abide by the terms of information-sharing agreements and use relevant information obtained from such agreements in carrying out its risk management program. CMECE is not currently party to any formal, UK, or international information-sharing agreements and arrangements. CMECE is not aware of any such arrangement between clearing houses in the UK but may initiate discussion with other UK clearing houses. CMECE has applied to join the European Association of Clearing Houses (EACH). Membership in EACH, which is open to all regulated central counterparty houses in Europe, does not involve formal information-sharing agreements. It does, however, provide close contacts for the informal sharing of information about risk concerns and risk perceptions

(not covering the precise information that may be needed for regulatory investigations) that is in practice the way in which clearing house risk managers can and do best co-operate and offer mutual support. CMECE will join the international exchange and clearing house information-sharing agreement administered by CME, which provides for information sharing on an international basis. CMECE will notify the Commission of its entry into information-sharing arrangements with other clearing organizations or other groups or associations, on a timely basis.

XIII. ANTITRUST CONSIDERATIONS

CMECE believes that its Clearing Member eligibility criteria and the CMECE Rules have been designed to avoid unreasonable restraints of trade or the imposition of any material anticompetitive burden. In particular, access to CMECE will not require the acquisition of any equity interest and will be available to qualified applicants on a fair, equitable, and timely basis. The criteria for access to the CMECE system are publicly disclosed. The CMECE system will operate without discrimination among different Clearing Members. CMECE will not adopt any rules or take other actions that would constitute an unreasonable restraint of trade or impose any additional anticompetitive burden.

XIV. LEGAL RISK

Through its agreements with its Clearing Members, its settlement banks, CME, and other service providers, CMECE believes that it has a well-founded, transparent, and enforceable legal framework for each aspect of the activities of the derivatives clearing organization.

The default rules of CMECE, which are framed in line with legal obligations of UK recognized clearing houses under English insolvency law, comprehensively describe the obligations of CMECE to Clearing Members, and CMECE's corresponding rights and permitted actions in the event of Clearing Member default.⁴¹

XV. CONCLUSION

Based on the foregoing information and the information contained in the Schedules and Exhibits attached hereto, CMECE believes that it is eligible for registration as a DCO and that its proposed activities in that capacity satisfy the applicable Core Principles set forth in Section 5b(c)(2) of the Act. CMECE acknowledges that the Commission will be publishing guidance or rules relating to on the Core Principles and will undertake to maintain compliance with the Core Principles in light of such guidance or rules.

CMECE respectfully requests that the Commission issue an order granting CMECE registration as a DCO.

⁴¹ A legal memorandum stating that "ring-fencing" of Client Sequestered Accounts would be effective under English law in the event of an insolvency of CMECE or a Clearing Member is attached as Exhibit FF.



David Stawick
November 26, 2010
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Should you have any questions regarding this application, please feel free to contact me at +44 020 7796 7170.

Sincerely,

A handwritten signature in black ink that reads "Andrew Lamb".

Andrew Lamb
Chief Executive Officer

Attachments

cc: Chairman Gary Gensler
Commissioner Michael Dunn
Commissioner Jill E. Sommers
Commissioner Bart Chilton
Commissioner Scott D. O'Malia
Ananda K. Radhakrishnan, Director, Division of Clearing & Intermediary Oversight
John Lawton, Deputy Director and Chief Counsel, Division of Clearing and Intermediary Oversight
Robert Wasserman, Associate Director, Division of Clearing and Intermediary Oversight

SCHEDULE I LIST OF EXHIBITS

Exhibit A	CMECE Rules
Exhibit B	Memorandum of Association and Articles of Association of CMECE
Exhibit C	List of the Directors of CMECE and Biographical Information
Confidential Exhibit D	Form of Regulatory Certification of CMECE Directors and Employees
Confidential Exhibit E	Form of Certificate of CMECE Regarding Director Qualifications
Confidential Exhibit F	Form of Certificate of CMECE Certifying the Determination of Director Independence
Confidential Exhibit G	Organizational Chart for CMECE
Confidential Exhibit H	Biographical Information of CMECE Employees
Confidential Exhibit I	Services Agreement
Confidential Exhibit J	Financial Projections for CMECE
Confidential Exhibit K	Intercompany Note
Confidential Exhibit L	CME Group Comfort Letter
Confidential Exhibit M	Conflicts of Interest Policy
Confidential Exhibit N	CMECE Clearing Procedures (includes Membership Procedure, Risk Management Procedure, Guarantee Fund Procedure, Clearing and Settlement Procedures, and Complaints Procedure)
Confidential Exhibit O	Clearing Member Application
Confidential Exhibit P	Clearing Member Agreement
Confidential Exhibit Q	Terms of Reference of the Audit Committee
Confidential Exhibit R	Terms of Reference of the Risk Committee
Confidential Exhibit S	CMECE SPAN Implementation Paper
Confidential Exhibit T	Guarantee Fund Policy
Confidential Exhibit U	CMECE Notice Regarding Transitional Period for Guarantee Fund Contributions
Confidential Exhibit V	CMECE Collateral Policy
Confidential Exhibit W	Stress Testing Policy
Confidential Exhibit X	Hypothetical Stress Test Results
Confidential Exhibit Y	Settlement Bank Agreement with Barclays Bank
Confidential Exhibit Z	Settlement Bank Agreement with JPMorgan N.A.
Confidential Exhibit AA	Custody Agreement

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Confidential Exhibit BB	CMECE Investment Policy
Confidential Exhibit CC	Settlement Price Procedures
Confidential Exhibit DD	CME Disaster Recovery Plan
Confidential Exhibit EE	CMECE Disaster Recovery Plan
Exhibit FF	“Ring Fence” Memorandum

CMECE is separately requesting confidential treatment for each Exhibit above designated as a “Confidential Exhibit.”