

“Proxy” features work. For the Conversion feature, the Reorg Guide will now state that: “On Conversions where the entitlement could be Cash, proceeds are credited to your account after the price determination period,” and “DTC will chill Delivery Orders the evening prior to the redemption date.” For the Proxy feature, the Reorg Guide will now state that: “DTC also offers election processing for Consent Solicitation events via its ATOP (Automated Tender Offer Program) service. Under this service, DTC allows participant instructions on Consent Solicitation events to be accepted via ATOP and transmitted electronically to balloting agents.” These changes will provide a more concise and coherent description of the procedures.

The proposed rule change is consistent with the requirements of the Act, specifically Section 17A(b)(3)(F),<sup>6</sup> and the rules and regulations thereunder, applicable to DTC in that it promotes efficiencies in the prompt and accurate clearance and settlement of securities transactions by enhancing the utilization of DTC’s existing services. Moreover, the proposed rule change reduces the costs, inefficiencies and risks associated with the processing or reorganization events by clarifying the procedures associated with the Reorganization Service.

*(B) Self-Regulatory Organization’s Statement on Burden on Competition*

DTC does not believe that the proposed rule change will have any impact, or impose any burden, on competition.

*(C) Self-Regulatory Organization’s Statement on Comments on the Proposed Rule Change Received From Members, Participants, or Others*

Written comments relating to the proposed rule change have not yet been solicited or received. DTC will notify the Commission of any written comments received by DTC.

**III. Date of Effectiveness of the Proposed Rule Change and Timing for Commission Action**

The forgoing rule change has become effective pursuant to Section 19(b)(3)(A)(iii) of the Act<sup>7</sup> and Rule 19b-4(f)(4)(i)<sup>8</sup> thereunder because it effects a change in an existing service of DTC that does not significantly affect the safeguarding of securities or funds in the custody or control of DTC or for which it is responsible and does not

significantly affect the respective rights or obligations of DTC or persons using this service. At any time within 60 days of the filing of the proposed rule change, the Commission summarily may temporarily suspend such rule change if it appears to the Commission that such action is necessary or appropriate in the public interest, for the protection of investors, or otherwise in furtherance of the purposes of the Act.

**IV. Solicitation of Comments**

Interested persons are invited to submit written data, views and arguments concerning the foregoing, including whether the proposed rule change is consistent with the Act. Comments may be submitted by any of the following methods:

*Electronic Comments*

- Use the Commission’s Internet comment form (<http://www.sec.gov/rules/sro.shtml>); or
- Send an email to [rule-comments@sec.gov](mailto:rule-comments@sec.gov). Please include File No. SR-DTC-2012-09 on the subject line.

*Paper Comments*

- Send in triplicate to Elizabeth M. Murphy, Secretary, Securities and Exchange Commission, 100 F Street NE., Washington, DC, 20549-1090.

All submissions should refer to File Number SR-DTC-2012-09. This file number should be included on the subject line if email is used. To help the Commission process and review your comments more efficiently, please use only one method. The Commission will post all comments on the Commission’s Internet Web site (<http://www.sec.gov/rules/sro.shtml>). Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for Web site viewing and printing in the Commission’s Public Reference Room, 100 F Street NE., Washington, DC 20549 on official business days between the hours of 10:00 a.m. and 3:00 p.m. Copies of such filings will also be available for inspection and copying at the principal office of DTC and on DTC’s Web site at [http://www.dtcc.com/downloads/legal/rule\\_filings/2012/dtc/SR-DTC-2012-09.pdf](http://www.dtcc.com/downloads/legal/rule_filings/2012/dtc/SR-DTC-2012-09.pdf).

All comments received will be posted without change; the Commission does not edit personal identifying information from submissions. You should submit only information that you wish to make available publicly. All submissions should refer to File Number SR-DTC-2012-09 and should be submitted on or before January 10, 2013.

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>9</sup>

**Kevin M. O’Neill,**  
*Deputy Secretary.*

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**SECURITIES AND EXCHANGE COMMISSION**

[Release No. 34-68441; File No. SR-CME-2012-26]

**Self-Regulatory Organizations; Chicago Mercantile Exchange Inc.; Order Approving Proposed Rule Change To Amend Rules in Connection With Status as a “Deemed Registered” Clearing Agency**

December 14, 2012.

**I. Introduction**

On October 15, 2012, Chicago Mercantile Exchange Inc. (“CME”) filed with the Securities and Exchange Commission (“Commission”) the proposed rule change (SR-CME-2012-26) pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (“Act”) <sup>1</sup> and Rule 19b-4 thereunder.<sup>2</sup> The proposed rule change was published for comment in the **Federal Register** on November 2, 2012.<sup>3</sup> The Commission received no comment letters regarding the proposal. For the reasons discussed below, the Commission is granting approval of the proposed rule change.

**II. Description**

*A. Background—CME’s Credit Default Swap Business and “Deemed Registered” Status*

CME began clearing credit default swaps prior to the passage of the Dodd-Frank Act.<sup>4</sup> These activities were facilitated by temporary exemptive relief granted by the Commission to

<sup>9</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 68121 (Oct. 29, 2012), 77 FR 66211 (Nov. 2, 2012).

<sup>4</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111-203, 124 Stat.1376 (2010).

<sup>6</sup> 15 U.S.C. 78q-1(b)(3)(F).

<sup>7</sup> 15 U.S.C. 78s(b)(3)(A)(iii).

<sup>8</sup> 17 CFR 240.19b-4(f)(4)(i).

CME.<sup>5</sup> Upon the passage of the Dodd-Frank Act, on July 16, 2011, this temporary relief expired.<sup>6</sup> To ensure that entities that were clearing credit default swaps prior to the passage of Dodd-Frank based on exemptions granted by the Commission could continue to do so without interruption, Section 763(b) of the Dodd-Frank Act<sup>7</sup> provided that (i) a depository institution registered with the Commodities Futures Trading Commission (“CFTC”) that cleared swaps as a multilateral clearing organization prior to the date of enactment of the Dodd-Frank Act and (ii) a derivatives clearing organization (“DCO”) registered with the CFTC that cleared swaps pursuant to an exemption from registration as a clearing agency prior to the date of enactment of the Dodd-Frank Act will be deemed registered with the Commission as a clearing agency solely for the purpose of clearing security-based swaps (“Deemed Registered Provision”).<sup>8</sup> On July 16, 2011, the Deemed Registered Provision, along with other general provisions under Title VII of the Dodd-Frank Act, became effective,<sup>9</sup> thereby requiring each affected clearing agency, including CME, to comply with all requirements of the Act and the rules and regulations thereunder applicable to clearing agencies registered with the Commission under the Act.

<sup>5</sup> See generally Securities Exchange Act Release Nos. 59578 (Mar. 13, 2009), 74 FR 11781 (Mar. 19, 2009), 61164 (Dec. 14, 2009), 74 FR 67258 (Dec. 18, 2009), and 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010) (temporary exemptions in connection with CDS clearing by Chicago Mercantile Exchange Inc.). In addition, the Commission 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 central counterparties for the CDS market. See Securities Act Release Nos. 8999 (Jan. 14, 2009), 74 FR 3967 (Jan. 22, 2009) (initial approval), 9063 (Sep. 14, 2009), 74 FR 47719 (Sep. 17, 2009) (extension until Nov. 30, 2010), and 9158 (Nov. 30, 2010) (extension until Jul. 16, 2011).

<sup>6</sup> Securities Exchange Act Release No. 61803 (Mar. 30, 2010), 75 FR 17181 (Apr. 5, 2010).

<sup>7</sup> The Dodd-Frank Wall Street Reform and Consumer Protection Act, Public Law 111–203, 124 Stat. 1376 (2010).

<sup>8</sup> See Section 763(b) of the Dodd-Frank Act (adding new Section 17A(l) to the Exchange Act, 15 U.S.C. 78q–1(1)). Under this Deemed Registered Provision, CME became a registered clearing agency solely for the purpose of clearing security-based swaps.

<sup>9</sup> Section 774 of the Dodd-Frank Act states, “[u]nless otherwise provided, the provisions of this subtitle shall take effect on the later of 360 days after the date of the enactment of this subtitle or, to the extent a provision of this subtitle requires a rulemaking, not less than 60 days after publication of the final rule or regulation implementing such provision of this subtitle.”

## B. Proposed Changes in Furtherance of Compliance With the Act

In light of CME’s requirement to comply with the Act and the rules and regulations thereunder, CME proposed rule changes concerning membership participation standards, administrative practices, and financial safety, and provided a description of CME’s governance arrangements in the context of the fair representation requirement in Section 17A(b)(3)(C) of the Act, as they relate to the CDS portion of CME’s clearing activities. The proposed changes are found within Chapter 8H of the CME Rulebook and are summarized and discussed in detail below. The text of the proposed changes is available on the CME’s Web site at <http://www.cmegroup.com>, at the principal office of CME, and at the Commission’s Public Reference Room.

## III. Discussion

### A. Statutory Standard

Section 19(b)(2)(C) of the Act directs the Commission to approve a proposed rule change of a self-regulatory organization if it finds that such proposed rule change is consistent with the requirements of the Act and the rules and regulations thereunder applicable to such organization.<sup>10</sup> In particular, Section 17A(b) of the Act requires that, among other things, the rules of a clearing agency:

- Subject to the provisions of Section 17A(b)(4) of the Act,<sup>11</sup> provide that any (i) registered broker or dealer, (ii) other registered clearing agency, (iii) registered investment company, (iv) bank, (v) insurance company, or (vi) other person or class of persons as the Commission, by rule, may from time to time designate as appropriate to the development of a national system for the prompt and accurate clearance and settlement of securities transactions may become a participant in such clearing agency;<sup>12</sup>
- Provide for fair representation of the clearing agency’s shareholders (or members) and participants in the selection of its directors and administration of its affairs;<sup>13</sup>
- Are designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency and for which it is responsible, to foster cooperation and coordination with persons engaged in the clearance and settlement of securities transactions, to remove impediments to and perfect the mechanism of a national system for the prompt and

accurate clearance and settlement of securities transactions, and, in general, to protect investors and the public interest; and are not designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency, or to regulate by virtue of any authority conferred by the Act matters not related to the purposes of this section or the administration of the clearing agency;<sup>14</sup>

- Provide that (subject to any rule or order of the Commission pursuant to section 17(d) or 19(g)(2) of the Act) its participants shall be appropriately disciplined for violation of any provision of the rules of the clearing agency by expulsion, suspension, limitation of activities, functions, and operations, fine, censure, or any other fitting sanction;<sup>15</sup> and

- Are in accordance with the provisions of Section 17A(b)(5) of the Act,<sup>16</sup> and, in general, provide a fair procedure with respect to the disciplining of participants, the denial of participation to any persons seeking participation therein, and the prohibition or limitation by the clearing agency of any person with respect to access to services offered by the clearing agency.<sup>17</sup>

### B. Summary of Proposed Rule Changes

#### 1. Membership Participation Standards

*CME Rule 8H04, CDS Clearing Member Obligations and Qualifications.* CME Rule 8H04 sets forth CDS Clearing Member obligations and qualifications. CME has proposed changes to this rule to provide specifically that CME may approve an application for CDS Clearing Membership to permit the clearing of security-based swaps submitted by any corporation, partnership, limited liability company, or any other type of entity, provided that CME determines such applicant satisfies applicable requirements. CME has also proposed to state in this rule that applicants within one of the enumerated categories of participants in Section 17A(b)(3)(B) of the Act<sup>18</sup> are specifically eligible to become CDS Clearing Members for the purpose of clearing security-based swaps. Further, additional revisions to CME Rule 8H04 would make clear that CME may, and in cases in which the Commission by order directs, shall, deny an application for CDS Clearing Membership to any person subject to a statutory disqualification, as such term is defined by the Act.

The Commission believes that these proposed changes to CME Rule 8H04 are consistent with Sections 17A(b)(3)(B)<sup>19</sup> and 17A(b)(4)(B)<sup>20</sup> of the Act, which provide that a registered clearing agency shall provide in its rules that the

<sup>14</sup> 15 U.S.C. 78q–1(b)(3)(F).

<sup>15</sup> 15 U.S.C. 78q–1(b)(4)(G).

<sup>16</sup> 15 U.S.C. 78q–1(b)(5).

<sup>17</sup> 15 U.S.C. 78q–1(b)(4)(H).

<sup>18</sup> 15 U.S.C. 78q–1(b)(3)(B).

<sup>19</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>20</sup> 15 U.S.C. 78s(b)(4).

<sup>10</sup> 15 U.S.C. 78s(b)(2)(C).

<sup>11</sup> 15 U.S.C. 78q–1(b)(4).

<sup>12</sup> 15 U.S.C. 78q–1(b)(3)(B).

<sup>13</sup> 15 U.S.C. 78q–1(b)(3)(C).

categories of applicants enumerated in Section 17A(b)(3)(B) of the Act<sup>21</sup> may become a participant in the registered clearing agency, subject to meeting the standards of financial responsibility, operational capability, experience, and competence prescribed by the rules of the clearing agency, among other things.<sup>22</sup> The Commission believes the proposed changes relating to CME's authority and obligation to restrict the membership and activities of persons subject to a statutory disqualification are consistent with Section 17A(b)(4)(A),<sup>23</sup> which provides, among other things, that a registered clearing agency may, and in cases in which the Commission, by order, directs as appropriate in the public interest shall, deny participation to any person subject to a statutory disqualification. In addition, the Commission finds that these proposed changes are consistent with Section 17A(b)(3)(F) of the Act,<sup>24</sup> which requires, among other things, that a registered clearing agency's rules not be designed to permit unfair discrimination in the admission of participants or among participants in the use of the clearing agency.

## 2. Administrative Practices

*New CME Rule 8H931.* CME has proposed to add new CME Rule 8H931, which would state that rules that relate to CME's activities as a clearing agency clearing security-based swaps will be adopted, altered, amended or repealed in accordance with the applicable requirements of Section 19(b) of the Act. Under this rule, CME would promptly notify all CDS Clearing Members of any proposal it has made to change, revise, add or repeal any rule that relates to its activities as a securities clearing agency. Such notice would include the text or a brief description of any such proposed rule change, along with its purpose and effect, in accordance with the requirements of the Act. CDS Clearing Members would have the opportunity to submit comments with respect to any such proposal in accordance with the applicable Commission rules. The Commission believes that proposed CME Rule 8H931 is consistent with CME's obligations as a clearing agency registered under the Act to file its proposed rule changes pursuant to

Section 19(b) of the Act and Rule 19b-4 thereunder.<sup>25</sup>

*New CME Rule 8H932, Records Relating to Disciplinary Proceedings and Security-Based Swaps.* Proposed CME Rule 8H932 would require CME to maintain records of any disciplinary proceeding related to the activities of a CDS Clearing Member involving security-based swaps in accordance with the requirements of the Act and Rule 17a-1 thereunder. The Commission believes that proposed CME Rule 8H932 is consistent with CME's obligation as a clearing agency under Section 17(a)<sup>26</sup> and Rule 17a-1 thereunder<sup>27</sup> to maintain records made or received by it in the course of its business as such and in the conduct of its self-regulatory activity.<sup>28</sup>

*New CME Rule 8H933, Notice Regarding Certain Disciplinary Matters Related to Security-Based Swaps.* Proposed CME Rule 8H933 would add language to Chapter 8H that would require CME to notify the Commission and any appropriate regulatory agency, as such term is defined by Section 3(a)(34) of the Act, regarding any final disciplinary sanction, denial of participation, prohibition or limitation with respect to access, and/or summary suspension taken against a CDS Clearing Member relating to activities involving security-based swaps. The Commission believes that proposed CME Rule 8H933 is consistent with Section 19(d)(1) of the Act, which requires a self-regulatory organization that imposes any final disciplinary sanction on any of its members or participants, denies membership or participation to any applicant, or prohibits or limits any person in respect to access to services it offers, promptly to file notice with the appropriate regulatory agency for the self-regulatory organization and (if other than the appropriate regulatory agency for the self-regulatory organization) the appropriate regulatory agency for such member, participant, applicant, or other person.<sup>29</sup> The Commission also believes that proposed CME Rule 8H933 is consistent with Section 17A(b)(3)(H) of the Act,<sup>30</sup> which requires that the rules of a clearing agency provide a fair

procedure with respect to the disciplining of participants, the denial of participation to any persons seeking participation therein, and the prohibition or limitation by the clearing agency of any person with respect to access to services offered by the clearing agency.<sup>31</sup>

*New CME Rule 8H938, Summary Suspensions Relating to Security-Based Swap Activities.* Under proposed CME Rule 8H938, CME would only summarily suspend and close the accounts of a CDS Clearing Member engaged in security-based swap clearing activities that (i) has been and is expelled or suspended from any self-regulatory organization, (ii) is in default of any delivery of funds or securities to the clearing agency, or (iii) is in such financial operating difficulty that the clearing agency determines and so notifies the appropriate regulatory agency for the member that such suspension and closing of accounts are necessary for the protection of the clearing agency, its members, creditors, or investors.

The Commission views summary suspensions, as discussed in Section 17A(b)(5)(C) of the Act,<sup>32</sup> as an exception to the general provisions Sections 17A(b)(5)(A)<sup>33</sup> and 17A(b)(5)(B)<sup>34</sup> of the Act, which require a clearing agency to adhere to specific processes prior to certain disciplinary actions taking place. The effect of the exception of Section 17A(b)(5)(C) is to allow registered clearing agencies to summarily suspend and close a participant's accounts only in the limited circumstances and in accordance with the minimum procedural requirements set forth in Section 17A(b)(5)(C). Thus, the Commission believes that proposed CME Rule 8H938 is consistent with Section 17A(b)(5)(C) of the Act, as well as Sections 17A(b)(3)(G)<sup>35</sup> and (H)<sup>36</sup> of the Act, which require the rules of the clearing agency provide that its participants shall be appropriately disciplined for violations of any provisions of those rules and to provide fair procedures for disciplining participants, denying participation in the clearing agency to any person, and prohibiting or limiting access to the

<sup>25</sup> The Commission is not making a determination whether this proposed rule change or any other proposed rule change discussed in this Order is sufficient for full compliance with the statute, rule, or regulation with which they are consistent.

<sup>26</sup> 15 U.S.C. 78q(a).

<sup>27</sup> 17 CFR 240.17a-1.

<sup>28</sup> The Commission is not making a determination whether this proposed rule change or any other proposed rule change discussed in this Order is sufficient for full compliance with the statute, rule, or regulation with which they are consistent.

<sup>29</sup> 15 U.S.C. 78s(d)(1).

<sup>30</sup> 15 U.S.C. 78q-1(b)(3)(H).

<sup>31</sup> The Commission is not making a determination whether this proposed rule change or any other proposed rule change discussed in this Order is sufficient for full compliance with the statute, rule, or regulation with which they are consistent.

<sup>32</sup> 15 U.S.C. 78q-1(b)(5)(C).

<sup>33</sup> 15 U.S.C. 78q-1(b)(5)(A).

<sup>34</sup> 15 U.S.C. 78q-1(b)(5)(B).

<sup>35</sup> 15 U.S.C. 78q-1(b)(3)(G).

<sup>36</sup> 15 U.S.C. 78q-1(b)(3)(H).

<sup>21</sup> 15 U.S.C. 78s(b)(2)(B).

<sup>22</sup> The Commission is not making a determination whether this proposed rule change or any other proposed rule change discussed in this Order is sufficient for full compliance with the statute, rule, or regulation with which they are consistent.

<sup>23</sup> 15 U.S.C. 78s(b)(4)(A).

<sup>24</sup> 15 U.S.C. 78s(b)(3)(F).

clearing agency's services, among other things.

### 3. Financial Safety

*Change to CME Rule 8H07, CDS Financial Safeguards and Guaranty Fund Deposit, and 8H802.B, Satisfaction of Clearing House Obligations.* CME has proposed changes to CME Rule 8H07, governing CDS financial safeguards and Guaranty Fund deposit matters, that would require CME to notify CDS Clearing Members regarding both the amount of and reasons for any charges to the CDS Guaranty Fund ("CDS Guaranty Fund," or "Guaranty Fund") for any reason other than to satisfy a clearing loss attributable to a CDS Clearing Member solely from that Clearing Member's Guaranty Fund deposit. CME has proposed changes to Rule 8H802.B that would specify that CME would provide notice to CDS Clearing Members as required by the Act regarding any amounts charged to the CDS Guaranty Fund due to losses incurred. By providing additional transparency to CDS Clearing Members regarding the use of the CDS Guaranty Fund, these proposed changes facilitate CDS Clearing Member monitoring of CME's financial condition as well as CME's accountability with regard to the CDS Guaranty Fund. The Commission thus believes that these proposed changes to CME Rule 8H07 and 8H802.B are consistent with Section 17A(b)(3)(F) of the Act,<sup>37</sup> which requires that the rules of a registered clearing agency be designed, among other things, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.

Further, additional proposed changes would also clarify that CME would apply CME Rule 8H07 on a uniform and non-discriminatory basis when determining minimum Guaranty Fund deposits. The Commission finds these changes to CME Rule 8H07 are consistent with Section 17A(b)(3)(F) of the Act, which, among other things, requires that a clearing agency's rules not be designed to permit unfair discrimination among participants in the use of the clearing agency.<sup>38</sup>

*New CME Rule 8H820, Performance Bond for Security-Based Swaps, and Changes to CME Rule 8H930, CDS Performance Bond Requirements.* Proposed CME Rule 8H820 would specify that CDS performance bond requirements will be as determined by CME staff from time to time and as set

forth in CME Rule 820. Further, the proposed rule would provide that, with respect to performance bond requirements that apply to security-based swap clearing activities, CME would be required under new CME Rule 8H20 to determine that each item that is enumerated as being acceptable performance bond pursuant to CME Rule 820 has been determined to assure the safety and liquidity of the clearing agency. New language in CME Rule 8H930 also would explain that (i) acceptable performance bond assets for security-based swaps and the applicable haircuts related to such assets will be set forth on a public Web site and that CME will have discretion to make adjustments to asset haircuts at any time; (ii) any such adjustment to the applicable asset haircut will be promptly communicated to CDS Clearing Members; (iii) any adjustments to the applicable asset haircut schedule for security-based swap clearing activities must be based on an analysis of appropriate factors including, for example, historical and implied price volatilities, market composition, current and anticipated market conditions, and other relevant information; and (iv) the Clearing House will conduct regular reviews of its then-current haircut schedules and make any necessary adjustments. CME also has proposed to revise CME Rule 8H930 to provide that CME will apply CME Rule 8H930 on a uniform and non-discriminatory basis when determining performance bond requirements.

By providing additional transparency concerning CME's process for determining CDS performance bond requirements as described above, the Commission believes that CME Rule 8H820 and the revisions to CME Rule 8H930 should provide guidance and an increased level of predictability to CME's CDS Clearing Members concerning performance bond requirements without compromising CME's ability to adjust them as market conditions warrant. CME Rule 8H975 continues to permit CME to require additional performance bond to be deposited to CME and/or to take any other action necessary to protect the financial integrity of CME in emergency situations as defined under CME Rule 8H975. With increased transparency and predictability concerning performance bond requirements, CDS Clearing Members should be better able to anticipate and manage amounts due to CME, which may translate into less risk that CME would not be able to collect on such requirements and ultimately, improved financial stability

for CME as well as its CDS Clearing Members. In addition, the requirement in CME Rule 820 that each item enumerated as being acceptable performance bond has been determined by CME to assure the safety and liquidity of the clearing agency should also provide additional assurance to Clearing Members that CME performs the diligence necessary to select appropriate performance bond assets in support of the CME's CDS clearing activities. Thus, the Commission believes the addition of CME Rule 820 and the revisions to CME Rule 8H930 described above to be consistent with Section 17A(b)(3)(F),<sup>39</sup> which requires that a clearing agency's rules be designed, among other things, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible, and to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions. The Commission also believes the changes to CME Rule 8H930 providing that CME will determine performance bond requirements in a uniform and non-discriminatory manner among members are consistent with Section 17A(b)(3)(F) of the Act,<sup>40</sup> which, among other things, requires that a clearing agency's rules not be designed to permit unfair discrimination among participants in the use of the clearing agency.

*New CME Rule 8H934, Reports to CDS Clearing Members.* Proposed CME Rule 8H934 would obligate CME to, as soon as practicable after the end of each calendar year, make available financial statements audited by independent public accountants to all CDS Clearing Members engaged in security-based swap clearing activities. CME would also be required under this rule to make available to CDS Clearing Members clearing security-based swaps a report by independent public accountants regarding the system of internal accounting control of CME Group Inc. ("CME Group"), CME's parent company, in describing any material weaknesses discovered and any corrective action taken or proposed to be taken.

The financial statements would, at a minimum include: (i) The balance of the Guaranty Fund, and the breakdown of the fund balance between the various forms of contributions to the fund, e.g., cash and secured open account indebtedness; (ii) the types and amounts of investments made with respect to the cash balance; (iii) the amounts charged

<sup>37</sup> 15 U.S.C. 78s(b)(3)(F).

<sup>38</sup> 15 U.S.C. 78s(b)(3)(F).

<sup>39</sup> *Id.*

<sup>40</sup> *Id.*

to the Guaranty Fund during the year in excess of a defaulting CDS Clearing Member's Guaranty Fund contribution; and (iv) any other charges to the fund during the year not directly related and chargeable to a specific CDS Clearing Member's Guaranty Fund contribution. CME also would make available to CDS Clearing Members clearing security-based swaps a report of CME Group by independent public accountant regarding its system of internal accounting control, describing any material weaknesses discovered and any corrective action taken or proposed to be taken.

CME would also furnish to all CDS Clearing Members engaged in security-based swap clearing activities, within 40 days following the close of each fiscal quarter, unaudited quarterly financial statements. These unaudited quarterly financial statements shall at a minimum consist of: (i) A statement of financial position as of the end of the most recent fiscal quarter and as of the end of the corresponding period of the preceding fiscal year; (ii) a statement of changes in financial position for the period between the end of the last fiscal year and the end of the most recent fiscal quarter and for the corresponding period of the preceding fiscal year; and (iii) a statement of results of operations, which may be condensed, for the most recent fiscal quarter and for the period between the end of the last fiscal year and the end of the most recent fiscal quarter and for the corresponding periods of the preceding fiscal year.

The Commission believes that CME Rule 8H934, requiring CME to provide to all CDS Clearing Members engaged in security-based swap activities financial statements of CME and reports regarding CME Group's system of internal accounting control, as described above, is consistent with Section 17A(b)(3)(F) of the Act,<sup>41</sup> which provides that the rules of a registered clearing agency should be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.

*New CME Rule 8H935, Use of Assets.* Proposed CME Rule 8H935 would limit CME's ability to invest the cash portion of the CDS Guaranty Fund and CDS Clearing Member performance bond contributions by only allowing investments in accordance with the requirements of CFTC Regulation 1.25,

including U.S. Government obligations or such other investments as the rules of CME may provide which assure safety and liquidity. CME would also be required to limit its use of CDS Guaranty Fund and performance bond contributions related to security-based swap activities to the purposes permitted by the Act under the proposed rule language. CDS Guaranty Fund and performance bond contributions shall not be permitted to be used to account for clearing agency losses attributable to day-to-day operating expenses.

The Commission expects that proposed CME Rule 8H935 should provide additional assurance as to the safety and liquidity of acceptable performance bond for security-based swaps positions. Thus, the Commission believes CME Rule 8H935 is consistent with Section 17A(b)(3)(F) of the Act,<sup>42</sup> which provides that the rules of a registered clearing agency should be designed to promote the prompt and accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.<sup>43</sup>

*New CME Rule 8H936, Capacity Reviews.* Proposed CME Rule 8H936 would specify that CME would perform periodic risk assessments of CME's operations and its data processing systems and facilities, and provide CME's Board of Directors or its designee, such as a Board Committee, with such reports, and supervise the establishment, maintenance, and updating of operations and data processing safeguards while reporting periodically to the Board or its designee concerning strengths and weaknesses in CME's system of safeguards. In addition, Rule 8H936 would make clear that CME is obligated to consider, and advise the Board of, the impact that new or expanded service or volume increases would have on CME's processing capacity, both physical, including personnel, and systemic risk.

The Commission believes that proposed CME Rule 8H936 is consistent with Section 17A(b)(3)(F) of the Act,<sup>44</sup> which provides that the rules of a registered clearing agency should be designed to promote the prompt and

accurate clearance and settlement of securities transactions and, to the extent applicable, derivative agreements, contracts, and transactions, to assure the safeguarding of securities and funds which are in the custody or control of the clearing agency or for which it is responsible.

#### 4. Fair Representation Requirement

Commission staff asked CME to provide an explanation of how CME's current governance arrangements relating to its CDS clearing offering should be viewed in light of the requirements of Section 17A(b)(3)(C) of the Act.<sup>45</sup> This provision requires that the rules of a clearing agency provide for fair representation of the clearing agency's shareholders (or members) and participants in the selection of its directors and administration of its affairs.

CME responded that the Board of Directors of the CME Group, the parent company of CME, also serves as the Board of Directors of CME. CME Group is a public company whose stock is listed on the Nasdaq Stock Market ("Nasdaq") and thus is subject to board composition requirements under Nasdaq listing standards. In addition, any member of the public is afforded the opportunity to purchase shares in CME Group and influence the selection of directors and administration of its affairs on that basis, subject to applicable law. CME cited Commission staff guidance in asserting that the Commission may find fair representation with respect to clearing agency participants if such participants are afforded an opportunity to acquire voting stock of the clearing agency in proportion to their use of its facilities.<sup>46</sup>

In addition, CME noted that it is also subject to governance and conflict of interest provisions under the core principles set out in the CEA for a DCO. The CFTC reviews CME for compliance with these principles. For example, Section 5b(c)(2)(O) of the CEA sets out governance fitness standards that apply to DCOs, including transparent governance arrangements, that are designed to ensure the consideration of views of owners and participants. Further, Section 5b(c)(2)(Q) of the CEA requires a DCO's board to include market participants. CFTC regulations also require a DCO's governance arrangements to be clear and transparent

<sup>42</sup> *Id.*

<sup>43</sup> The Commission is not making a determination whether this proposed rule change or any other proposed rule change discussed in this Order is sufficient for full compliance with the statute, rule, or regulation with which they are consistent.

<sup>44</sup> *Id.*

<sup>45</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>46</sup> See Regulation of Clearing Agencies, *supra* note 10. Rather than prescribing a single method, Commission staff guidance has stated that the Commission will evaluate a clearing agency's procedures with regard to the fair representation requirement on a case-by-case basis. *Id.*

<sup>41</sup> *Id.*

and “to support the objectives of relevant stakeholders.”<sup>47</sup>

CME also stated that it believes CDS participants will have a meaningful input into decisions affecting the clearing operations for CDS through participation on the CME CDS Risk Committee. CME noted that the CDS Risk Committee was formed under CME Rule 8H27 to provide guidance and oversight to CME on matters relating to CDS products. The CDS Risk Committee, among other things, is responsible for reviewing CDS-related financial safeguards, clearing member requirements, risk management policies and practices, and rule changes, among other things.

CME noted that the Charter of the CDS Risk Committee sets forth certain composition requirements that ensure the perspectives of CDS Clearing Members are represented. More specifically, the Charter requires that at all times the CDS Risk Committee is populated with up to nine and no fewer than five individuals who are representative of CDS Clearing Members. Because of these composition requirements of the CDS Risk Committee, and the scope of its responsibilities, CME stated that it believed the Commission could find that its current governance arrangements meet the fair representation requirement of the Act.

Further, CME also noted that the Charter of the CDS Risk Committee specifically provides that its Chairman shall be a member of the CME Board of Directors. In this capacity, the Chairman of the CDS Risk Committee serves as a liaison to the full Board of Directors of CME. He or she can relay any concerns addressed by the CDS Risk Committee to the full CME Board of Directors. CME noted that the CDS Risk Committee is required to reassess the adequacy of this Charter on an annual basis and submit any recommended changes to the full CME Board of Directors for approval. CME believes these features provide a concrete nexus between the activities of the CDS Risk Committee and the full CME Board of Directors and ensure that there will be a fair representation of CDS Clearing Members in accordance with the spirit and letter of the Act.

Based on the representations made by CME, as described above, the Commission believes that CME's governance structure could accommodate fair representation of the clearing agency's shareholders (or

members) and participants in the selection of CME's directors and administration of its affairs, consistent with Section 17A(b)(3)(C) of the Act.<sup>48</sup> The Commission intends to monitor these governance arrangements over time for consistency with fair representation requirement, taking into consideration the interaction between the CDS Risk Committee, including its Chairman, with the CME Board of Directors, any changes to the composition of the CDS Risk Committee relative to that of the CME Board of Directors, the scope and proportion of CME's CDS clearing relative to its other activities, and other facts and circumstances as appropriate.

#### IV. Conclusion

On the basis of the foregoing, the Commission finds that the proposal is consistent with the requirements of the Act and in particular with the requirements of Section 17A of the Act<sup>49</sup> and the rules and regulations thereunder. *It is therefore ordered*, pursuant to Section 19(b)(2) of the Act,<sup>50</sup> that the proposed rule change (File No. SR-CME-2012-26) be, and hereby is, approved.<sup>51</sup>

For the Commission, by the Division of Trading and Markets, pursuant to delegated authority.<sup>52</sup>

**Kevin M. O'Neill,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-68442; File No. SR-BATS-2012-046]

### Self-Regulatory Organizations; BATS Exchange, Inc.; Notice of Filing of a Proposed Rule Change To Modify Exchange Rule 11.23 Relating to Auctions of Exchange-Listed Securities

December 14, 2012.

Pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 (the “Act”),<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> notice is hereby given that on December 6, 2012, BATS Exchange, Inc. (the “Exchange” or “BATS”) filed with the

<sup>48</sup> 15 U.S.C. 78q-1(b)(3)(C).

<sup>49</sup> 15 U.S.C. 78q-1.

<sup>50</sup> 15 U.S.C. 78s(b)(2).

<sup>51</sup> In approving the proposed rule change, the Commission considered the proposal's impact on efficiency, competition and capital formation. 15 U.S.C. 78c(f).

<sup>52</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

Securities and Exchange Commission (“Commission”) the proposed rule change as described in Items I, II, and III below, which Items have been prepared by the Exchange. The Commission is publishing this notice to solicit comments on the proposed rule change from interested persons.

#### I. Self-Regulatory Organization's Statement of the Terms of Substance of the Proposed Rule Change

The Exchange is filing with the Commission a proposal to amend Rule 11.23 entitled “Auctions” including to amend Rule 11.23(a)(6) to incorporate the Exchange's clearly erroneous execution standards into the definition of Collar Price Range,<sup>3</sup> to amend Rule 11.23(a)(22) to provide that any portion of a market Regular Hours Only<sup>4</sup> (“RHO”) order will be cancelled immediately following any auction in which the order is not fully executed, to make changes to Rules 11.23(b)(2)(B), 11.23(c)(2)(B), and 11.23(d)(2)(C) to help to prevent the possibility of erroneous executions occurring in auctions on the Exchange, and to make changes to Rule 11.23(d)(2)(A) entitled “Publication of BATS Auction Information” in order to both make clear that the rule should apply to IPO Auctions and to make a change to the data that will be disseminated by the Exchange.

The text of the proposed rule change is available at the Exchange's Web site at <http://www.batstrading.com>, at the principal office of the Exchange, and at the Commission's Public Reference Room.

#### II. Self-Regulatory Organization's Statement of the Purpose of, and Statutory Basis for, the Proposed Rule Change

In its filing with the Commission, the Exchange included statements concerning the purpose of and basis for the proposed rule change and discussed any comments it received on the proposed rule change. The text of these statements may be examined at the places specified in Item IV below. The Exchange has prepared summaries, set forth in Sections A, B, and C below, of the most significant parts of such statements.

<sup>47</sup> The Commission notes that compliance with the requirements of other regulatory authorities does not necessarily substitute for compliance with the Exchange Act and the rules and regulations thereunder.

<sup>3</sup> As defined in BATS Rule 11.23(a)(6).

<sup>4</sup> As defined in BATS Rule 11.23(a)(22).