

TO: Clearing Member Firms

FROM: CME Clearing

DATE: November 14, 2016

ADVISORY #: 16-483

SUBJECT: **Initial Payment Calculation Change for CDS Transfers in FEC+ Moved to December 5, 2016**

Please be advised that CME will push the Production date for the Initial Payment Calculation Change for Credit Default Swaps (CDS) Transfers in FECPlus to **Monday, December 5, 2016**. In the meantime, the regular Initial Payment calculation will be automatically applied to CDS Transfer or users can specify their own Initial Payment value

Testing for this change will be available in New Release (NR) starting Wednesday 11/23.

Initial Payment Calculation Change

Previously, for CDS transfers, FEC would calculate an upfront fee on the transfer based upon the trade price and original trade date that the user specified on the transfer trade. Users could also specify an upfront fee to move with the transfer. This might have led to money movements that transfer parties did not intend to make with one another. Additionally, CDS clients wanted better alignment between the CDS & IRS transfer process in terms of allowing clients to move transfers with variation margin. Doing so would prevent clients from having to double-fund variation margin at their FCMs. The FEC process for supporting this was extremely manual and relied upon the FCMs to complete and input the proper calculations. We're hoping to make this calculation more straightforward with this release into FEC+.

For any prior-day CDS transfer, on which an Initial Payment is not specified, FECPlus will calculate the Initial Payment automatically and will now include the trade's Variation Margin, as well as price alignment interest (PAI).

Below is an example that helps explain this functionality:

- Client A has a trade cleared at Clearing Member Firm 1 and wishes to transfer the trade to Clearing Member Firm 2.
- Prior to transfer, client A has paid or received daily variation margin and PAI on this trade. Let's say that as of the current date, the client has paid variation margin equaling +\$1,000.00.

In the above vanilla scenario, if client A transfers the trade from Clearing Member Firm 1 to Clearing Member Firm 2, the client will be required to pay Clearing Member Firm 1 +\$1,000.00 only to receive that money plus any additional variation margin back from Clearing Member Firm 2. Additionally, the client would exchange a PAI cash flow with Clearing Member Firm 1.

Previously, in order to prevent this cash flow movement, Clearing Member Firm 1 would manually calculate the reversing cash flow to offset both the variation margin payment and the PAI cash flow and input this cash flow on the transfer trade in FEC.

Now, with this enhanced functionality, FEC+ will automatically calculate the proper cash flow that required in order to offset the variation margin and PAI payment to Clearing Firm 1.

In the above example, FEC+ would calculate a +\$1,000 payment plus PAI on the offsetting trade to offset the client's variation margin & PAI payment to Clearing Firm 1. FEC would also perform the same on the onsetting trade, however the cash flows would be in the opposite direction. The end result is that client A will be able to easily continue making daily variation margin and PAI cash flow exchanges with its new clearing firm without any cash flow hassle.

The formula that will be used in the calculation is as follows:

$$\text{Initial Payment} = - (\text{Variation Margin} + \text{PAI Amount} + \text{Coupon Amount (1)})$$

(1) Coupon Amount to be considered only if the CDS Transfer occurs the day before Coupon Payment

The executing side of the Transfer will have the ability to amend the Initial Payment on the CDS Transfer after the transfer has been submitted, but only until the transfer has been accepted, after which no change to the Initial Payment can be made.

For more information, please contact CME Clearing at ccs@cmegroup.com or via phone at Chicago (312) 207 2525 | London (44) 203 379 3198 | Singapore (65) 6593 5591