

TO: Clearing Member Firms

FROM: CME Clearing

DATE: November 30, 2016

ADVISORY #: 16-502

SUBJECT: **Initial Payment Calculation Change for CDS Transfers in FECPlus Postponed**

Please be advised that CME will postpone the Production date for the Initial Payment Calculation Change for prior day Credit Default Swap (CDS) Transfers in FECPlus. No specific date has been determined, but as soon as one is available we will publish that information. In the meantime, the regular Initial Payment calculation will be automatically applied to prior day CDS Transfers, or users can specify their own Initial Payment value.

Initial Payment Calculation Change

Previously, for CDS transfers, FEC would calculate an Initial Payment on the Transfer based upon the Trade Price and Original Trade Date specified by the User. Users could also specify an Initial Payment to move with the transfer. This might have led to money movements that 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 in FECPlus.

For any prior day CDS transfer, on which an Initial Payment is not specified, FECPlus will use the new calculation for Initial Payment which will represent the trade's Variation Margin, Price Alignment Interest (PAI) and Coupon (when applicable). The Trade Date will drive whether this new calculation is used for the Initial Payment. If the Trade Date specified is before the current Trade Date, the new calculation will be used, otherwise the standard Initial Payment calculation will be used. Additionally, if a user supplies a specific value for Initial Payment, FECPlus will use that value and will not include additional VM or PAI in the IPMT amount. Below is a table that outlines some scenarios:

	Current Day	Prior Day
IPMT not Specified by User	Standard Calculation	New Calculation
IPMT Specified by User	Use specified amount	Use specified amount
IPMT of 0.00 Specified by User	Use 0.00	Use 0.00

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.

With this enhanced functionality, FECPlus will automatically calculate the proper cash flow required in order to offset the variation margin and PAI payment to Clearing Firm 1.

In the above example, FECPlus 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. FECPlus 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