

TO: Clearing Member Firms
Chief Financial Officers
Back Office Managers
Margin Managers

FROM: CME Clearing

ADVISORY #: 19-262

DATE: August 7, 2019

SUBJECT: Enhancements to the Market Risk Component of the CME OTC IRS Margin Model

CME is making enhancements to its OTC IRS margin model. The changes are now available for testing in the New Release environment as of August 6th, 2019. The production date will be announced in the coming weeks and is targeted for mid-September (pending all relevant regulatory review periods). Below is a description of the enhancements to the model.

I. Refining the Market Risk Component:

- a. Un-Scaled Component: In addition to the existing filtered historical value at risk (“FHVaR”), CME will use an un-scaled component which utilizes historical scenarios from longer lookback periods and facilitates the injection of hypothetical scenarios within a historical value at risk framework (“VaR”). The existing market risk component would now be calculated as the weighted sum of FHVaR and the VaR from the new unscaled component. The addition of this new component will allow for retention of historical and hypothetical scenarios in the margining process, whilst further enhancing the stability of the margin requirements across different market regimes. The lookback periods for both components are subject to re-calibration as part of the enhancement.
- b. Event Risk Component: As part of actively managing risk in accordance with its risk appetite, CME Clearing monitors upcoming events that may have meaningful market impact and may choose to inject scenarios as warranted. In case of a known forthcoming market event (e.g. a governmental election), CME may choose to add one additional VaR component which consists of scenarios specific to the coming event. The final market risk margin is the larger of either the enhanced market risk component (as highlighted above) or the VaR from this new component.

- II. Risk Factor Enhancement: CME Clearing will use the spread implied from the Eurodollar Futures prices and the corresponding underlying prices from LIBOR 3M curve as a risk factor, instead of

the Eurodollar Futures prices. Given that the underlying risk dynamics driving LIBOR 3M and Eurodollar futures are the same, synchronizing the common elements across the risk factors will produce a better representation of historical moves.

- III. Volatility Floor Application: CME will continue to preserve the application of volatility floors as currently utilized in the model framework including the calibration approach. However, the framework will move from applying the volatility floor at a risk factor level (e.g. at a curve/tenor level) and instead apply the floor at a margin level.

CME CORE: CME CORE is an online analytics tool which allows users to calculate initial margin for all CME cleared products. CME CORE's New Release (NR) test and production applications will begin to calculate enhanced initial margins using the enhanced model consistent with the dates in this advisory.

Please note the CME CORE margin calculator methodology will reflect the enhanced methodology in production when CME Clearing implements the change. In general, CME CORE utilizes prior day settlement to calculate initial margin. Because of the model enhancements, on the day CME implements the enhancements in production, CORE will reference the new model inconsistent with the prior day's risk data.

If you have questions, please contact the IRS Risk team at IRSQuantRisk@cmegroup.com or by phone on 312.338.7112.

CME Clearing will send a follow up advisory confirming the timings for Production launch.

Regards,

CME Clearing