

TO: Clearing Member Firms; Back Office Managers

FROM: CME Clearing

ADVISORY #: 20-321

DATE: 8/19/2020

SUBJECT: OTC IRS New Release – SOFR Discounting and Price Alignment: Phase 1 Testing

Please be advised that CME will begin New Release testing of the SOFR Discounting and Price Alignment Transition on August 26, 2020. Testing will be broken into two phases to test both the Transition Date, and post-Transition Date processing. Between these two phases, CME will hold a Dress Rehearsal to simulate the end-to-end discounting transition processing.

Phase 1 Testing: August 26 – Sept 18

- Daily simulation of the Transition Date, October 16, in the New Release environment
- Allows for testing of NPV changes, cash adjustment amounts, and processing the IRS Discounting Transition Report
- Daily operational processing:
 - CME runs a standard end-of-day clearing cycle using Fed Funds discounting
 - Next, CME runs transition processing with SOFR discounting and produces the IRS Discounting Transition Report. This report contains revised Adjusted NPVs, NPVs, and Cash Adjustment Amounts.
- Price Alignment references Fed Funds
- SOFR curve files are available to compare against revised NPVs

Dress Rehearsal: Sept 18 – Sept 21

- Sept 18 simulates the Transition Date (Friday, Oct 16) using New Release trade data
 - IRS Discounting Transition Report published with revised Adjusted NPVs, NPVs and Cash Adjustment amounts
 - Re-hedging swaps are computed and booked to position accounts
 - IRS Trade Register is published with re-hedging swaps included in the report
 - 3 new Risk Reports will be made available allowing clients to allocate the risk of the re-hedging swaps back to the USD swaps within their portfolio:
 - Trade-Level Discounting Delta Report: *IRSDLT_XXX_YYYYMMDD_EOD.csv*
 - "XXX" = Firm ID
 - IRS Trade Register for Re-hedging Swaps: *IRSTR_RISKCOMP_YYYYMMDD_EOD.csv*
 - Re-hedging Swap Sensitivity (Delta) Report: *IRSDLT_RISKCOMP_YYYYMMDD_EOD.csv*
- Sept 21 simulates the business day following the Transition Date (Monday, Oct 19)
 - Mock auction will take place at approximately 9:00 am ET

- Once the Auction Clearing Price is set, offsetting trades are booked to participating accounts with the allocated fee (cost to participating clients)
- End-of-day Variation Margin amount is calculated as SOFR Adjusted NPV (current day) minus SOFR Adjusted NPV (previous day)

Phase 2 Testing: Sept 21 – October 16

- Allows for testing of post-transition operations, with all USD swaps using SOFR-based discounting and price alignment
- All NPVs are calculated using the SOFR discounting curve
- IRS Discounting Transition Report are no longer published in New Release
- Price Alignment references the SOFR rate
- SOFR curve files remain available

SOFR Discounting and Price Alignment Transition Overview

- Summary: Single-step transition for OTC USD interest rate products from Fed Funds to SOFR discounting and price alignment
- Product Scope: All cleared OTC USD interest rate products, excluding SOFR-indexed products. (IRS, OIS, FRAs, Basis, Zero Coupon Swaps)
- Operational Process: CME conducts a standard end-of-day valuation cycle with Fed Funds discounting. Upon completion of this cycle, CME conducts transition processing to re-value all USD swap products, calculate cash adjustment amounts and book re-hedging swaps
- Cash Adjustment: To neutralize the value transfer from the discounting change, CME will process a cash adjustment that is equal and opposite to the NPV change on each USD trade
- Re-Hedging Swaps: CME's Re-hedging mechanism restores participants back to their approximate EFFR discounting exposures by booking a series of EFFR/SOFR basis swaps to participants accounts
- Auction Process: CME will facilitate an auction for participants looking for an efficient way to unwind their re-hedging swaps
- The SOFR discounting and price alignment transition is subject to regulatory approval

Testing Notes – How to Participate

- **For FCMs** – CME Clearing will be creating two test accounts on behalf of every client-clearing FCM. In these test accounts, CME Clearing will also be booking a representative set of USD transactions. Both of these test accounts will be signed up to participate in the new release auction process. One of the accounts will be set to receive basis swap hedges while the other account will be setup to receive synthetic basis swap hedges (fixed/float swaps). We believe that organizing the testing process in this way will provide several benefits:
 1. FCMs will be able to test the processing of basis swap hedges and fix-float swap hedges
 2. FCMs will be able to test the processing of re-hedging swap offsets following the auction.

An additional benefit is that FCMs can use these accounts to show clients how the process will look on their customer statements. We also foresee that doing this will reduce required communication back and forth between CME, its FCMs and clients. CME will be creating these accounts and making these elections by default, so no special input or work from the FCM is required.

The naming convention for these accounts will be as follows:

Account Type (client election)	Account Naming Convention (### = FCM firm number)
Receive Basis Swaps, Participate in Auction	SFRACTBAS###1
Receive Synthetic Basis Swaps, Participate in Auction	SFRACTSYN###1

If you wish to receive any accounts beyond the two default accounts noted above, please contact the CME Client Services Team at onboarding_clearing@cme.com and indicate your testing requirements. While we hope that the two default accounts will cover all of your testing needs, if you do need additional accounts or scenarios covered for this test, please indicate what account numbers you want to have created in CME's test environment, what your client elections are for those accounts and what, if any, affirmation platform you would like them connected to. Related to affirmation platforms, you will need to decide how you will be getting trades into these accounts, either via affirmation platform or by CME entering trades on your behalf.

- **For end clients** – we recommend that you discuss your testing needs first with your FCM. Your FCM can then work with CME to determine setup requirements. For FCMs, please consider the points outlined above in the FCM testing section – you may be able to use the generic accounts to facilitate your client testing requirements.
- **For dealer clients, service providers and all other entities** – please contact the CME Client Services Team at onboarding_clearing@cme.com to discuss your testing requirements. Please indicate what portion of the test you are interested in.
- **For MarkitWire Sync participants** – If a client would like to participate in the CME Dress Rehearsal on Sept 18, they will need to be permissioned by both MarkitWire and CME:
 - For **MW** permissioning, a client must email mk_mwire.implementation@markitserv.com and inform them that they would like to sign up for CME-MW Netting Sync in NR
 - For **CME** permissioning, a client must contact onboarding_clearing@cme.com with the below position account details:
 - Full registered legal name of the fund owner at CME
 - Authorized individual to sign the 'CME STP Production Environment Hosting ISV Authorization Form'
 - Verification Officer (if known)

Please visit CMEGroup.com through the below link for detailed workflows and educational webinars discussing this transition:

<https://www.cmegroup.com/education/articles-and-reports/estr-and-sofr-discounting-transitions-for-cleared-swaps.html>

For questions, please contact the CME Client Services Team at onboarding_clearing@cme.com or +1 312 338 7112.

Regards,

CME Clearing