CME Group | Advisory Notice

TO:	Clearing Member Firms; Back Office Managers
FROM:	CME Clearing
ADVISORY #:	20-358
DATE:	9/15/2020
SUBJECT:	OTC IRS New Release – SOFR Discounting and Price Alignment: Dress Rehearsal and Testing Phase 2

As mentioned in advisory 20-321, please be advised that CME will hold a Dress Rehearsal over the weekend of Sept 18 – Sept 21 to simulate the end-to-end processing of the SOFR Discounting Transition. This event is held in our New Release environment and meant to test operational and technical impacts.

Testing Phase 2 begins on Monday, Sept 21. During this phase CME will test our daily processing post-SOFR transition. All USD-denominated swaps will use SOFR-based discounting and price alignment rates.

Dress Rehearsal: Sept 18 – Sept 21

- **Friday, 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 the re-hedging swaps
  - 4 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.nr.csv*
      - "XXX" = Firm ID
    - Position Account-Level Discounting Delta Report: *IRSPADLT_XXX_YYYYMMDD_EOD.nr.csv*
      - "XXX" = Firm ID
    - IRS Trade Register Template for Re-hedging Swaps: *IRSTR_RISKCOMP_YYYYMMDD_EOD.nr.csv*
    - Re-hedging Swap Template Sensitivity (Delta) Report: *IRSDLT_RISKCOMP_YYYYMMDD_EOD.nr.csv*
- **Monday, Sept 21** simulates the business day following the Transition Date (Monday, Oct 19)
  - Mock auction will take place at approximately 11:00 am ET
  - Once the Auction Clearing Price is set, offsetting trades are booked to participating accounts with the allocated fee (cost to participating clients). Onset trades are booked to winning account.
  - End-of-day Variation Margin amount is calculated as SOFR Adjusted NPV (current day) minus SOFR Adjusted NPV (previous day)

Testing Phase 2: Sept 21 – October 16

- Allows for testing of post-transition operations, with all USD swaps using SOFR-based discounting and price alignment rates
- All USD swaps have NPVs calculated using SOFR discounting
- Price Alignment references SOFR
- SOFR curve files remain available in Production and New Release
- IRS Discounting Transition Report is no longer published in New Release
    - CME will publish daily indicative IRS Discounting Transition Reports to FTP sites in the Production environment. This report contains the indicative NPV changes and cash adjustments for Production accounts.

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 has created two test accounts on behalf of every client-clearing FCM. In these test accounts, CME Clearing will 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 is set to receive basis swap hedges while the other account is setup to receive synthetic basis swap hedges (fixed/float swaps). Organizing the testing process in this way will provide two key 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.

    Note CME Clearing has communicated account names to each clearing firm.

- **For end clients –** CME Clearing asks you discuss your testing needs first with your FCM. Your FCM can then work with CME to determine setup requirements.

- **For dealer clients, service providers and all other entities** – please contact the CME Client Services Team at onboarding_clearing@cmegroup.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 Sync tests on Sept 18 or 25, they will need to be permissioned by both MarkitWire and CME:
    - For **CME** permissioning, a client must contact onboarding_clearing@cmegroup.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)
    - 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
    - CME recommends contacting CME first to expedite the setup process, since MW requires CME account details before completing MW setup

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@cmegroup.com or +1 312 338 7112.

Regards,

CME Clearing