

## Conversion Plan: CME Cleared MXN TIIE Interest Rate Swaps

Based on feedback and support from the industry, this document is being put forth as CME Group's official plan to help facilitate the transition from 28D TIIE to TIIE de Fondo (F-TIIE) for MXN denominated interest rate swaps.

### Background:

In December 2022, pursuant to various recommendations issued by the Financial Stability Board and the International Organization of Securities Commissions, the Bank of Mexico issued a [press release](#) announcing that:

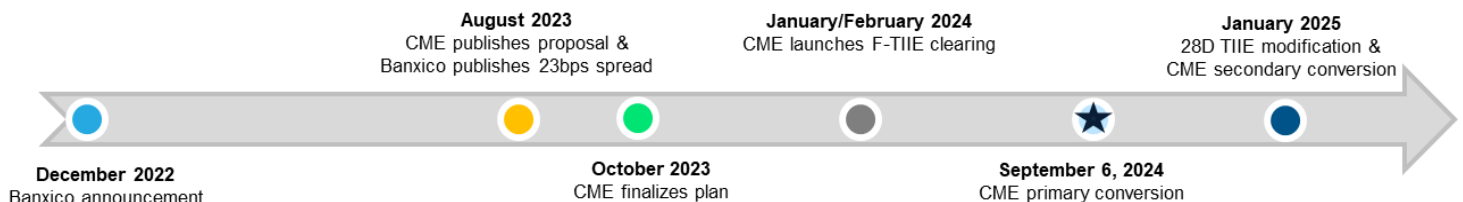
- The use of 28-day term TIIE for new agreements would be prohibited from January 1, 2025 onwards
- Following January 1, 2025, financial institutions will only be allowed to use the TIIE de Fondo (Funding TIIE / F-TIIE) as a benchmark rate
- The Bank of Mexico will modify the methodology for calculating TIIE greater than 1 banking day so that current agreements that use such reference rates will not require to be adjusted via amending agreements

Given the limitations of trading the modified 28D TIIE, CME Group is of the view that a conversion to F-TIIE for cleared swaps will be required prior to January 2025.

### Considerations:

- CME has successfully guided the industry through similar transitions, including the conversion of USD LIBOR swaps to SOFR using the ISDA fallback pricing methodology during Q2 2023
- Based on feedback received, there is a strong preference amongst the TIIE trading community to avoid bifurcating liquidity
- The transition of liquidity to F-TIIE will be taking place over a compressed timeline, with the 28D TIIE prohibited in new transactions from January 1, 2025 onwards
- The primary conversion by CME of cleared 28D TIIE interest rate swaps is intended to act as a catalyst event to move liquidity to the new F-TIIE index; the September 2024 conversion timing ensures that this shift occurs well ahead of the 28D TIIE modification date and corresponding prohibitions
- Participants prefer to keep the cleared F-TIIE product specifications closely aligned with the current 28D TIIE

### Timeline:



- CME is on track to launch F-TIIE swap clearing in November 2023 in the new release (testing) environment, and in production by January/February 2024
- This will allow participants the opportunity to conduct test trades and ensure their systems can handle the new OIS product
- Subject to regulatory review, CME will run a conversion on **September 6, 2024**, converting all legacy 28D TIIE swaps that contain fixings beyond the January 1, 2025 modification date
- Following the September 6, 2024 primary conversion event, CME will continue to clear 28D TIIE swaps through the end of 2024
- On the first good business day of 2025, January 2<sup>nd</sup>, CME will run a secondary conversion to convert any outstanding 28D TIIE swaps. This should be viewed as the beginning of daily conversion cycles to support the clearing of any 28D TIIE swaps that are the result of bilateral swaption expiries, as well as a cleanup exercise for any 28D TIIE swaps cleared between the primary conversion and the modification date

### Conversion Approach:

There are two critical items required to conduct this conversion: **1) A binding economic relationship** between the 28D TIIE and the F-TIIE rates, and **2) A primary curve** that can be used to price both the legacy 28D TIIE positions, as well as the replacement swaps. The combination of these two items allows CME to maintain NPV-neutrality, as any valuation differences between the legacy trades (priced under their corresponding post-modification methodologies) and the replacement swaps are neutralized via the inclusion of an equal and offsetting upfront payment amount.

CME intends to leverage the binding economic relationship that has been established by the Bank of Mexico to underpin the conversion pricing methodology for 28D TIIE (consistent with ISDA fallback pricing protocol for USD LIBOR swaps) and the F-TIIE curve to conduct the exercise. This will be accomplished as follows:

1. For the purpose of converting cleared 28D TIIE swaps, the Bank of Mexico has calculated a fixed fallback spread of 23bps corresponding to the ISDA fallback pricing protocol ([see slide 16](#))
2. CME will utilize a similar methodology that was implemented during other recent industry conversions (i.e. USD LIBOR), taking the 23bps spread into account

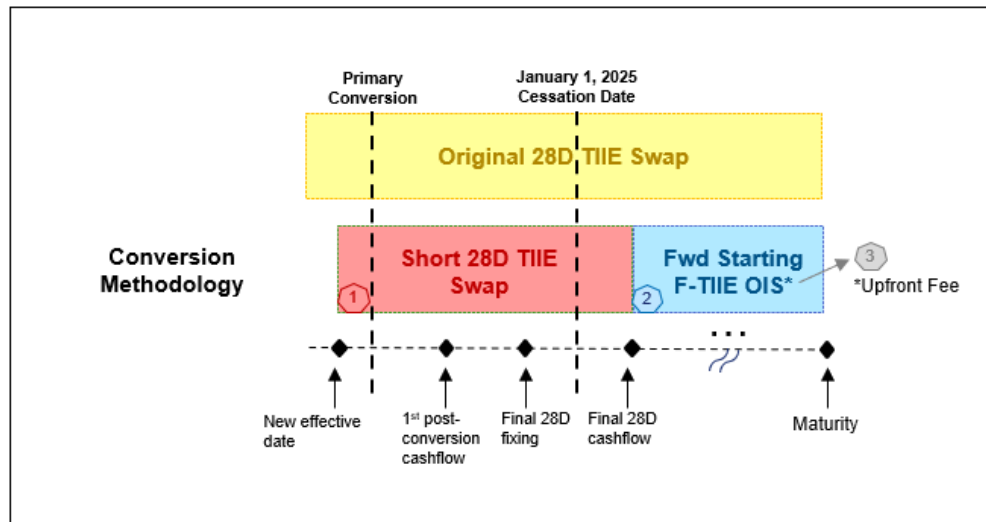
This approach will offer the following benefits:

- Consistent with new F-TIIE trade calculations, making it possible to hedge legacy cleared 28D TIIE swap positions with the new index
- Industry is familiar with the ISDA fallback pricing mechanism, which will help accelerate timelines for adoption and readiness
- As CME will be utilizing the same F-TIIE curve for closing out legacy trades (using fallback pricing) and establishing the replacement trades and corresponding cash compensation, exposure to any potential kinks in the curve will be mitigated during the conversion process

**Note, for the avoidance of doubt, the above approach is distinct from the Bank of Mexico's modification methodology that will be applied to 28D TIIE instruments held outside of clearing (see [Annex 11](#) for the modified 28D TIIE calculation).**

Given the Bank of Mexico's trading restrictions on the modified 28D TIIE index beginning in January 2025, CME Clearing does not have the ability to support the modification. Upon consulting with the industry, CME is of the view that leveraging the ISDA fallback methodology for converting cleared swaps is the most optimal approach and ensures that liquidity will not be bifurcated amongst multiple indices.

### Conversion Methodology:



As outlined in the above visual, CME will leverage the following conversion methodology, whereby any legacy cleared 28D TIIE swaps that have fixings beyond January 2025 will be terminated and replaced with the following:

1. A short-dated 28D TIIE replacement swap that is designed to capture any 28D TIIE fixings scheduled to occur prior to the January 2025 modification (legacy swap economics will carry over)
2. A forward starting F-TIIE replacement overnight index swap (OIS) that will maintain the legacy swap's fixed rate, replace the 28D floating rate with daily compounding F-TIIE plus the 23bps fallback spread, and will apply a 2D payment offset to both the fixed and floating legs. This swap will become effective once the short-dated 28D TIIE replacement swap expires, and its maturity will match the original legacy swap
3. A cash adjustment in the form of an upfront fee will be included on the forward starting F-TIIE replacement OIS to account for any differences between the legacy 28D TIIE swap (valued under the ISDA fallback pricing protocol) and the corresponding replacement swaps booked by CME

### Next Steps:

- CME Group will publish detailed operational resources and documentation over the course of October and November 2023, which will provide additional information on the following items:
  - Fallback pricing protocol
  - Conversion methodology and examples
  - Operational timelines (i.e. dress rehearsal schedule and processing times)
  - Reporting

### Contact Information:

Please contact us at [ClearedSwapConversion@cmegroup.com](mailto:ClearedSwapConversion@cmegroup.com) if you would like to raise any questions or arrange a call with our team to discuss this plan in greater detail.

The contents of this document provide an overview of CME Group's plan to facilitate the transition from 28D TIIE to TIIE de Fondo (F-TIIE) in the cleared MXN interest rate swap market. The plan is subject to change at any time without prior notice. Any implementation of this plan and the points discussed in this document are subject to regulatory review and to any necessary internal and external approvals.