

SUBMISSION COVER SHEET

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Registered Entity Identifier Code (optional): 20-240

Organization: Chicago Mercantile Exchange Inc. ("CME")

Filing as a: DCM SEF DCO SDR

Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): 05/22/20 Filing Description: Modifications to Euro-Denominated Interest Rate Swap Products to Support Transition to ESTR Price Alignment and Discounting

SPECIFY FILING TYPE

Please note only ONE choice allowed per Submission.

Organization Rules and Rule Amendments

- | | | |
|-------------------------------------|-------------------------------------|------------|
| <input type="checkbox"/> | Certification | § 40.6(a) |
| <input checked="" type="checkbox"/> | Approval | § 40.5(a) |
| <input type="checkbox"/> | Notification | § 40.6(d) |
| <input type="checkbox"/> | Advance Notice of SIDCO Rule Change | § 40.10(a) |
| <input type="checkbox"/> | SIDCO Emergency Rule Change | § 40.10(h) |

Rule Numbers: See filing.

New Product

Please note only ONE product per Submission.

- | | | |
|--------------------------|---------------------------------------|------------|
| <input type="checkbox"/> | Certification | § 40.2(a) |
| <input type="checkbox"/> | Certification Security Futures | § 41.23(a) |
| <input type="checkbox"/> | Certification Swap Class | § 40.2(d) |
| <input type="checkbox"/> | Approval | § 40.3(a) |
| <input type="checkbox"/> | Approval Security Futures | § 41.23(b) |
| <input type="checkbox"/> | Novel Derivative Product Notification | § 40.12(a) |
| <input type="checkbox"/> | Swap Submission | § 39.5 |

Product Terms and Conditions (product related Rules and Rule Amendments)

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|-------------------------------------|---|----------------------|
| <input type="checkbox"/> | Certification | § 40.6(a) |
| <input type="checkbox"/> | Certification Made Available to Trade Determination | § 40.6(a) |
| <input type="checkbox"/> | Certification Security Futures | § 41.24(a) |
| <input type="checkbox"/> | Delisting (No Open Interest) | § 40.6(a) |
| <input checked="" type="checkbox"/> | Approval | § 40.5(a) |
| <input type="checkbox"/> | Approval Made Available to Trade Determination | § 40.5(a) |
| <input type="checkbox"/> | Approval Security Futures | § 41.24(c) |
| <input type="checkbox"/> | Approval Amendments to enumerated agricultural products | § 40.4(a), § 40.5(a) |
| <input type="checkbox"/> | "Non-Material Agricultural Rule Change" | § 40.4(b)(5) |
| <input type="checkbox"/> | Notification | § 40.6(d) |

Official Name(s) of Product(s) Affected: See filing.

Rule Numbers: See filing.

May 22, 2020

VIA ELECTRONIC PORTAL

Mr. Christopher J. Kirkpatrick
Office of the Secretariat
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, N.W.
Washington, D.C. 20581

**Re: Regulation 40.5(a) Submission of Rules for Commission Review and Approval –
Modifications to Discounting and Price Alignment for Euro-Denominated Interest Rate
Swap Products to Support and Facilitate Cash and Derivative Market Transition to the
Euro Short-Term Rate (“€STR”) and Procedures to Facilitate Transition.
CME Submission No. 20-240**

Dear Mr. Kirkpatrick:

Chicago Mercantile Exchange Inc. (“CME”), a registered derivatives clearing organization (“DCO”) under the Commodity Exchange Act, as amended (“CEA” or “Act”) hereby requests approval by the Commodity Futures Trading Commission (“CFTC”) of a new rule applicable to Euro (“EUR”) Interest Rate Swap products cleared by CME intended to support and facilitate the cash and derivatives market transition to €STR by facilitating a transition to €STR price alignment and discounting for those products.

CME is a systemically important derivatives clearing organization (“SIDCO”)¹ and its clearing division (the “Clearing House”) offers clearing for all products traded on CME, The Board of Trade of the City of Chicago, Inc., New York Mercantile Exchange, Inc., and Commodity Exchange, Inc. as well as other cleared products, and provides clearing services to third parties.

Background

In September 2018 the European Central Bank (“ECB”) convened a private sector working group on Euro risk free rates (the “ECB Working Group”),² which determined that €STR should replace the European Money Markets Institute (“EMMI”) Euro overnight index average (“EONIA”) as the new EUR risk free rate for all cash and derivative market products and contracts. €STR is calculated by the ECB and is based on the money market statistical reporting of the Eurosystem. Publication of €STR by the ECB began on October 2, 2019 under a reformed methodology for the calculation of EONIA, where EONIA is calculated as €STR plus a fixed spread of 8.5 basis points. €STR provides a broad measure of the cost of borrowing unsecured EUR cash on an overnight basis in wholesale markets based on a large number of banks contributing data and a significant transaction volume.³

¹ On July 18, 2012, CME Inc. was designated as a systemically important financial market utility under Title VIII of the Dodd-Frank Act.

² The ECB Working Group was also convened by the Financial Services and Markets Authority (“FSMA”), the European Securities and Markets Authority (“ESMA”) and the European Commission.

³ Further details on the administration of €STR are available on the ECB website at www.ecb.europa.eu.

The ECB Working Group has recommended that publication of EONIA be discontinued on January 3, 2022, which would necessitate a transition from EONIA to €STR for some products.⁴ In August 2019 the ECB Working Group published a report analyzing the impact of the required transition from EONIA to €STR for EUR cash and derivatives products, which included a recommendation that cleared derivatives contracts transition from discounting methodology utilizing EONIA to €STR as early as possible, and preferably towards the end of the second quarter of 2020.⁵ Such a transition would require clearing houses to utilize €STR as a replacement for EONIA for the purposes of calculation of price alignment (the adjustment used to reflect the overnight cost of funding collateral for a bilateral over the counter (“OTC”) swap contract to mitigate the basis risk between cleared and uncleared swaps) and for the applicable discounting rate (used for the discount curve to calculate swap value) (together, “PA/discounting”). The ECB Working Group anticipates that updating the PA/discounting environment for cleared swaps from EONIA to €STR will help promote liquidity in €STR cash and derivative contracts and prepare the market for discontinuation of EONIA in January 2022.

Summary of Proposed Transition Process

CME’s OTC EUR interest rate swap products currently utilize EONIA for PA/discounting. As a result, in order to support the derivative market transition from EONIA to €STR, and consistent with the scope and timing of the wider cash and derivative market industry initiative to switch to €STR discounting in line with the recommendations of the ECB Working Group, CME proposes to update the PA/discounting protocol for CME cleared EUR interest rate swap products from EONIA to €STR, to take effect at close of business on the target date of July 24, 2020 (the “Transition”).

In accordance with the recommendation of the ECB Working Group and with broader industry initiatives, the Transition shall (i) apply to new swap contracts entered into from the effective date of the Transition and also to existing cleared “legacy” swap contracts outstanding at that date and (ii) provide for compensation “to counter adverse price effects on derivatives subject to the transition.” As part of the “single day” approach to the Transition and to mitigate the economic effects of the change in PA/discounting protocol, “legacy” swap contracts will be subject to a mandatory cash adjustment process on the date of the Transition. As part of that process, CME will implement an offsetting cash adjustment mechanism under which a cash amount equal and opposite to the change in net present value of each cleared trade affected by the change to €STR discounting will be applied to the relevant position holder account to ensure that net cash flows for position holders impacted by the change to €STR discounting are zero on the date of the Transition.

Further details on the proposed Transition process are provided below.

Overview of Engagement with Market Participants and Industry Groups

As noted above, the transition to €STR PA/discounting is a key part of the ECB Working Group recommendations to facilitate the wider transition from the use of EONIA to the use of €STR in cash and derivatives markets. The transition and the development of markets for €STR-linked products is supported by regulatory authorities and market participants.

⁴ See EMMI announcement: <https://www.emmi-benchmarks.eu/euribor-eonia-org/about-eonia.html>

⁵ See ECB Working Group Report “On the impact of the transition from EONIA to the €STR on cash and derivative products” (August 19, 2019): <https://www.ecb.europa.eu/press/pr/date/2019/html/ecb.pr190819~9dbe3c0ce6.en.html>. The report goes on to note that the switch to €STR PA/discounting would mean that cleared derivatives will become subject to a new discounting regime and that “compensation schemes should be devised to counter adverse price effects on derivatives subject to the transition.”

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€STR is derived from an active, well defined and deeply liquid market and is produced in a transparent manner based on observable transactions. On this basis, CME has determined that €STR is an appropriate rate to be applied for the purposes of PA/discounting for EUR interest rate swaps and that CME should support and facilitate the industry transition to €STR for PA/discounting proposed by the ECB Working Group, through the change set out in this filing.

CME has consulted with a diverse cross-section of market participants to obtain feedback on the proposals for the Transition. A summary of CME's Transition plan was provided to market participants and made publicly available on January 31, 2020.⁶ The ECB Working Group, and feedback from market participants, have encouraged CME to align its approach with the wider industry initiative to transition to €STR PA/discounting for EUR interest rate swaps, in terms of scope and timing.⁷ CME will utilize €STR for PA/discounting on a "flat" basis, *i.e.*, without any spread, in accordance with the ECB Working Group's recommendations. CME believes that its proposed single day orderly transition to €STR PA/discounting for cleared EUR interest rate swaps can be achieved in a manner coordinated with the accepted industry timeline for transition. In addition, CME's methodology and approach will mitigate the cash flow impact of the discounting transition valuation change for market participants. When combined with the coordinated industry approach, CME's Transition approach is designed to minimize the risk of market disruption and avoid any undue and material impact on the competitive interests of any market participant.

The new rule will be implemented via Advisory Notice published by the Clearing House setting out the terms of the Transition and the PA/discounting environment to be applied with respect to affected contracts following the Transition, in the form set out in Exhibit 1 (the "Advisory Notice"). The Advisory Notice will be binding on all position holders and Clearing Members from the effective date of the notice.

Further details on the proposed Transition process are set out below:

Operational Overview of Proposed Transition Process

The Transition will apply to cleared trades in the following CME cleared EUR interest rate swap products, each of which currently utilizes EONIA for PA/discounting (the "Affected Contracts"):

- Fixed / Float IRS
- Zero Coupon Swaps
- Overnight Index Swaps
- Basis Swaps
- Forward Rate Agreements

Market participants that exercise uncleared swaptions contracts into CME cleared swaps that are Affected Contracts prior to the Transition will be subject to the Transition with respect to those Affected Contracts. Any Affected Contract accepted for clearing by CME after the Transition will be subject to €STR PA/discounting from acceptance by the Clearing House and will not be subject to the cash adjustment process.

We recognize that the Transition for Affected Contracts may create ambiguities with respect to the exercise of legacy uncleared swaption contracts that expire after the date of the Transition and which anticipate EONIA PA/discounting for the resulting cleared interest rate swap once the swaptions contracts are

⁶ <https://www.cmegroup.com/education/articles-and-reports/euro-str-discounting-price-alignment-plan.html>

⁷ The ECB Working Group Report "On the impact of the transition from EONIA to the €STR on cash and derivative products" (August 19, 2019) recommends that for cleared trades, CCPs should align their discounting switch dates "as much as possible to transition from an EONIA discounting regime to a €STR discounting regime, which would represent a "big bang" for cleared markets."

exercised. While this remains an issue for market participants and cannot be resolved directly by central clearing counterparties ("CCPs"), which are not counterparties to the uncleared swaptions, we encourage the industry to resolve these ambiguities by agreeing to a set of industry protocols and practices to address the issue.⁸

Change of PA/discounting environment from EONIA to €STR

The change in PA/discounting to €STR will result in a change in valuation for positions in Affected Contracts, resulting in valuation gains or losses in each case depending on the position. As part of the Transition, CME will implement certain processes that it has designed to mitigate the effects of the PA/discounting change. These processes are summarized below:

Positions in Affected Contracts held open at close of business ("COB") on July 24, 2020 (the "Transition Date") will be included in the following Transition operational process to update the EONIA PA/discounting environment to €STR PA/discounting:

- At COB on the Transition Date, the Clearing House will conduct a standard valuation calculation during the end of day clearing cycle, to determine the net present value ("NPV") for cleared trades in the Affected Contracts as calculated with EONIA-based PA/discounting. The calculation will be based on the closing curve levels on the Transition Date for each position account.
- Upon completion of this initial valuation calculation, the Clearing House will then conduct an additional calculation to determine the NPV for cleared trades in the Affected Contracts as calculated with €STR-based PA/discounting based on the closing curve levels on the Transition Date for each position account.
- The difference between the two calculations for each cleared trade (the "Transition Calculation") represents the change in NPV arising from the switch from EONIA to €STR PA/discounting.
- From the completion of the end of day clearing cycle on the Transition Date, the Affected Contracts will be subject to €STR PA/discounting for the remaining lifecycle of the relevant cleared swap and settlement variation (as defined in the CME rules (the "Rulebook")) for each clearing cycle following the Transition Date will be determined accordingly.⁹ Any trade in an Affected Contract accepted for clearing by CME after the Transition Date will be subject to €STR PA/discounting once CME accepts that cleared trade for clearing.

The above operational process to change the discounting environment will likely give rise to gains/losses in positions in Affected Contracts, resulting in a value transfer between swap participants with cleared trades in Affected Contracts. This is due to the change in the NPV of each cleared swap resulting from the change in discounting approach from EONIA to €STR which shall apply to Affected Contracts on the next clearing day following the Transition Date.

Cash Adjustment

Based on feedback from market participants and alignment with wider industry initiatives, the Clearing House will apply a mandatory cash adjustment process during the next end of day clearing cycle following the Transition Date to neutralize value transfers attributable to the change in the discounting basis from

⁸ See ECB Working Group request for feedback on Swaptions impacted by transition from EONIA to €STR, 13 March 2020: <https://www.ecb.europa.eu/press/pr/date/2020/html/ecb.pr200313-52d08d7256.en.html>

⁹ Note that coupon payments on cleared swaps are unaffected as these remain determined by their original interest rate index, e.g. EURIBOR in the case of a EUR Fixed/Float IRS.

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EONIA to €STR.¹⁰ CME will implement a cash adjustment that is equal and opposite to the change in NPV of each position in each Affected Contract resulting from the change in discounting approach, determined by the Transition Calculation (“Cash Adjustment”). The Cash Adjustment will be applied to the relevant account by the Clearing House during the end of day clearing cycle following the Transition Date, as illustrated in the hypothetical examples below:

Cash Adjustment Example

Net Present Value on Transition Date			NPV Change	Offsetting Adjustment	Net Cash Flow
Trade	EONIA Discounted	€STR Discounted			
Position 1	€300,000	€311,000	€11,000	(€11,000)	€0
Position 2	(€180,000)	(€184,000)	(€4,000)	€4,000	€0
Position 3	€28,000	€29,200	€1,200	(€1,200)	€0
Position 4	(€680,000)	(€694,000)	(€14,000)	€14,000	€0
Position 5	€550,000	€562,500	€12,500	(€12,500)	€0
Total	€18,000	€24,700	(€6,700)	€6,700	€0

Using Position 1 as an example, where the holder of the position in a cleared trade receives a positive change in NPV of that position resulting from the change to €STR discounting (which represents a change in value which must be paid to the account holder from the Clearing House as central counterparty (and therefore party to the other side of the cleared trade)), the Cash Adjustment will operate to provide an equal and opposite offsetting adjustment amount which must be paid from the holder of Position 1 to the Clearing House (again, in its capacity as central counterparty acting as the other party to the cleared trade). Given that the change in NPV and the Cash Adjustment are equal and opposite, the net cash flow for each account in respect of each cleared trade is zero.

In the case of Position 2, where the holder of the position in a cleared trade receives a negative change in NPV of that position resulting from the change to €STR discounting which must be paid from the account holder to the Clearing House (as central counterparty and party to the other side of the cleared trade), the Cash Adjustment provides for an equal and opposite offsetting adjustment amount which must be paid to the holder of Position 2 from the Clearing House. Again, the net cash flow for each account in respect of each cleared trade is therefore zero.

The Cash Adjustment amount will be applied by the Clearing House to each relevant position account during the end of day clearing cycle following the Transition Date during which settlement variation for positions will be determined utilizing €STR discounting and price alignment and outstanding exposures and payments netted and settled in accordance with CME Rule 814. Given that the change in NPV calculated by the Transition Calculation is offset exactly by the Cash Adjustment amount, indicated by the figure in the “Offsetting Adjustment” column in the examples in the table above, the net cash flow in respect of the discounting change is zero on both a per account basis and an overall product basis for the Clearing House.

The Cash Adjustment process is a mandatory process that will apply only to cleared trades in Affected Contracts at the Clearing House as of COB on the Transition Date.

We acknowledge that the PA/discounting change will also change the discounting risk profile of positions in Affected Contracts (as EONIA discounting risk will be replaced by €STR discounting risk, as determined by the €STR closing curve on the date of the Transition). However, given the fixed nature of the spread between EONIA and €STR due to the methodology used for the calculation of EONIA (which is equal to €STR plus a fixed spread of 8.5 basis points), CME will not be providing any process for risk compensation to account for the change in discounting risk profile. This approach is consistent with the wider industry approach to the transition and with the needs and expectations of market participants.

¹⁰ Valuation changes will be determined by the EUR discounting risk for the portfolio and the relative levels of the EONIA and €STR forward curves at the time of the end of day clearing cycle on the Transition Date.

Implementation of Transition

No amendments to the Affected Contract terms or the Rulebook are necessary to implement the Transition. The PA/Discounting change will be implemented via Advisory Notice published by the Clearing House setting out the terms of the Transition, in the form set out in Exhibit 1. The Advisory Notice will be made available to Clearing Members, market participants and the general public via the CME website. The Advisory Notice will be binding on position holders in all Affected Contracts on and after the effective date of the Advisory Notice and €STR PA/discounting will also apply to any trade in an Affected Contract accepted for clearing by CME after the Transition Date.

The Cash Adjustment process is a mandatory process and market participants will be notified in the Advisory Notice that the Transition will apply to all positions in Affected Contracts on the Transition Date. Market participants will be reminded that while there is broad industry alignment on the timing and approach to the transition to €STR PA/discounting, market participants should consider the terms and impact of the Transition as set out in the Advisory Notice and take appropriate action prior to the Transition Date. Position holders that do not wish to participate in the Transition must close out any cleared trades in Affected Contracts prior to the Transition Date.

In addition to the information provided in the Advisory Notice, the Clearing House will update the relevant information on the applicable PA/discounting rate applicable to Affected Contracts in each case in:

- the end of day operational report (PAA Report and Trade Register report) made available by the Clearing House only to IRS clearing members via an sFTP site; and
- the CME OTC IRS Bookkeeping document, made available to IRS Clearing Members and their customers on request.

On the Transition Date the Clearing House will provide firms receiving the Clearing House IRS Trade Register reports with an additional one-time report on a per account basis providing confirmation of the Cash Adjustment and NPV changes for cleared trades in Affected Contracts that will be implemented by the Clearing House at the next clearing cycle following the Transition Date. Details of the IRS €STR curve utilized for the purposes of discounting for the Affected Contracts will also be made available by the Clearing House on the CME website.

Governance, Industry Consultation, Comments/Opposing Views:

We recognize that the Transition will have an impact on market participants holding open positions in Affected Contracts. CME has engaged in discussions with Clearing Members and market participants with respect to the CME proposals and wider industry initiatives to move to €STR PA/discounting. The Transition process and the text of the Advisory Notice is a product of the feedback provided by market participants during these consultation processes.

The approach to the Transition set out in the Advisory Notice and the timeframe for implementation of the Transition reflects an industry-wide initiative to transition OTC EUR interest rate swaps from EONIA to €STR discounting, in line with the recommended timeline of the ECB Working Group, which is widely supported by market participants as promoting the transition from EONIA to €STR. Market participants have stressed the importance of industry alignment to implement the transition of cleared OTC EUR interest rate products from EONIA to the €STR PA/discounting environment. CME's timeline for the Transition is designed to align with these broader industry initiatives.

The Transition has been designed to provide a simple and efficient mechanism to effect the transition to €STR PA/discounting for EUR interest rate swaps with minimal operational complexity for market participants. Based on the feedback from market participants and wider industry initiatives, the Transition

provides for a Cash Adjustment to neutralize the one-time valuation change arising from the switch to the €STR discounting curve. However, the Transition does not include a mechanism to account for changes to the original risk profile of position holders caused by the transition to €STR PA/discounting. Market participants have deemed such a mechanism unnecessary due to the fixed nature of the spread between €STR and EONIA and therefore CME has adopted an approach consistent with these practices.

During the consultation process, there were no substantive opposing views raised by market participants with respect to the proposals for the Transition as set out in the text of the Advisory Notice.

CME is not aware of any other substantive opposing views with respect to the Transition or the text of the Advisory Notice.

Analysis of the Transition and Advisory Notice under DCO Core Principles

CME reviewed the derivatives clearing organization core principles (“Core Principles”) as set forth in the CEA. During the review, CME identified the following Core Principles as potentially being impacted:

Core Principle D – Risk Management: Following extensive market consultation, the implementation and timetable of the Transition via the Advisory Notice by CME has been designed to align with broader industry initiatives to move from EONIA to €STR PA/discounting for OTC EUR interest rate swap products. Market participants have welcomed the planned industry alignment on timing of implementation because it will serve to minimize uncertainty and potential market disruption. The mandatory Cash Adjustment process to the relevant position accounts of participants with positions in Affected Contracts at COB on the Transition Date is designed to address the valuation changes arising from the change in discounting environment. Given the fixed nature of the spread between EONIA and €STR due to the methodology used for the calculation of EONIA (which is equal to €STR plus a fixed spread of 8.5 basis points), CME will not be providing any process for risk compensation to account for the change in discounting risk profile. This approach is consistent with the needs and expectations of market participants.

Core Principle L – Public Information: The implementation of the Transition via the Advisory Notice and the operational elements of the Transition will change the discounting environment of the Affected Contracts from EONIA to €STR. CME has taken appropriate steps to provide market participants with sufficient information to enable those market participants to identify and evaluate effectively the risk associated with holding positions in the Affected Contracts at the time of Transition and thereafter. The operational workflows and legal basis for the Transition have been made publicly available.

Core Principle N – Antitrust Considerations: The Transition will not result in any unreasonable restraint of trade or impose any material anticompetitive burden. The Transition reflects implementation of an industry-wide initiative to transition OTC EUR interest rate swaps from EONIA to €STR discounting, in line with the recommendations of the ECB Working Group, which are widely supported by market participants and regulatory authorities as promoting the further market adoption of €STR as the successor to EONIA as the EUR risk-free rate. CME has engaged with market participants to obtain feedback on the proposals for the Transition and has not received any comments regarding antitrust/fair competition concerns.

The text of the Advisory Notice is provided in Exhibit 1.

The Advisory Notice is intended to be effective as of the date of publication, which shall be prior to the Transition Date.

Pursuant to Section 5c(c) of the CEA and CFTC Regulation 40.5(a), CME certifies that the new rule in the form of the Advisory Notice complies with the CEA and the regulations thereunder.

CME certifies that this submission has been concurrently posted on CME Group's website at <http://www.cmegroup.com/market-regulation/rule-filings.html>.

Should you have any questions concerning the above, please contact the undersigned at (212) 299-2200 or via e-mail at CMEGSubmissionInquiry@cmegroup.com.

Sincerely,

/s/ Christopher Bowen
Managing Director & Chief Regulatory Counsel

Attachment: Exhibit 1 – Form of CME Advisory Notice

Exhibit 1 Form of Advisory Notice



TO: Clearing Member Firms
Back Office Managers

DATE: May 22, 2020

FROM: CME Clearing

NOTICE #: 20-210

SUBJECT: **Transition to €STR Price Alignment and Discounting for Euro OTC IRS**

Background

In September 2018 the European Central Bank (“ECB”) convened a private sector working group on Euro (“EUR”) risk free rates (the “ECB Working Group”), which determined that the Euro Short-Term Rate (“€STR”) should replace the European Money Markets Institute (“EMMI”) Euro overnight index average (“EONIA”) as the new Euro risk free rate for all products and contracts in cash and derivatives markets. €STR is calculated by the ECB and is based on the money market statistical reporting of the Eurosystem. €STR provides a broad measure of the cost of borrowing unsecured EUR cash on an overnight basis in wholesale markets based on a large number of banks contributing data and based on a high transaction volume.¹

In August 2019 the ECB Working Group recommended that EUR cleared derivatives contracts should transition from utilizing EONIA to utilizing €STR for the purposes of calculating price alignment (the adjustment used to reflect the overnight cost of funding collateral for a bilateral swap contract to mitigate the basis risk between cleared and uncleared swaps) and for the applicable discounting rate (used for the discount curve to calculate swap value) (together, “PA/discounting”). The ECB Working Group noted that this transition should occur as early as possible, and preferably towards the end of the second quarter of 2020. The ECB Working Group anticipates that updating the PA/discounting environment for cleared swaps from EONIA to €STR will help promote liquidity in €STR cash and derivative contracts.

In order to support the market transition from EONIA to €STR, and consistent with the wider industry initiative to switch to €STR discounting in line with the recommendations of the ECB Working Group, Chicago Mercantile Exchange Inc. (“CME” or “CME Clearing”), pending CFTC approval, proposes to update the PA/discounting protocol for CME cleared EUR interest rate swap products from EONIA to €STR² (the “Transition”). In accordance with the recommendation of the ECB Working Group and with broader industry initiatives, the Transition will follow a “single day” approach and will take effect on July 24, 2020 (the “Transition Date”), from which date all existing and new positions in such products will be subject to €STR PA/discounting.

¹ Further details on the administration of €STR are available on the ECB website at www.ecb.europa.eu.

² CME’s cleared OTC EUR interest rate swap products currently utilize EONIA for PA/discounting.

CME has consulted with a diverse cross-section of market participants to obtain feedback on the proposals for the Transition. A summary of CME's Transition plan was provided to market participants and made publicly available on January 31, 2020 on the CME website.³ Feedback from market participants has encouraged CME to align its approach with the wider industry initiative to transition to €STR PA/discounting for EUR interest rate swaps, both in terms of scope and timing. CME believes that its methodology and timing for the Transition of CME cleared EUR interest rate swaps is consistent and coordinated to an appropriate extent with the wider industry approach, such that a single day orderly transition to €STR PA/discounting for cleared EUR interest rate swaps by CME can be achieved while mitigating any ensuing valuation changes for market participants, thereby minimizing the risk of market disruption.

Based on feedback from market participants, the Transition includes a mechanism designed to mitigate valuation changes for market participants arising from the change in discounting environment. The Transition seeks to accomplish this by way of a cash adjustment process designed to neutralize value transfers attributable to the change in the discounting basis from EONIA to €STR,⁴ further details of which are set out in this Advisory Notice.

This Advisory Notice sets out the binding rules and operational processes under which CME Clearing will implement the transition of the price alignment and discounting protocols from EONIA to €STR with respect to open cleared trades in affected CME cleared products at the Transition Date, and for the calculation of price alignment and discounting in relation to such products following the Transition.

Terms used but not defined in this Advisory Notice shall have the meaning set out in the rules of CME (the "Rulebook").

CME cleared contracts subject to this Advisory Notice

The Transition will apply to the following CME cleared EUR interest rate swap products (the "Affected Contracts"):

- Fixed / Float IRS
- Zero Coupon Swaps
- Overnight Index Swaps
- Basis Swaps
- Forward Rate Agreements

Uncleared swaptions contracts that exercise into CME cleared swaps in Affected Contracts prior to the Transition will be subject to the Transition with respect to those Affected Contracts. Any Affected Contract accepted for clearing by CME after the Transition will be subject to €STR PA/discounting from acceptance by the Clearing House and will not be subject to the cash adjustment process.⁵

Terms and Operation of Transition Process

³ <https://www.cmegroup.com/education/articles-and-reports/euro-str-discounting-price-alignment-plan.html>

⁴ Valuation changes will be determined by the EUR discounting risk for the portfolio and the relative levels of the EONIA and €STR forward curves on the Transition Date.

⁵ We recognize that the Transition for Affected Contracts may create ambiguities with respect to the exercise of legacy uncleared swaption contracts that expire after the date of the Transition and which anticipate EONIA PA/discounting for the resulting cleared interest rate swap on exercise. While this remains an issue for market participants and cannot be resolved directly by CCPs (which are not counterparties to the uncleared swaptions), we encourage the industry to resolve these ambiguities by agreeing to a set of industry protocols and practices to address the issue.

1. From close of business (“COB”) on the Transition Date, CME Clearing will subject each open cleared trade in an Affected Contract to the following Transition process to update the EONIA PA/discounting protocol of such contract to €STR PA/discounting:
 - (a) CME Clearing will calculate the net present value (“NPV”) utilizing EONIA (at closing curve levels on the Transition Date) for valuation and calculation of discounting and price alignment amount for each cleared trade in an Affected Contract. CME Clearing will then conduct an additional calculation to calculate the NPV utilizing €STR (at closing curve levels on the Transition Date) for valuation and calculation of discounting and price alignment amount for each cleared trade in an Affected Contract (the “Transition Calculation”).
 - (b) CME Clearing will determine settlement variation for each cleared trade in an Affected Contract on the Transition Date utilizing EONIA (at closing curve levels on the Transition Date) for valuation and calculation of discounting and price alignment amount for the end of day clearing cycle on the Transition Date.
2. At the next end of day clearing cycle following the Transition Date, for each cleared trade in an Affected Contract, CME Clearing will:
 - (a) determine settlement variation utilizing €STR for valuation and calculation of discounting and price alignment amount; and
 - (b) apply to each position in a cleared trade in an Affected Contract an offsetting cash adjustment that is equal and opposite to the change in such position’s NPV resulting from the change from EONIA to €STR discounting, as determined by CME Clearing during the Transition Calculation (“Cash Adjustment”);
 - (c) settle outstanding exposures and payments from the end of day clearing cycle (including for the avoidance of doubt, settlement variation and the Cash Adjustment) in accordance with CME Rule 814. The relevant Cash Adjustment will offset the change in NPV for each position arising from the discounting change such that the net cash flow in respect of the discounting change will be zero for each cleared trade in an Affected Contract per account.
3. Following the Transition Date, CME Clearing will apply €STR PA/discounting to cleared trades in all Affected Contracts. The Cash Adjustment process will apply only to open cleared trades in Affected Contracts at COB on the Transition Date. Any trade in an Affected Contract accepted for clearing by CME after the Transition Date will be subject to €STR PA/discounting.
4. Coupon payments on Affected Contracts are not affected by the Transition and will remain linked to the relevant original interest rate index, e.g. EURIBOR in the case of a EUR Fixed/Float IRS.
5. The terms of this Advisory Notice and the Transition process are binding on Clearing Members and position holders in all Affected Contracts as at and following the effective date of the proposal pending CFTC approval. To the extent that there is any conflict between the Rulebook and the terms of this Advisory Notice with respect to the Transition process, this Advisory Notice shall prevail.

The Cash Adjustment process is a mandatory process. The Transition and the Cash Adjustment will therefore apply to all positions in cleared trades in Affected Contracts on the Transition Date. Market participants should consider the terms and impact of the Transition as set out in this Advisory Notice and take appropriate action prior to the Transition Date. Position holders that do not wish to participate in the Transition must close out any positions in Affected Contracts prior to the Transition Date.

Operational information

CME Clearing will update the relevant information on the applicable PA/discounting rate applicable to Affected Contracts in each case in:

- the end of day operational report (PAA Report and Trade Register report) made available by CME Clearing only to IRS clearing members via an sFTP site; and
- the CME OTC IRS Bookkeeping document, made available to IRS Clearing Members and their customers on request.

Inquiries regarding the aforementioned may be directed to:

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