Market Practice
Cleared Derivatives IM to Third Party Contract Notifications

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Document History

Version #	Change Date	Description of Change	Page	Author
1.0	06/22/2012	Draft version	NA	D. Luhar
1.1	12/5/2012	Final version. Market practice updated per ISITC member feedback.	NA	D. Luhar
1.2	12/12/2012	Updated Cover page, Document history, and language on page 7 for final publication.	1,2,7	E. Choinski
1.3	05/17/2014	Updated to modify the counterparty definition and contract id definition.		D. Luhar
1.4	07/29/2014	Removed section 3.1.4 Messaging Structure as it is redundant; already defined in the Swaps Data Elements spreadsheet and Sequencing Examples spreadsheet.	11	D. Luhar
1.5	10/22/2014	Made formatting changes 1. Font on Title Heading to Arial 2. Indenting of bullets 3. Indenting of headings. 4. Display logo consistently on the right side of the header section.		D. Luhar
1.6	11/13/2014	Updated link on Page 6 and moved title on left side starting on Page 4.		D.Luhar
1.7	11/4/2015	Updated Activity Diagram	5	B Manning
1.8	6/10/2016	Added language to clarify swaptions deal ID	12	B Manning
1.9	5/24/2017	Updated external links due to website update	7, 11	B Manning

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1.0 Background

This document presents the Market Practice recommended by the ISITC Derivatives Working Group related to contract notifications sent from Investment Managers to Third Party Providers including Custodians, Accounting Agents and Prime Brokers for Cleared Derivatives. Contract notifications from Investment Managers enable provision of services such as settlement, accounting, valuation and reconciliation. Automation of these notifications has become a high priority due to the mandate from CFTC to process OTC derivative trades by clearing house.

1.1 Scope
The notifications in scope in this document relate only to post-allocated trade events in the lifecycle of Cleared OTC contracts. Events such as resets, periodic payments, expirations, exercises, and credit events are excluded. Affirmation and confirmation events are also excluded.

1.2 Definitions
The contract lifecycle events covered in this document are listed below with brief descriptions and equivalent names commonly used in the industry:
- Initiation – The contract creation event. Also called Open.
- Amendment –The bilaterally agreed revision of one or more terms of a contract that involves more than a change in notional and has an economic effect. The events that are revised can be contract create, partial termination, contract create cancels, and contract termination cancels. An amendment is indicated by referencing the same conversation id, but incrementing the version.
- Termination – The full or partial end of the contract. The partial termination is, in effect, a decrease of the notional. A full termination is also known as Close or Unwind, and a partial termination is also known as a Decrease.
- Cancel Initiation – The cancel of a contract create event. This will cancel the open transaction.
- Cancel Termination – The cancel of a full or partial termination of the contract.

1.3 Actors and Roles
The roles and actors in the contract notification process are listed below. The roles played by the various actors in the processes downstream from the notifications are not listed because they beyond the scope of this document.

OTC Contract Notification Sender	OTC Contract Notification Receiver
Investment Manager	Custodian Bank
Portfolio Manager	Fund Accountant
Middle Office Provider	Interested Party/Vendor
Hedge Fund	Prime Broker

1.4   Activity Diagram

An Activity Diagram of the OTC Cleared Derivatives contract notifications process is included in this version of the document the diagram in section 1.4 shows all the activities that are in scope for cleared derivatives processing.
Trade Date
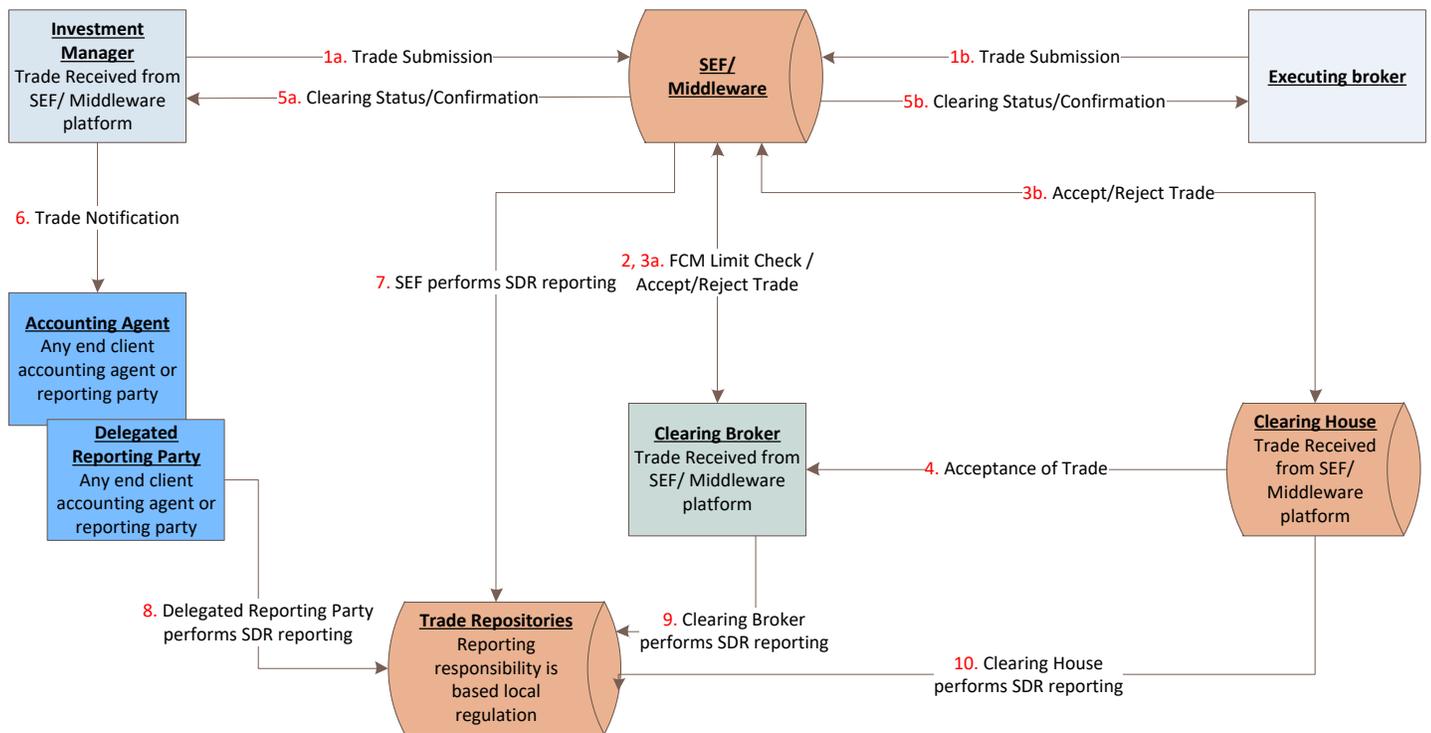
1a, 1b – Investment Manager and Executing Broker execute trade on SEF or submit trade to Middleware for Clearing.

2 – SEF/Middleware submits trade to Clearing Broker to check against Clear Broker limits with the Investment Manager

3a, 3b – Clearing Broker and Clearing House send notification to SEF/Middleware of trade acceptance

4 – Clearing House notifies Clearing Broker of trade acceptance

5a, 5b – SEF/Middleware notifies Investment Manager and Executing Broker of Cleared Trade

6 – Investment Manager sends trade notification to Accounting Agent/Delegated Reporting Party

7/8/9/10 (optional) – SEF, Delegated Reporting Party, Clearing Broker and Clearing House perform SDR reporting to Trade Repository

Trade Date + 1
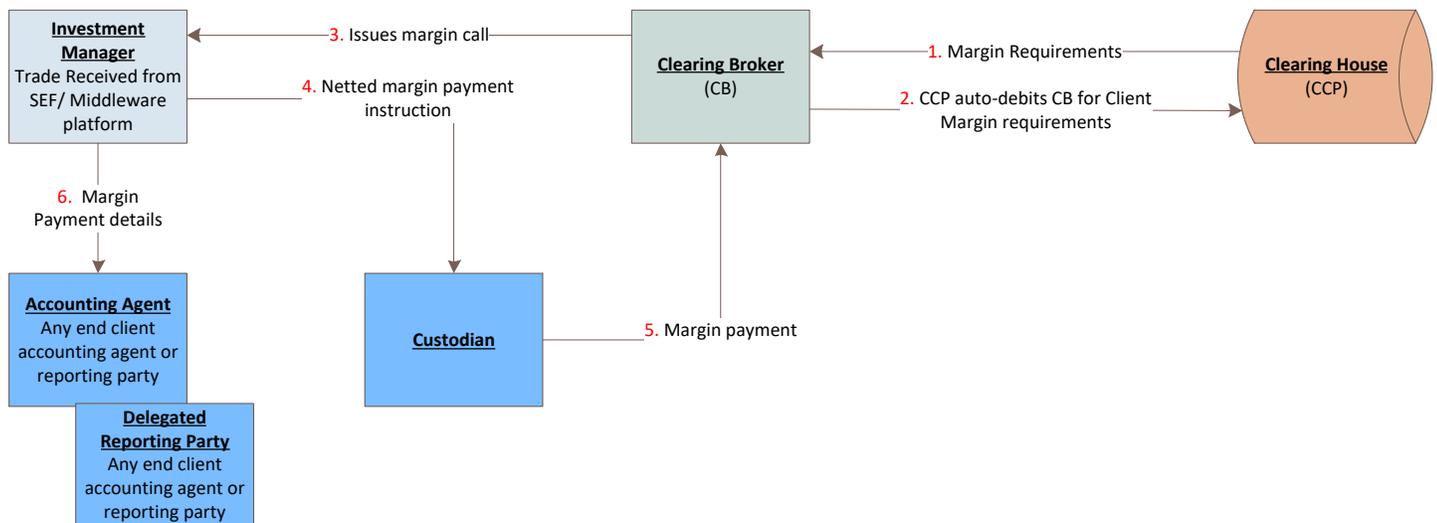
1 – CCP calculates IM and VM requirements and communicates requirements to the Clearing Broker.

2 – CCP will auto-debit the Clearing Broker account for margin

3 – Clearing Broker issues margin calls (IM & VM) to the Investment Manager

4 – Investment Manager instructs Custodian to meet margin calls

5 – Custodian sends payment/collateral to Clearing Broker

6 – Investment Manager send notification to Accounting Agent/Delegated Reporting Party with margin movement details

2.0   Business Definition

2.1   Business Data Requirements

ISITC and the Asset Managers Forum[1] (AMF) have collaborated to draft a <u>Swap Data Elements</u> spreadsheet listing the recommended IRS, CDS data elements for Notification, Accounting, and Reconciliation processes. This document has been enhanced to include the new data elements that are required for Central Clearing as agreed to by ISITC members in the FpML Messaging Business Case version 1.11. The latest version is available on the ISITC website.

In the Swap Data Elements spreadsheet, the Notification column indicates whether the elements are **M**(andatory), **O**(ptional), or **C**(onditional) in Initiation, Amendment and Termination events. If the attribute is **C**(onditional), the condition will be explained in the Condition column. In addition, there are examples of Notification messages within the Swap Data Elements spreadsheet to assist in determining what a message may look like.

Click on the document link below for the Swap Data Elements spreadsheet.

Swap Data Elements

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[1] For more information on the AMF go to http://www.theassetmanager.com/

2.2 Market Practice Recommendations

1. **Status of Contracts -** Notifications shall be sent for cleared trades.

2. **Timing of Contract Notifications -** Contract notifications should be sent real time and, at the latest, by end of trade date.

3. **Contract Notification Medium -** Contract notifications should be sent electronically. The recommended syntax is FpML[2]. Appendix section 3.1 (FpML 4.2, 4.4, and 4.6) contains additional recommendations when FpML is used. If another syntax or message type is used, it should include the elements recommended in the Swap Data Elements document.

4. **Contract Notifications <u>do not</u> include Cash Settlement Instructions -** Contract notifications may include cash payment information. These are not to be interpreted as cash settlement instructions. Instead, we recommend using the ISO20022 Customer Credit Transfer Initiation (pain 001.001.03) to instruct payments, and the Notice to Receive (camt 057.001.01) to advise on expected cash receipts. For additional information on cash settlement instruction formats and recommendations, please refer to the Payments MP – Derivatives Appendix produced by the ISITC Payments Working Group.

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[2] Financial products Markup Language (FpML) is the industry standard for swaps, derivatives and structured products. The open source standard, freely licensed, is owned by the International Swaps and Derivatives Association (ISDA)

3.0   Appendix

The recommended electronic message syntax is FpML, the industry standard. This appendix details the usage of FpML to support the business requirements stated in previous sections.

3.1   FpML 4.x

3.1.1 Message Sequence Diagram

The messages shown in the following section flow from Investment Manager to Custodian / Accounting Agent / Clearing Broker as illustrated in the diagram of section 1.4. The recommended message sequencing rules through the life of a given swap contract are also detailed.

3.1.2 Message Usage Rules

FpML 4.2, 4.4, and 4.6 include message types designed to support the IM-to-Third Party contract notification business requirements. When they become available, FpML versions higher than 4.6 will also support the messages listed below.

The message types that in scope are:

1. **Contract create** is for notification of the original contract as well as any increase to the contract.

2. **Partial Termination** is for notification of a partial termination and full termination. The partial termination message explicitly states the notional amount that is to be terminated.

   Available in FpML 4.2 and forward
   ContractCreated for the notification of a contract initiation.
   ContractCancelled for the cancellation of the notification of a contract initiation.
   ContractPartialTermination for the notification of a partial termination.

   Available in FpML 4.4 and forward
   ContractPartialTerminationCancelled for the cancellation of the notification of a partial termination.

   Available in FpML 4.6 and forward
   ContractCreated for the notification of a contract initiation.
   ContractCancelled for the cancellation of the notification of a contract initiation.
   ContractPartialTermination for the notification of a partial termination.
   ContractPartialTerminationCancelled for the cancellation of the notification of a partial termination.

3.1.3 FpML sequencing rules

Sequencing rules are important to establish and maintain a coherent notification stream during the lifecycle of a contract. The key FpML elements are the message name, conversationId, contractId, and contractId version. Refer to the matrix following the rules listed below for sequence samples.

Contract Notification Sequencing Rules:
a) All notifications must include the <conversationId> which uniquely identifies each lifecycle event for a given swap contract. For example, the ContractCreated could have a <conversationId> of 001. The next event notification for the same contract, e.g. ContractTermination or ContractCreated, would have a different <conversationId>, e.g. 002.
b) All notifications of a given contract must have a unique versionedContractId->version which sequences the notifications. The ContractCreated would normally have a <version> of 1, but it must be an increment of the previous version received.
c) A notification of a given contract can be corrected with a subsequent one of the same type and <conversationId>, but with a higher contract id <version>.
d) A ContractCreated must precede any of the other message types.

e) A ContractPartialTermination that terminates the entire notional of the current contract should be the last notification for that contract, unless a ContractPartialTerminationCancelled negates the termination notification. In the latter case, other message types can follow, but with a different <conversationId>.
f) A ContractPartialTermination with a zero <outstandingNotionalAmount> should be the last notification for that contract, unless a ContractPartialTerminationCancelled negates the termination notification. In the latter case, other message types can follow, but with a different <conversationId>.
g) A ContractPartialTermination should be the last notification for that contract if the entire contract is terminated.
h) A ContractCancelled must be the last notification for that contract.
i) For a given swap contract, a ContractPartialTerminationCancelled must be the last notification with the <conversationId> of the partialtermination.

Example 1
The following table illustrates rules (a) thru (d). The first two messages are ContractCreated that notify the contract initiation event,identified by conversationId 001. The second ContractCreated message (with version 2) corrects the first one. The third message is a ContractCreated event and has new conversationId 002. The version number serves to sequence all the messages for contractId IRS004004 which the internal asset internal asset identifier for investment manager. The third message which is a contract creates increases the position.

Event Description	Message to Administrator/Custodian	Contract Id	conversation ID #	version #
IM and Dealer agree on new contract	ContractCreated	IRS004004	001	1
IM provided incorrect Notional, Amounts or Date information on message to Administrator/Custodian	ContractCreated	IRS004004	001	2
IM and Dealer agree to increase size of contract by sending a contract create.	ContractCreated	IRS004004	002	3

Example2
The following table illustrates rule (e). Rules (f) thru (g) are the ContractPartialTermination and ContractFullTermination equivalents of rule (e).

Event Description	Message to Administrator/Custodian	contract ID	conversation ID #	version #
IM partially terminates the contract.	ContractPartialTermination	IRS006006	005	4
IM cancels the partial termination notification.	ContractPartialTerminationCancelled	IRS006006	005	5
IM and Dealer agree to reduce part of the notional on the contract	ContractPartialTermination	IRS006006	006	6

Refer to the matrix in the following pages for sequence samples further illustrating all the above rules.

CCP FpML Contract Notification Sequencing Examples

3.2   Recommendations on transmission of Contract ID

The section below describes the best practice for transmitting trades using FpML messages for cleared trades and how identifiers such as cleared deal id, contract id are transmitted and the impact on netting.

Netting and transmitting trades

1. Netting for cleared trades requires that the investment managers send through all cleared trades as per one of the two methodologies defined below.
    a. Event type contract create to establish position, increase position or decrease position. The contract create events must have a contract id, cleared deal id, custodian account, clearing broker and clearing house. All the aforementioned data elements must all be equal in order to net positions.
    b. Event type contract create to establish position or increase position and contract terminate event to decrease position. The contract create and contract termination events must have a contract id, cleared deal id, custodian account, clearing broker and clearing house. All the aforementioned data elements must all be equal in order to net positions.
2. Contract Id
    a. The contract id field is a mandatory field.
    b. Investment managers that are auto/ selective netting the contract id is required to be positional. The contract id is expected to be identical for all events (contract create and partial termination) that are to be netted at the clearing house.
    c. Investment managers that are gross netting, the contract id is required to be unique.
3. Cleared Deal Id
    a. Market Practice for Cleared deal id – Identifier on the trade message from the investment manager.
        i. Credit default swaps – product identifier provided by the clearing house i.e.
            1. CME - CDXIG12V2.SR.XR.USD.14M.100
            2. ICE - ICE CODE (XY2001J18U0500XXI)
        ii. Interest rate swap – positional identifier provided by the investment manager i.e. IRS99123
        iii. Swaption – positional identifier provided by the investment manager ie SWP12345

Example1 – Trades sent as contract create only methodology

Scenario	Custodian Fund	Transaction Type	Contract ID	Conversation ID	Version	USI	Cleared Deal Id	CCP	Transaction Type	FCM	Notional	Total Net Position
Initial Trade Open	123	Contract Create	CDX123456	100	1	515134657676	CDX.NA.IG.19.SR.XR.USD100 201712	CME	Buy of Credit Protection	Goldman Sachs	10,000,000	10,000,000
Decrease in Exposure	123	Contract Create	CDX123456	101	2	54651357986	CDX.NA.IG.19.SR.XR.USD100 201712	CME	Sale of Credit Protection	Goldman Sachs	2,000,000	8,000,000
Changing Exposure Direction	123	Contract Create	CDX123456	102	3	564657515187	CDX.NA.IG.19.SR.XR.USD100 201712	CME	Sale of Credit Protection	Goldman Sachs	10,000,000	-2,000,000

Example2 – Trades sent as contract create and contract termination methodology

Scenario	Custodian Fund	Transaction Type	Contract ID	Conversation ID	Version	USI	Cleared Deal Id	CCP	Transaction Type	FCM	Notional	Total Net Position
Initial Trade Open	123	Contract Create	CDX123456	100	1	515134657676	CDX.NA.IG.19.SR.XR.USD100 201712	CME	Buy of Credit Protection	Goldman Sachs	10,000,000	10,000,000
Increase in Exposure	123	Contract Create	CDX123456	101	2	54651357986	CDX.NA.IG.19.SR.XR.USD100 201712	CME	Buy of Credit Protection	Goldman Sachs	2,000,000	12,000,000
Decrease Exposure	123	Partial Termination	CDX123456	102	3	567576577578	CDX.NA.IG.19.SR.XR.USD100 201712	CME	PT of Buy of Credit Protection	Goldman Sachs	-5,000,000	7,000,000
Changing Exposure Direction	123	Partial Termination	CDX123456	103	4	78678946579	CDX.NA.IG.19.SR.XR.USD100 201712	CME	PT of Buy of Credit Protection	Goldman Sachs	7,000,000	0
Changing Exposure Direction	123	Contract Create	CDX123456	102	5	578979849987	CDX.NA.IG.19.SR.XR.USD100 201712	CME	Sale of Credit Proection	Goldman Sachs	-5,000,000	-5,000,000