



## Q & A: ICE Eris Credit (CDX) Futures

**Q: Define ICE Eris (CDX) Credit Futures...**

A: ICE Exchange and Eris Exchange collaborated to introduce two new products to the marketplace: The Investment Grade (IG) CDX 5-year Credit Future and the High Yield (HY) CDX 5-year Credit Future. These futures index contracts cash-settle after 5 years. The value of each contract reflects the value of a basket of credit default protection on the entities in the index as published by Markit.

**Q: What's the underlying? How liquid is that?**

A: The underlying is the 5-year CDX.IG and CDX.HY Cash Indices. These are the most liquid credit indices available to trade. The chart below provides Average Daily Volume for both on-the-run and off-the-run IG and HY contracts. These contracts cleared at ICE Clear Credit include both dealer to dealer and dealer to client volume. Typically, dealer to client clearing constitutes approximately 70-80% of all index clearing.

CDX IG & HY Average Daily Volume	
Instrument	ADV (Sep 20-Feb 26th)
CDX.NA.HY.24 V2-5Y	\$1,228,849,275
CDX.NA.HY.25 V1-5Y	\$4,805,417,153
CDX.NA.IG.24 V1-5Y	\$1,851,582,391
CDX.NA.IG.25 V1-5Y	\$13,563,801,758

**Q: How do ICE Eris CDX Credit Futures work?**

A: CDX Credit Futures are derivative instruments typically used to hedge exposure to credit risk on a basket or portfolio of single-name entities within the index. The futures contracts replicate the cash flows of OTC-Cleared Credit Index Default Swaps (CDX Swaps). These contracts are used to provide protection upon the occurrence of a credit event. Traders buy or sell protection to be short or long Credit Risk. The Credit Futures' prices move daily based on traders' perceived changes in the credit risk environment.

**Q: Where do they trade?**

A: The ICE Eris CDX Credit Futures are listed on ICE Futures U.S. Exchange and cleared ICE Clear US. Trading occurs 16 hours a day: 2AM - 6PM (ET) with (currently) the greatest liquidity between 9:30AM -4PM (ET). The Fixed Income Group at R.J. O'Brien has experience and expertise executing CDX Credit Futures via voice and offers Bloomberg™ EMSX client-based direct execution.

**Q: Can you outline the CDX Credit Futures contract specifications? What is the contract size, tick size, and block size for trading?**

A: Each futures contract has a notional value of \$100,000. They trade in tick sizes of 0.01, with each tick equivalent to \$10. The minimum price fluctuation is 0.0001 index points → equal to \$0.10 per contract. As of February 2016, the minimum block size is 2 contracts, meaning a trade with a notional value of \$200,000 or higher can be executed via block trading, providing flexibility for accessing liquidity within the market.

**Q: How do they price?**

A: The futures price = A + B - C (as calculated using the Eris Methodology)

A= 100 + (clean price + accrued interest -100) x index factor

B= The sum of all historical cash flows

C= Cumulative PAI

See link provided to find values for inputs: <https://www.theice.com/marketdata/reports/185>

**Q: How does the pricing work, after execution?**

A: Contracts are designed to replicate net cash flows associated with OTC CDX swaps including Price Alignment Interest (Eris PAI) to account for interest paid on margin between OTC counterparties. All cash flows are incorporated in the daily variation margin and accounted for in the daily settlement price. The Credit Futures and OTC-Cleared CDX Swaps settle to the same valuation curve.

**Q: Outline the trading convention. How do I become a buyer of protection, or a seller of protection?**

A: Buy Futures → Receive Premium → Long Credit Risk (seller of protection)

Sell Futures → Pay Premium → Short Credit Risk (buyer of protection)

As credit spreads tighten, the value of the Credit Future will increase, and as spreads widen, the value of the Credit Future will decrease. Over the course of a year, IG increases in value by 1% and HY increases in value by 5%. These are the compensation premiums for the protection seller.

**Q: How much margin is involved?**

A: CDX Credit Futures provide significantly lower margin requirements vs. the equivalent OTC-Cleared CDX Swap. Futures margin = 1-day HVaR vs. OTC-Cleared CDX Swap margin of 5-day HVaR.

Initial Margin Requirement 5-yr Futures vs. OTC				
	ICE-Eris Credit Futures		ICE OTC	
	Speculators	Outright Hedgers	Buy Protection	Sell Protection
CDX.NA.IG.S25	\$440	\$400	\$1,114	\$2,034
CDX.NA.HY.S25	\$2,090	\$1,900	\$3,520	\$5,997

(as of March 2016-subject to change by ICE)

**Q: What about maintenance margin?**

A: Maintenance margin is assessed daily based upon the mark-to-market closing prices. Daily payments of profits and losses are not collateral, but are reflected in an account's daily accrual based on the instrument's change in price from the previous trading session's closing price. FCMs collect and distribute daily margin debits and credits from end-users of the Credit Futures.

**Q: What are the other trading costs outside of margin?**

A: RJO charges a fee to clients on a per-contract basis. RJO does not charge fixed monthly "open account" fees.

**Q: How often are new 'on the run' index series introduced? How does one roll from the previous index into the newest released index?**

A: ICE will list new CDX futures contracts every 6 months, on the First Trading Day a new underlying OTC index series becomes the 'on the run' series. The new contracts for the CDX IG Futures are introduced on March 20th and September 20th, while the new CDX HY Futures are introduced on March 27th and September 27th. There is no set roll period, though it is expected that the futures contracts roll to the new series within 10 days of the First Trading Day the new index is introduced.

The Fixed Income Group at RJO: 800-367-3349

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**Q: What happens at expiration?**

A: If contracts are held to maturity for 5 years as futures contracts, they are cash settled. There is no physical delivery.

**Q: What happens if a credit event occurs for a specific bond within the index?**

A: An auction will occur on the single name CDS for the underlying entity which has defaulted. Everyone trading the index will trade with all single name constituents including the defaulted name until the auction occurs. Once the credit event auction has been completed for the OTC swap, cash settlement of the auction takes place for the futures contract T+1 day after the auction. (The seller of protection, buying the index, pays out. The buyer of protection, selling the index, receives payment.) ICE will release version 2 of the index: the factored down index without this defaulted single name constituent. The notional exposure stays the same, but factored down to .99 assuming only one name has defaulted in the index, and the notional is divided by 124 names (IG contract). On the day after the auction, ICE settles on T+1, by adding or subtracting the value from the one day accrual which is incorporated in the daily cash flow.

**Q: What happens when new single name CDS are added to the index?**

A: The index is looking for the 125 most liquid names in IG and combine them in the index. Every six months at roll, if there are no credit events, and 5 names outside of the index are trading larger volumes than the names within the index, the new higher-volume 5 names will be swapped into the index. A holder of the credit index futures can simply roll their position into the newly modified index. Virtually all volume and open interest is anticipated to be located in the "current" Credit Future. The "old" futures will exist to trade; but limited liquidity and interest should be assumed.

**Q: What if market makers go away? What happens to "Existing" Credit Futures positions?**

A: It's possible to take an equal and opposite position in the OTC Cleared CDX Swaps. Since both the Futures and the OTC-Cleared settle to the same valuation curve, the result would be a riskless position.

**Q: The CDX futures typically require less than half the margin of the identically settled OTC product. "If that's a future, and most market makers are banks, why aren't they all using the future?"**

A: It all comes down to profit motives. These are newer, more modern contracts where overhead costs are lower, providing more value to the end-user. We expect most volume to move to these futures after Jan-1, 2017 when Basel III becomes an economic deterrent for OTC cleared.

**Q: How liquid are these Credit Futures?**

A: The futures bid/ask is typically \$30 wide per \$100,000- which roughly equates to 0.664 basis points wide on the cash CDX.IG. Conversion calculations are drawn from the CDS Valuation page provided on the Bloomberg Terminal. The visible bid/ask in Credit Futures is instantly trade-able. A client may bid/offer at any level to seek "mid-market" or "off-market" execution. Voice-accessible block markets exist and may offer better pricing than streaming, visible electronic markets.

**Q: What is being done to increase volume and liquidity within the credit futures market?**

A: New players are constantly being sought and added to the market place in both the OTC and the futures markets to increase daily trade volume and liquidity. The combination of both Basel III and reduced margin costs are expected to be drivers in transferring volumes towards Credit Futures.

**Q: How does The Fixed Income Group at RJO source liquidity?**

A: Besides the streaming market, we can source liquidity through block market makers. The minimum block size is 2 contracts (\$200,000 notional). The Fixed Income Group does not "make markets," so we are not "beholden" to our firm's trade desk. Our liquidity sources include traditional market maker banks and firms, other funds, and other clients.

**Q: What's the benefit of trading the Futures contract vs. OTC?**

A: The futures contract allows for lower costs due to reduced margin, as well as generally lower FCM costs for futures vs. OTC cleared. The credit futures provide the same economics of swaps, with the efficiency and cost-effectiveness of futures. Credit Futures have the advantage of being fully anonymous, Dodd-Frank compliant, and have an unimpeachable daily settlement value.

**Q: Who can access the market to trade the IG and HY Credit Futures?**

A: Everybody. New trading opportunities are made available through the use of the CDX Credit Futures for market participants who are unable to trade the OTC Credit Swap products due to costs, mandate restrictions, or legal and operational constraints. No ISDAs are required- just standard futures agreements.

**Q: How would our company utilize the CDX Credit Futures?**

A: Anybody that currently uses the CDX.IG or CDX.HY OTC indices can easily utilize credit futures to hedge credit exposure. For any enterprise holding fixed income assets below U.S. Treasury credit, let us show you other applications and hedge strategies utilizing the Credit Futures.

**Q: What are some Bloomberg screens that provide information on these contracts?**

A: On a Bloomberg terminal, type the following commands to view the current listed contracts, and quotes, for both the IG and HY Credit Futures.

"CWIA Index CT <go>" - for CDX IG Future

"CWYA Index CT <go>" - for CDX HY Future

Call us for a walk-through on valuation, comparison to OTC-cleared, and SEF-reported transactions.

**Q: What are the vendor codes for each of the contracts?**

Vendor Codes			
	ICE	BBG	Trading Technologies (TT)
Eris CDX.NA.IG 5 year	IG5	CWIA Index	5YR NA IG
Eris CDX.NA HY 5 year	HY5	CWYA Index	5YR NA HY

**Q: Ok, so I'm ready to start trading. How do I get set up?**

A: Setting up an account with the Fixed Income Group at RJO is simple and easy. Again, there are no ISDAs or credit-checks required. We will send you our account docs to be filled out, and once completed, your account will be open and ready to trade. RJO does NOT charge clients fixed monthly fees for market access and "unused" open accounts. Fees are processed on a per-contract basis.

**Q: What are some useful links for further information?**

A: Additional information is available on the websites on both the ICE Exchange and the Eris Exchange. Links to specific brochures are available below:

[https://www.theice.com/publicdocs/Eris\\_Credit\\_Futures\\_Presentation.pdf](https://www.theice.com/publicdocs/Eris_Credit_Futures_Presentation.pdf)

<https://www.theice.com/products/44365521/Eris-CDX-IG-Credit-Future-5-Year>

<https://www.theice.com/eris-futures>