**Standardized TRS converter**

**I – Introduction**

This paper aims to highlight a possible new model for standardized TRS (STRS) upfront spread, in addition of the classical STRS upfront amount calculation. To reach this goal, the analysis will go through existing standardized CDS ISDA conversion mechanism and try to adapt it in STRS context.

**II – CDS VS TRS**

Before entering in conversion mechanisms, this chapter will compare CDS and TRS products, and highlight similarities and differences for those two-credit derivatives product, which will be fruitful in next sections.

Let’s start by a summary tab about two possible strategies if one trader aims to hedge his credit risk coming from a risky Bond, with possible default on date τ:

Graphical user interface

Description automatically generated

We can observe several differences between those two strategies that should be highlighted:

* TRS is a linear product which implies that performance flow can be paid to one or another counterparty according to price levels. It’s a key point in this default context as it explains the final flow from performance receiver to performance payer, assuming that price after default will obviously less than price before default. This flow is the “equivalent” of CDS protection flow after default.
* As TRS performance payer must, contractually, pay performance if price will rise, and hence carries market risk other than only credit risk (this kind of obligation doesn’t exist for CDS, which only focuses on credit risk), it leads to financial reward from performance receiver. That explains that contrary to CDS spread flows which fall from protection buyer to protection seller, TRS spread flow come from performance receiver to performance payer.
* As CDS only focuses on possible default, if this last one won’t occur, the protection buyer is fully-entitled to Bond’s performance. On the contrary on TRS context the full performance is directly shifted to performance receiver: that’s a perfect hedge during life cycle, contrary to CDS which will only hedge credit risk.
* The previous mentioned perfect hedge for TRS after default is quite theoretical and assumes that , which is mathematically correct but market practice can be different : after default the underlying won’t be traded anymore and hence may be not in line (but close) to the previous formula.

The main and most important point, which will be the “fil rouge” of all next sections, is then the nature of risk(s) embedded in both products’ spread :

As Bond’s price can rise or drop according to market conditions (interest rate for example), credit (obviously after default, but even before) and liquidity (a fly to quality can dramatically impacts specific Bond’s price). Those effects are not autonomous and can impact each other, and that’s basically which will lead to complexities, as well see in next sections.

**III – CDS ISDA conversion overview**