Responses to the ARRC Consultation on Swaptions Impacted by Central Counterparty Clearing Houses' Discounting Transition to SOFR

Anonymous 1

Below are our responses to the ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR that was published on February 7, 2020, and we understand the ARRC has reopened the comment period. We have requested our response to be anonymous, but would note that we are a US-based life insurance company that uses swaptions to hedge product-related interest rate risks.

Please note that our responses were largely formulated in late-February / early-March and do not reflect any potential risk of delays in the CCP "Big Bang" from COVID-19 and work disruption from stay-at-home orders.

We appreciate the ARRC's effort to develop a robust alternative rate to Libor, the outreach on this and other proposals, and the opportunity to provide our feedback on the questions. Each of the questions has been copied below, and our responses are in **bold blue text**.

Part IV: Consultation Questions

Questions 1-3 refer to legacy swaptions

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged

B. The ARRC recommending that voluntary compensation should not be exchanged

C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

We respond "C," the ARRC should not issue a recommendation on voluntary compensation on legacy swaptions. We do not think that the market should be pressured to agree to compensation, nor should firms be told that they shouldn't agree to compensation if two willing participants choose to do so. Additionally, we would not object to the ARRC suggesting a market standard approach for those market participants who may want to voluntarily agree to exchange compensation.

As to why we do not believe voluntary compensation should be agreed upon:

1) **There have been plenty of market structure changes in the past where no compensation has changed hands. (For instance, the switch from Libor discounting to Fed Funds, evolution of CME-LCH basis on cleared swaps, and even the adoption of agreed Libor fallback language and spread adjustment has had an implicit value transfer as markets shift to the standard fallbacks)**
2) **According to the memo provided by ISDA that is attached to the consultation, the provisions of the 2006 ISDA Definitions do not contemplate any adjustments or compensation related to a change in the relevant CCP discount curve prior to exercise of a swaption. There may be a winner and a loser. It will be challenging for the loser to get approval to pay something that they are not obligated to do.**

3) **Especially for trades entered more recently once the CCP Big Bang was known, it is challenging to suggest that participants should be encouraged to "amend" their economic terms if one side was not aware of the impact when it may have been evident to the broader market. The market should have been pricing that risk (likelihood, magnitude, and directionality) into the trade levels at inception.**

Question 2.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop

C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

We do not support a recommendation that voluntary compensation be paid. If such a suggestion is for a market standard approach, we would likely support "A," being at trade-level and at time of expiry.

Swaption valuation models are option based, so valuation models are more complex than swaps. The models would need to value a SOFR-discounted swap, with a Fed Funds discounted OTC option. Throw in additional complexity for those who trade Bermudan swaptions, and approach "B" may be challenging to implement in practice, prior to swap expiry. "A" is apt to be more feasible in our opinion.

Question 3.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions

C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism

D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

We do not believe the ARRC should recommend voluntary compensation. If firms bilaterally agree to do so, they can bilaterally choose which trades to impact. Choices "A" and "B" would not be fair, given that the market should have been aware of this issue previously. While "C" is the most fair choice provided, as the "" question highlights, even choice "C" isn't going to have a clear cut-off date that would be fair for all parties.**

Therefore, we would likely suggest "D," leaving it up to those participants who choose to voluntarily exchange compensation to bilaterally determine what trade to which to apply compensation.

Question 4 refers to new swaptions traded until the CCP discounting switch date

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve

B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)

C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)

D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

We would support "C" for European swaptions. The single expiry date can easily be compared to the planned CCP Big Bang dates and would be fair as it is in alignment with market expectations and pricing.

The choice is more complicated for Bermudan swaptions given the exercise date is not known in advance. Some trades may obviously be before or after the Big Bang date, which might suggest "C". However, firms may not always agree, and the approach may be difficult to standardize, so we would instead suggest "A" or "D" for Bermudan swaptions.

Anonymous 2

Response to ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

Question 1. In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged

B. The ARRC recommending that voluntary compensation should not be exchanged

C. The ARRC not issuing a recommendation regarding voluntary compensation

Response

(C) The ARRC not issuing a recommendation regarding voluntary compensation

Please explain: We support ARRC initiatives on IBOR transition, however in this scenario our answer (C) is based on legality and voluntary nature of ARRC recommendation. We also have concerns around adverse selection by counterparties on compensation. For example this could leave a market participant in a position where one side of a hedge follows an ARRC recommendation and another does not, leading to a negative outcome.

Question 2. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop

C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Response

: (A). The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

Please explain: If the ARRC issues recommendation we would like it to be definite, operationally attainable and also clear guidance for all scenarios, including but not limited to where two bilateral counterparties fail to agree on the compensation amount. Based on this considerations we would like to select option “A”. Classification: Limited

Question 3. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended
Response
Response: (A) The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

Question 4. In relation to the amendments that ISDA will publish for new swaptions, do you support:
A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
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D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Response (C) The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards

Anonymous 3

<u>Part IV: Consultation Questions</u>

<u>Questions 1-3 refer to legacy swaptions</u>

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged

B. The ARRC recommending that voluntary compensation should not be exchanged

C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

<u>We support "A.</u> The ARRC recommending that voluntary compensation should be exchanged."

We generally agree with the analysis of Part II of the consultation paper. The fact that CCPs would need to switch the discount curve for cleared interest rate swaps and that they would provide valuation and risk compensation have not been sufficiently accounted for by market participants until now, and parties to interest rate swaptions have not fully analyzed, understood, or reflected the potential implications of such a switch on their contracts when entering them. Though parties to interest rate swaptions are under no contractual obligation to exchange compensation related to the upcoming CCP discounting change, it would be reasonable to agree to do so to better reflect the original intentions of interest rate swaptions transactions when they are entered. Therefore, we support the ARRC recommending that voluntary compensation should be exchanged.

Question 2.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop

C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

<u>We support "A.</u> The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry."

This is because that, it is in general not so easy to agree on swaptions values, and therefore, in option B (a one-time portfolio level amendment prior to expiry) it would be practically difficult to agree on the compensation amount.

Question 3.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions

C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements regarding their plans for the discounting switch and compensation mechanism**

D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

****If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?**

<u>We support "B.</u> The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions."

We also suggest that, if this consultation finds that overwhelming majority of market participants support "B", the ISDA should consider developing a protocol pursuant to which adherents will agree to amend interest rate swaptions transactions entered into before the effective date of the ISDA amendments for new swaptions so that those interest rate swaptions transactions specify EFFR as the (Agreed) Discount Rate. Such a protocol will enable adherents to clarify the original intentions when they are entered (i.e., EFFR PAI/discounting for swaps resulting from exercises of swaptions), and contractually oblige those adherents to exchange compensations at time of swaption expiry.

<u>**Question 4 refers to new swaptions traded until the CCP discounting switch date**</u>

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve

B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)

C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)

D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

We support C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards).

To limit the size of the population of swaptions that could be subject to the compensation exchanges, the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry.

Anonymous 4

Part IV: Consultation Questions

Questions 1-3 refer to legacy swaptions

Question 1.
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C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

Question 2.
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A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Question 3.
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C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

Question 4 refers to new swaptions traded until the CCP discounting switch date 9

Question 4.
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C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Consultation Responses

Question1:

We choose A.
Swaptions are used to hedge long term risks. It is important to ensure that the market remains predicable and fair. Changes in regulation and conventions should be neutral and not benefit one participant to the detriment of another. Creating winners and losers will also reduce confidence, thus potentially reducing liquidity. Participants that benefit should compensate the ones that loose.

Question2:

We chose B.
Option maturities in the Swaption markets can extend for many years. It is in the interest of all participants to resolve the change in convention in a timely fashion. We suggest making a one-time adjustment and move on.

Question3:

We choose B
Different market participants have different access to the rule making process. The cutoff should be set so that the future alternative is clear and has been sufficiently communicated. This is best achieved once the recommendation has been adopted by ISDA

Question4:

We choose B.
In order to avoid uncertainty it is better to be explicit about the conventions used. This will be achieved with choice B.

Anonymous 5

March 5, 2020

Anonymous Response to ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

Question 1.
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A. The ARRC recommending that voluntary compensation should be exchanged
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C. The ARRC not issuing a recommendation regarding voluntary compensation

We support Option A.

Please explain.
In the absence of compensation, the discounting switch introduces cases of arbitrary value transfer. Even the most prudent of risk managers would be exposed to random gains/losses (i.e. both parties priced it "correctly at the onset"). To facilitate a smooth transition, it is important for this issue to be addressed by the ARRC.

Question 2.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

We support Option B.

Please explain.
In our view B would be the cleanest approach, enabling everyone to be "all square" ahead of the discounting switch, and then discount everything at SOFR thereafter. Of course, it may prove challenging to engage all parties on any given date (for that reason, option A would be our second preference).

Question 3.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism

D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

We support Option C.

Please explain.
**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?
When LCH released a statement on their website announcing their intention to make the discounting switch. Though we appreciate there may be valid arguments for other similar dates (we'd support these too). We believe this would serve well to ring-fence trades that we propose a compensation scheme for. The key point here is that we believe compensation should be exchanged for the older legacy population, that has been unequivocally hit by arbitrary value transfer. For more recent trades, there will be justifiable arguments either way as to what discounting should be applied. Using more recent dates, or future dates, will likely increase disagreement. It is for this reason only that we are suggesting option C.

Question 4.
In relation to the amendments that ISDA will publish for new swaptions, do you support:
A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

We support Option C.

Anonymous 6

Part IV: Consultation Questions

Questions 1-3 refer to legacy swaptions

Question 1. In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

Option A. - We plan to consider compensating our counterparties in situations where we believe we entered into transactions that clearly assumed Fed Funds discounting, but now, as a result of the October 2020 Single Step Process will be cleared using SOFR discounting.

Question 2. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Option C. - We think this is best left to individual counterparties to determine how and when to compensate one another for the change in discounting. For those who don't hedge discounting risk, exchanging compensation on the date of the Single Step may actually introduce an unintended outcome in the event the swaption ends up out of the money (the idea was to hedge rate risk, without regard to a view on the SOFR/Fed Funds basis). In other cases, where both counterparties hedge the discount risk, exchanging value at the time of the Single Step Process may be more appropriate.

Question 3. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

Option D - We will consider offering voluntary compensation on any deals:

1. Entered into prior to the release of the Paced Transition Plan in (circa October of 2017)
2. Entered into after the Paced Transition Plan was released (circa October of 2017), with maturities between the Single Step process in October of 2020 and the original planned date of the move to SOFR PAI (2Q 2021).

**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

Question 4 refers to new swaptions traded until the CCP discounting switch date

Question 4. In relation to the amendments that ISDA will publish for new swaptions, do you support:
A. The ARRC recommending that the default should be to not specify a discount curve
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D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

D. We believe any deal entered into now should clearly assume SOFR discounting for any maturity after the planned Single Step Process in October of 2020. We feel it prudent to be very specific with your dealer about what assumptions regarding discounting you are making when entering into new transactions.

Anonymous 7

For the attention of the ARRC Secretariat (arrc@ny.frb.org)

Response to:

ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

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B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

Response: A
In light of the change to the original ARRC Paced Transition Plan and conversion of cleared swaps from EFFR to SOFR PAI/discounting with compensation, the ARRC should recommend that market participants follow a similar course and exchange compensation for the value transfer created in the swaption market (European / Bermudan / American). Exchanging compensation does not add a meaningful operational burden and prevents claims of mismatched treatment between swaps and swaptions and thus a loss of credibility for the swaption market and the Libor transition effort.

Question 2.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Response: B
Moving discounting of swaptions from EFFR to SOFR will promote liquidity in the SOFR derivative market and should be supported by the ARRC. Recommending portfolio level amendments will allow this shift to take place sooner and can be taken as a step in the same spirit as recommendations for bilateral CSAs to move from EFFR to SOFR. Operationally, portfolio level amendments prevent the long tail of effort required to settle each swaption individually at expiry, and potentially remove uncertainty from the market.

Question 3.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.
**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?
Question 4 refers to new swaptions traded until the CCP discounting switch date 9

Response: B
Operationally, choosing a well advertised future transition date supported by ISDA amendments is the cleanest approach, and is reasonable given the relatively small basis between EFFR and SOFR. Choices A and C are reasonable as well. The market could benefit from the clarity provided by a specific recommendation from the ARRC, and therefore we do not support choice D.

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Response: C
The ARRC should recommend use of the new discount curve flag in order to remove potentially harmful uncertainty from the market. Operationally, trading for the expected prevailing discount curve at time of expiry is most straightforward and avoids the creation of unnecessary conversion work for market participants in the future.

Anonymous 8

ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

Consultation Questions	**Responses**
Questions 1-3 refer to legacy swaptions ***Question 1.*** *In light of considerations discussed in Part II and as it relates to* <u>*legacy*</u> *swaptions specifically, do you support:* *A. The ARRC recommending that voluntary compensation should be exchanged* *B. The ARRC recommending that voluntary compensation should* <u>*not*</u> *be exchanged* C. *The ARRC not issuing a recommendation regarding voluntary compensation* *Please explain.*	A. In light of considerations discussed in Part II and as it relates to <u>legacy</u> swaptions specifically, [we] support: [A] The ARRC recommending that voluntary compensation should be exchanged.
Question 2. *If the ARRC issues a recommendation that voluntary compensation should be exchanged for* <u>*legacy*</u> *swaptions, do you support:* *A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry* *B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop* *C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange* *Please explain.*	B. If the ARRC issues a recommendation that voluntary compensation should be exchanged for <u>legacy</u> swaptions, [we] support: [B] The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop.
Question 3. *If the ARRC issues a recommendation that voluntary compensation should be exchanged for* <u>*legacy*</u> *swaptions, do you support:* *A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation*	B. If the ARRC issues a recommendation that voluntary compensation should be exchanged for <u>legacy</u> swaptions, [we] support: [B] The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for “new” swaptions.

Consultation Questions	**Responses**
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions *C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism* D. *The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended* *Please explain.*	
Question 4 refers to <u>new</u> swaptions traded until the CCP discounting switch date ***Question 4.*** *In relation to the amendments that ISDA will publish for new swaptions, do you support:* *A. The ARRC recommending that the default should be to <u>not</u> specify a discount curve* *B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions <u>traded</u> prior to the CCP discounting switch date and SOFR afterwards)* *C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions <u>expiring</u> prior to the expected CCP discounting switch date and SOFR afterwards)* D. *The ARRC not issuing a recommendation regarding specification of a the default discount curve*	D. In relation to the amendments that ISDA will publish for new swaptions, [we] support: [D] The ARRC not issuing a recommendation regarding specification of a [] default discount curve.

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ARRC consultation on swaptions based on USD LIBOR that could be affected by the discounting change for cleared derivatives from FedFund to SOFR

	Questions	Response
1	In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support: **A. The ARRC recommending that voluntary compensation should be exchanged** B. The ARRC recommending that voluntary compensation should not be exchanged C. The ARRC not issuing a recommendation regarding voluntary compensation Please explain.	**A.** We appreciate that ARRC may not have the power to compel, but we believe this supports avoiding value transfer between counterparties & is consistent to the approach CCPs are taking.
2	If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support: A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry **B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop** C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange Please explain.	**B.** This option avoids a long tail of cash transfers & we believe is the cleanest option. Note we believe the backstop at expiry should be removed as an option. We would also appreciate regulatory involvement to resolve any disputes related to a difference in opinion between counterparties regarding the compensation amount.
3	If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support: A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation **B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions** C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended Please explain. ***If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?*	**B.** This would help to align legacy swaptions with the amended definitions for new swaptions.
4	In relation to the amendments that ISDA will publish for new swaptions, do you support: A. The ARRC recommending that the default should be to not specify a discount curve B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards) **C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)** D. The ARRC not issuing a recommendation regarding specification of a the default discount curve *** Question 4 refers to new swaptions traded until the CCP discounting switch date*	**C.** This would help to align legacy swaptions with new swaptions and the updated collateral cash price matrix.
	Additional comments	There may also be impacts beyond swaptions, for example for multiple call instruments (Bermudans) and CMS. We believe it would be helpful to have these products considered as well. We believe it would be useful to

		achieve consistency with other currencies (such as EONIA to ESTR in EUR) in respect of compensation methodology for existing swaptions and conventions of new swaptions.

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Question 1.
In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged

B. The ARRC recommending that voluntary compensation should not be exchanged

C. The ARRC not issuing a recommendation regarding voluntary compensation Please explain.

Recommended answer is A.
Given the multitude of dealer exposure for any given legal entity it becomes imperative that voluntary compensation enables price alignment across counterparties. The process itself would introduce transparency in the market as bilateral exposure would get marked to mutually agreed upon valuations.

Question 2.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop

C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Recommended answer is A.
Trade level compensation exchange would provide better controls to manage the book keeping for legacy exposure. The need to pro-rate compensation exchange across multiple trading books would not exist in this approach.
In addition, expiry is a natural event in the lifecycle of swaption that lends itself to compensation discussion (both for physical and cash settling trades). We feel that expiry would be opportune time for that compensation to take place.

Question 3.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for “new” swaptions

C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism

D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.
**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

Recommended answer is C.
As majority of swaptions are physical cleared swaptions we feel that aligning the CCP announcement date would be a natural fit for ARRC recommended dates. We would prefer ARRC recommended dates to align with LCH announcement date of 26th July 2019.

Question 4 refers to new swaptions traded until the CCP discounting switch date

Question 4.
In relation to the amendments that ISDA will publish for new swaptions, do you support?
A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of the default discount curve

Recommended answer is C.
Since majority of swaptions are physical cleared swaptions we feel ARRC recommendation should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards). This would align the swaption discounting to that of mutually agreed upon clearing house and avoid any need for cash compensation or risk exchange to address discount curve misalignment at the time of exercise of swaption into cleared swap.

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9th March 2020

1. In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:
    A. The ARRC recommending that voluntary compensation should be exchanged
    B. The ARRC recommending that voluntary compensation should not be exchanged
    C. The ARRC not issuing a recommendation regarding voluntary compensation Please explain.
    We advocate 1.B.
    We believe that the market requires clarity and certainty.
    The swaptions market appears to have been using Option B to price trades for some time.
    Options A and C may create uncertainty.

2. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
    A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
    B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
    C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange
    We are in favour of 2.C
    Option A is our least favoured choice as it could be quite difficult to implement

3. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
    A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
    B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
    C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
    D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended
    We are in favour of 3.D

4. In relation to the amendments that ISDA will publish for new swaptions, do you support:
    A. The ARRC recommending that the default should be to not specify a discount curve
    B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
    C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
    D. The ARRC not issuing a recommendation regarding specification of a the default discount curve
    We support 4.D.
    The Discount Curve specified is now to be part of the trade attributes that are agreed between the two parties.
    It should be up to the two parties to agree and specify which Discount Curve to use.
    Trying to specify defaults may end up causing more trouble than it saves – especially if the Discount Curve prevalent in the market were to change in an unexpected manner.

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ARRC Consultation – Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

Question 1 – In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support: (A) The ARRC recommending that voluntary compensation should be exchanged; (B) The ARRC recommending that voluntary compensation should not be exchanged; or (C) The ARRC not issuing a recommendation regarding voluntary compensation. Please explain.

Answer:

- We oppose Option A as the proposed compensation scheme is voluntary. This voluntary scheme will increase uncertainty and confusion in the market. This could lead to gamesmanship and disputes between market participants on whether compensation should be exchanged. Some market participants may try to cherry pick and pursue compensation with counterparties where it is favorable to them to do and avoid it when the result would be unfavorable.
- We support Option "B" – the ARRC should recommend that voluntary compensation should not be exchanged. This would provide the market with relative certainty on this matter and does not stop counterparties from exchanging compensation if they decide to do so.

Question 2 – If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support: (A) The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry; (B) The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop; or (C) The ARRC not issuing a recommendation regarding the timing of the compensation exchange. Please explain.

Answer:

- We oppose Option A as this would increase complexity and uncertainty in the compensation negotiations between counterparties. It may lead to compensation being only granted for some trades between counterparties and not others.
- We support Option B as it would be simpler and operationally achievable to determine compensation at one point in time for the entire portfolio.

*Question 3. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support: (A) The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation; (B) The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions; (C) The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism; or (D) The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended. Please explain.*

***If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?*

Answer:

- We support Option A as the recommendation will apply to all impacted swaptions and have consistency across the product class.

Question 4 – In relation to the amendments that ISDA will publish for new swaptions, do you support: (A) The ARRC recommending that the default should be to not specify a discount curve; (B) The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards); (C) The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards); or (D) The ARRC not issuing a recommendation regarding specification of a the default discount curve.

Answer:

- We support Option C – the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry. However, in order for this to be viable, the date for discounting curve needs to be specified and this date should be hard coded. The date for the discounting curve cannot change even in the event that the CCP's transition from EFFR to SOFR is changed.
- We wholeheartedly support the amendments ISDA will publish for new swaptions and these should be adopted as the new market standards.

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Part IV: Consultation Questions
Questions 1-3 refer to legacy swaptions

Question 1.
In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:
A. The ARRC recommending that voluntary compensation should be exchanged
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation Please explain.

Answer: A. *By the ARRC making a recommendation, it may discourage adverse selection, where counterparties only agree to compensation when it is to their benefit. It will not be a legal obligation but may encourage a level playing field.*

Question 2.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Answer: B. *A one-time portfolio level compensation exchange can be aligned with the compensation mechanism for the swap portfolio – this would allow for offsetting exposures to be netted. As the majority of swaptions specify LCH as the clearing house, members can exchange risk net of swaption delta.*

Question 3.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

Answer: B. *this gives some time to allow the market to adjust. It makes the split between "legacy" & "new" swaptions.*

Question 4 refers to new swaptions traded until the CCP discounting switch date 9

Question 4.
In relation to the amendments that ISDA will publish for new swaptions, do you support:
A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Answer: C.

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ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

Part IV: Consultation Questions

Questions 1-3 refer to legacy swaptions

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged

B. The ARRC recommending that voluntary compensation should not be exchanged

C. The ARRC not issuing a recommendation regarding voluntary compensation Please explain.

Please explain.

Response 1:

We prefer option C. Due to the fact that (a) compensation is voluntary and would lack consistent application across all clients/legacy swaptions and (b) the current participants in this consultation do not include sufficient buy-side client input, we feel recommending voluntary compensation could have unintended adverse consequences.

Question 2.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop

C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Response 2:

We prefer option B. Executing compensation exchange at trade-level would encourage cherry-picking and inconsistent decision-making that would ultimately reduce liquidity in the product. We understand that this will require a bilateral agreement between the counterparties which may be problematic if this not accepted across the market.

Question 3.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions

C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.
**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?
Question 4 refers to new swaptions traded until the CCP discounting switch date

Response 3:
We prefer option B. We are of the view that ISDA's revised definition of Collateralized Cash Price and Collateral Cash Price Matrix clearly distinguish what constitutes as "legacy" swaptions being transactions executed prior to the CCP switch. The bifurcated Collateral Cash Price Matrix will now track applicable discounting methodology that the CCPs will apply. However, we further note that this will only apply for trades executed on or after the date of the revised definition of Collateralized Cash Price and the Collateral Cash Price Matrix.

Question 4.
In relation to the amendments that ISDA will publish for new swaptions, do you support:
A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Response 4:
We prefer option C. This ensures consistency of the underlying swap executed at time of expiry with respect to the prevailing standard of cleared swaps, so participants can minimize/eliminate the amount of swaps discounted differently from the existing swaps portfolio both before/after discounting switch.

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VIA EMAIL TO arrc@ny.frb.org

March 9, 2020

Alternative Reference Rates Committee
Attn.: ARRC Secretariat
New York, NY

Re: Consultation Response – Consultation on swaptions based on U.S. dollar (USD) LIBOR

Ladies and Gentlemen:

We appreciate the opportunity to comment on the consultation released by the Alternative Reference Rates Committee (the "ARRC") related to swaptions based on U.S. dollar (USD) LIBOR (the "Consultation"). We are a financial end-user of derivatives, including USD LIBOR swaptions.

We offer the following views on the questions posed in the Consultation:

- Question 1

  We support Option A (the ARRC recommending that voluntary compensation should be exchanged). Legacy swaption trades were transacted assuming federal funds overnight indexed swap for price alignment interest ("PAI") and the discounting curve through the life of the option and the underlying physically settled swap. As such, those trades did not contemplate PAI based on Secured Overnight Financing Rate ("SOFR").

  Since the parties did not anticipate SOFR PAI, legal certainty is fleeting regarding whether and what compensation is due on the trades. Since unanticipated and unprecedented exogenous events caused this situation, compensation is appropriate. We make that statement as a party that would both benefit economically from that position for some trades and be harmed by the view on others. An ARRC recommendation that voluntary compensation should be exchanged will encourage market adoption. That adoption default will, in turn, allow the parties to focus solely on the timing and amount of compensation.

- Question 2

  We support Option C (the ARRC not issuing a recommendation regarding the timing of the compensation exchange). Portfolio-level amendments would provide more immediate clarity on the discounting curve switch. Unfortunately, modeling differences may preclude such an approach. By contrast, determining compensation at the trade-level at time of swaption expiry would minimize model differences, at the cost of providing earlier resolution.

While the outcome is unclear, only sophisticated users may be well positioned to support the portfolio approach. The result may be that the interdealer market takes the portfolio approach, while many dealer clients (including end-users) opt for a trade-level approach at time of swaption expiry. Given those unknown factors and developments, Option C would allow parties to act based on their resources, models and constraints, as well as emerging market guidance and practices.

- Question 3

  We support Option B (the ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions). Once ISDA updates its 2006 ISDA definitions, those terms become part of new swaptions trades at inception and factor into pricing. Accordingly, ISDA's implementation date is the appropriate cut-off time for voluntary compensation. In contrast, using the ARRC recommendation date would not have a similar impact on swaptions trades and pricing; therefore, the ARRC date is not relevant as a cut-off trade date.

- Question 4

  We support Option C (the ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)). For swaptions that will settle into a cleared physical swap, specifying a discount curve will eliminate future issues if the rate used for the PAI changes. We view the time of expiry to be more appropriate than the time of trade. Currently, swaptions are transacted assuming that (1) the federal funds discounting curve is applied if they are exercised into a swap prior to the expected CCP discounting switch date and (2) SOFR discounting is applied if they are exercised into a swap after that date. Therefore, Option C is consistent with market practice.

Thank you for your efforts on this important topic.

Anonymous 16

March 9, 2020

Alternative Reference Rates Committee ("**ARRC**")

Via email submission to: arrc@ny.frb.org

Re: Consultation Response – ARRC Consultation on Swaptions Impacted by Central Counterparty Clearing Houses' Discounting Transition to SOFR

The firm welcomes the opportunity to respond to the ARRC consultation on swaptions impacted by the CCP discounting transition to SOFR. Our responses are as follows:

Questions 1-3 refer to legacy swaptions

Question 1: In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:
A. The ARRC recommending that voluntary compensation should be exchanged
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation
Please explain.

Response: We prefer option A – the ARRC recommending that voluntary compensation should be exchanged. The firm thinks the approach should be similar to swaps. The underlying swap is using OIS discounting and the CCP will not arrange compensation unless the swap is exercised before the switch. CCPs have stated they will not provide compensation afterwards. This means counterparties to bilateral swaps will need to reach agreement ahead of time.

Question 2: If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange
Please explain.

Response: We prefer option B - the ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop. Swaptions are not cleared when they convert. The CCPs have offered to provide independent valuation guidance to bilateral negotiations. The firm's rationale is based on the fact that A is not viable for long dated options, by the time the option expires the OIS curve may no longer be applicable. Also, trade level amendment will be operationally challenging. Option B is preferred from an operational perspective since the compensation exchange is done once and at the portfolio level and can be completed in bulk.

Question 3: If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended
Please explain.

Response: The firm prefers the later date of option A and option B. We think it makes sense to provide compensation for legacy swaps, there is no reason to compensate for swaps defined as "new."

Question 4: In relation to the amendments that ISDA will publish for new swaptions, do you support:
A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Response: The firm prefers option C. For new swaptions it should be SOFR discounting and legacy continue until the switch. This is consistent with the other answers provided above. If you have cash-settled swaptions you want it to be consistent with physically-settled swaptions. Cash convention is the discounting curve, and this is the one we expect to be prevalent at the time of expiry.

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Question 1. In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:
A. The ARRC recommending that voluntary compensation should be exchanged
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation

We do not support the ARRC issuing a recommendation that deviates from the ISDA definitions governing legacy swaptions. Rationale being an ARRC recommendation would not be legally binding, and it would not be possible to avoid adverse selection.

Question 2. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

While we do not support the ARRC issuing a recommendation altogether, we would note that Option B appears preferable to Option A. It would reduce – but not eliminate – both the operational burden and adverse selection associated with compensation. Adverse selection would be reduced by requiring a counterparty to make an "all-or-nothing" decision regarding voluntary compensation with a given counterparty (no ability to 'pick and choose').

Question 3. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments descr bed above for "new" swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Question 4. In relation to the amendments that ISDA will publish for new swaptions, do you support:
A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Option C would eliminate the operational burden associated with compensation for the discounting changes which have been announced (EONIA to ESTR and EFFR to SOFR). At the same time, it would provide economic certainty in case their transition date changes or other discounting changes take place in the future.

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Questions 1-3 refer to legacy swaptions	Comments
Question 1. In light of considerations discussed in Part II Legacy Swaptions and as it relates to legacy swaptions specifically, do you support: A. The ARRC recommending that voluntary compensation should be exchanged B. The ARRC recommending that voluntary compensation should not be exchanged C. The ARRC not issuing a recommendation regarding voluntary compensation.	A. Our firm is supportive of choice A., a recommendation that voluntary compensation should be exchanged **Explanation**: We support an outcome that allows the transition of risk free rates in a manner that limits market impact. We feel that that voluntary compensation helps with this transition, and if all counterparties act in good faith then this can be achieved.
Question 2. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support: A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange	B. Our firm is supportive of choice B., a recommendation that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop **Explanation**: For operational ease a one-time, portfolio-level amend is preferred. However this will not be possible for all counterparties and counterparties could disagree on the value before expiry, as such a backstop of calculation and exchange at expiry is sensible.
Question 3. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support: A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended	B. Our firm is supportive of choice B., a recommendation that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions **Explanation**: We feel that using the date of the ISDA amendment for the swaption definitions is the most suitable methodology. This will benefit from impacting all swaption currencies and CCPs at the same time and allows participants to prepare for the shift without ambiguity on the date.
Question 4 refers to new swaptions traded until the CCP discounting switch date	**Comments**
Question 4. In relation to the amendments that ISDA will publish for new swaptions, do you support: A. The ARRC recommending that the default should be to not specify a discount curve B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards) C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards) D. The ARRC not issuing a recommendation regarding specification of a the default discount curve	C. Our firm is supportive of choice C., a recommendation that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards) **Explanation**: This is most representative of what participants expect at time of trading, and is consistent with a mechanism of voluntary compensation for legacy swaptions.

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ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR
Due March 9th 2020

Part IV: Consultation Questions

Questions 1- 3 refer to legacy swaptions

Question 1.
In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

a. ***The ARRC recommending that voluntary compensation should be exchanged***
b. The ARRC recommending that voluntary compensation should not be exchanged
c. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain:
Response: **We recommend that voluntary compensation should be exchanged. We believe it is the fairest option.**

Question 2.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

a. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
b. ***The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop***
c. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.
Response: We prefer B, as long as we are able to get a breakdown and details of the supporting trade/s.

Question 3.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. ***The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions***

C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.
***Response:* We chose Option B.**

***If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?*
Question 4 refers to new swaptions traded until the CCP discounting switch date

Question 4.
In relation to the amendments that ISDA will publish for new swaptions, do you support:

a. ***The ARRC recommending that the default should be to not specify a discount curve.***
b. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
c. The ARRC recommending that the default should be to specify a discount curve that isexpected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards).
d. The ARRC not issuing a recommendation regarding specification of a the default discountcurve

***Response:* We chose Option A.**

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ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

Anonymous submission

Consultation paper:
https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Swaption_Consultation.pdf

Questions 1-3 refer to legacy swaptions

Question 1:

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged

B. The ARRC recommending that voluntary compensation should not be exchanged

C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

Response 1: A. Would be preferable, but this only works if everybody adheres to it.

Question 2:

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop

C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Response 2: B.

<u>Question 3:</u>

If the ARRC issues a recommendation that voluntary compensation should be exchanged for <u>legacy</u> swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for “new” swaptions

C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements**** regarding their plans for the discounting switch and compensation mechanism

D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

****If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

Response 3: C. With the issue that there are 2 announcement dates, 4 months apart. We would support the earlier of the two dates, July 26, 2019.

Question 4 refers to new swaptions traded until the CCP discounting switch date

Question 4:

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve

B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)

C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)

D. The ARRC not issuing a recommendation regarding specification of the default discount curve

Response 4: B or C.

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ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

Our answer:
B. The ARRC recommending that voluntary compensation should not be exchanged

Question 2.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

Our answer:
A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

Question 3.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

Our answer:
A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

Question 4.
In relation to the amendments that ISDA will publish for new swaptions, do you support:

Our answer:
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)

Anonymous 22

ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

General comments:

It would be worth considering whether there could be an intermediary agent responsible for overseeing and arbitrating the voluntary compensation process.

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:
A. The ARRC recommending that voluntary compensation should be exchanged
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

Option A is our preferred answer. Ideally, we would like a mandatory compensation mechanism to be defined and applicable to all market participants. We question the feasibility of the proposed voluntary compensation as there might be cases where this would not be used by all counterparties and therefore winners and losers could arise.

Question 2.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Option B is our preferred answer due to its operational simplicity and the fact it would reduce counterparty credit risk.

Question 3.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:
A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
*C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism*
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?
Question 4 refers to new swaptions traded until the CCP discounting switch date

Option D is our preferred answer as we don´t think a cut-off trade date would simplify the process. A mandatory compensation mechanism could smooth the transition and reduce friction between counterparties.

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:
A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Option C is our preferred answer. We believe that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry.

Anonymous 23

Confidential [responses to remain anonymized]

Please find our feedback to the ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR. We are happy to answer any questions or further discuss. Many thanks for your support, engagement and efforts on the transition.

Questions 1-3 refer to legacy swaptions

Question 1.
In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation Please explain.

Please explain.

Response: We support "a". We recommend a voluntary process to resolve the problem, as it cannot be mandatorily solved.

Question 2.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Response: We support "b". The settlement should be computed and settled once at portfolio level as we cannot spread the exercise along all expiry dates.

Question 3.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
*C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism*
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

INTERNAL

***If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?*

Response: We recommend that this should apply to Swaptions trades before the date on which the CCPs will switch their discount rate from EFFR to SOFR. Rather than choosing the population based on an ISDA or ARRC publication date, waiting for the CCPs change of discounting method gives clarity to all counterparts. (June for EURO, October for USD).

Question 4 refers to new swaptions traded until the CCP discounting switch date

Question 4.
In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Response: We support "b".

Anonymous 24

Question 1. In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation

Option A. This best achieves alignment with the underlying cleared market. This should consist of monetary compensation in addition to risk compensation. For Risk Compensation, Counterparties should enter into two new swaps with each other (Fixed vs. EFFR and Fixed vs. SOFR) to offset change in risk to mirror the handling by the CCPs.

Question 2. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Option B. This best achieves alignment with the underlying cleared market, and prevents the matter from hanging over the market for undetermined period beyond transition date whereby parties are continually spending effort determining exact amounts of monetary compensation.

Question 3. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Option B: March 30 would be used as the cutoff date. This is the most practical cut-off date to determine legacy swaptions, as prior to this date no legal language existed to cover compensation, while after this date such legal language does exist.

Question 4. In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)

C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Option A: By leaving unspecified, it limits the population that will require compensation in the future and creates a very clear outcome at settlement.

Anonymous 25

Thank you for the opportunity to respond to this consultation.

Our primary view, consistent throughout this response, is that the originally intended economics of a swaption transaction should be best preserved. This is of particular importance for legacy positions. In addition, we view simplicity and efficiency of application in the context of the current liquidity environment for SOFR discounting as a critical consideration for any forthcoming ARRC recommendation.

Responses:

1) As it relates to legacy swaptions, we would support the ARRC recommending that voluntary compensation should be exchanged. This better captures the intended economics of the original transaction agreed to by both parties. We'd also support a recommendation for it to be acceptable for parties to mutually waive compensation for immaterial valuation differentials.
2) In the event that voluntary compensation is recommend by the ARRC, we'd support the ARRC also recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop. In our view, approaching this at the portfolio level simplifies the process greatly.
3) In the event that voluntary compensation is recommended by the ARRC, we'd support that this only apply to swaptions traded prior to the date on which the ARRC issues this recommendation.
4) In relation to the amendments that ISDA will publish for new swaptions, we would support the ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards). This seems the cleanest solution given the current liquidity conditions in SOFR markets.

Anonymous 26

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

RESPONSE: We believe that questions 1 and 2 should be taken together – please see our response to Question 2 below

Question 2.

If you support the ARRC recommending that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange apply to the entire relationship's portfolio but be calculated at the trade-level and at time of each swaption's expiry
B. The ARRC recommending that the compensation exchange take place at a pre-agreed date prior to October 16, 2020, with compensation exchange for each swaption at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

RESPONSE: We believe that the best approach would be to have option A in question 1 and option B in question 2, i.e. that compensation is exchanged and that it is achieved via a one-time portfolio-level adjustment.

However, if option B is not selected for question 2 then we would prefer to follow option B in question 1 and have no compensation exchanged at all.

The reason for this is that the requirement on parties to continue to calculate compensation on expiry well into the future is very likely to cause confusion and may ultimately reduce liquidity.

For completeness, we believe that a recommendation in one direction or another is required, and so we would strongly suggest not adopting option C in either question 1 or 2.

Question 3.

If you support the ARRC recommending that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

RESPONSE: We are supportive of what appears to be a consensus that has recently formed that this should apply to trades prior to a cut-off date, with such date to be agreed bilaterally but which should in any event be no later than 30 March 2020 in order to be consistent with the effective date of the latest supplement to the ISDA Definitions.

Question 4 refers to new swaptions traded until the CCP discounting switch date

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

RESPONSE: We note that the amendments have already been published and have no further comments.

Alliance Bernstein

AB's Response to Part IV: Consultation Questions

AB's preferred answers to the swaption consultation questions are indicated in red below.

Questions 1-3 refer to legacy swaptions

Question 1.
In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged

B. The ARRC recommending that voluntary compensation should not be exchanged

C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

Question 2.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop

C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Question 3.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions

C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism

D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.
**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

Question 4 refers to new swaptions traded until the CCP discounting switch date 9

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve

B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)

C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)

D. The ARRC not issuing a recommendation regarding specification of the default discount curve

Bank of Nova Scotia

ARRC Consultation on Swaptions Impacted by the
CCP Discounting Transition to SOFR

<u>Bank of Nova Scotia Response</u>

Questions 1-3 refer to legacy swaptions

Question 1. In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

a. The ARRC recommending that voluntary compensation should be exchanged
b. The ARRC recommending that voluntary compensation should not be exchanged
c. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

<u>Answer</u>
We select (a). Our view is that the industry would greatly benefit from the ARRC taking the step of recommending that voluntary compensation should be exchanged. This would help guide the swaptions industry members' decisions as to how to resolve compensation issues upon cessation of LIBOR.

Question 2. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

a. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
b. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
c. The ARRC not issuing a recommendation regarding the timing of the compensation exchange Please explain.

Please explain.

<u>Answer</u>
We select (a) based on the fact that the amount of compensation that would be exchanged would have to be calculated at the trade level.

Question 3. If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

a. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
b. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
c. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
d. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended.

Please explain.

**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

<u>Answer</u>
We select (b). Our view is that "new" swaptions – those that are traded after the ISDA amendments become effective – will not require the application of a voluntary compensation mechanism. As such, the recommendation does not need to extend to new swaptions, but only to those traded prior to the ISDA amendments becoming effective.

Question 4 refers to new swaptions traded until the CCP discounting switch date

Question 4. In relation to the amendments that ISDA will publish for new swaptions, do you support:

a. The ARRC recommending that the default should be to not specify a discount curve
b. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
c. The ARRC recommending that the default should be to specify a discount curve that isexpected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
d. The ARRC not issuing a recommendation regarding specification of a the default discount curve

<u>Answer</u>
None

Caisse de depot et placement du Quebec

Part IV: Consultation Questions

Questions 1-3 refer to legacy swaptions

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. **The ARRC recommending that voluntary compensation should be exchanged**
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation

For a specified set of trades (more details below) it is in the best interest of each market participant to exchange voluntary compensation to reflect the real market value.

Question 2.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. **The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry**
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

A one-time compensation has transfer value risk. In a situation where a market participant has an important discounting risk, the market can be distorted because of insufficient liquidity or for other reasons. A trade-level compensation spread the change in risk profile on a longer period which reduces transfer value risk.

A transparent evaluation process needs to be put in place for all market participants to easily agree on the swap PV adjustment at expiry (this also applies to the cash settlement adjustments) caused by the EFFR-SOFR basis.

Question 3.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for “new” swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements regarding their plans for the discounting switch and compensation mechanism**
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

December 3rd 2019. Before this date, it wasn't clear if LCH would change its date to match CME's or vice-versa. It also wasn't clear if they both would change the date to a single transition date that was different than the ones initially published by both CME and LCH. It's only on December 3rd where we got the confirmation that October 17th will be the date where the change in the discounting curve will happen for both CCPs.

Prior to this date, the compensation must be voluntary given the market convention was EFFR and there was no certainty about a specific timing in the discounting curve change.

After this date, even though there wasn't a way to confirm a different discounting curve like we can today ("Agreed Discount Rate" in Markit Wire), the information was known by all market participants that the discounting rate will change to SOFR after October 17th. We can thus assume that swaptions with an expiry of October 17th or greater was priced accordingly.

**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

Question 4 refers to new swaptions traded until the CCP discounting switch date

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

It will reduce the manual PV adjustment needed at maturity if the discount curve at the CCP isn't the same as the one confirmed in the legal confirmation of the trade.

Capital One

Part IV: Consultation Questions

Questions 1-3 refer to legacy swaptions

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

We support (A) the ARRC recommending that voluntary compensation should be exchanged so that market participants can be compensated for the valuation differences and risk created if legacy swaptions are exercised after the discounting conversion date. Based on the recommendation, market participants can begin planning and negotiating in advance to prepare for the changes on the current legacy swaptions in their portfolio.

Question 2.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

We support (B) the ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop. For market participants with a larger book of swaptions, a singular settlement approach will greatly reduce operational inefficiencies. The expiry compensation exchange is a sufficient backstop to address contracts that were not covered in the one-time payment.

Question 3.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions
C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

We support (B) the ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions. This would provide a definitive cut-off trade date to distinguish between "legacy" and "new" swaptions.

<u>Question 4 refers to new swaptions traded until the CCP discounting switch date</u>

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

We support (B) the ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards). New contracts should reflect the relevant discount curve at the time of trade to align with the CME and LCH conversion.

Citadel

March 9, 2020

The Alternative Reference Rates Committee (ARRC)
Re: ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

Please see the responses from Citadel below (selected answers in red).

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged

B. The ARRC recommending that voluntary compensation should not be exchanged

C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

This decision should be left to the contracting parties, as there are a variety of considerations to take into account with respect to each bilateral relationship. Furthermore, any ARRC recommendation would not change the legal construct, which requires mutual agreement between the contracting parties.

Question 2.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop

C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Any compensation exchange must be calculated at the portfolio-level in order to accurately reflect the total risk position between the two relevant counterparties, taking into account netting.

Question 3.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions

C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism

D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

Once the ISDA amendments are effective, there is an industry solution in place to address any lack of clarity regarding the appropriate discount rate.

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve

B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)

C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)

D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

Please explain.

Specifying a discount rate provides both counterparties with additional clarity, and the discount rate should reflect what is expected to be applied at the CCP at the time of expiry.

* * * * * * * * * *

Please feel free to call the undersigned at (646) 403-8200 with any questions regarding these comments.

Respectfully,

/s/ Stephen John Berger

Managing Director

Global Head of Government & Regulatory Policy

CME Group

9 March 2020

Alternative Reference Rates Committee
Via electronic submission to: arrc@ny.frb.org

Re: ARRC Consultation on Swaptions Impacted by Central Counterparty Clearing Houses' Discounting Transition to SOFR

To whom it may concern:

CME Group Inc. ("CMEG")[1] is grateful for the opportunity to provide comments to the Alternative Reference Rates Committee ("ARRC") "**Consultation on Swaptions Impacted by Central Counterparty Clearing Houses' Discounting Transition to SOFR**"[2] ("Consultation"), published 7 February 2020.

CMEG has been an active member of the ARRC since September 2015 and appreciates the collaborative forum provided by the ARRC to address important topics facing the industry such as those covered in the Consultation. Treatment of uncleared swaptions has been an active topic amongst market participants for the past 12 months, and the ARRC decision to solicit feedback on what role the ARRC should play regarding this topic was the appropriate decision.

CMEG makes no recommendations what these best practices recommendations should include; however, CMEG supports the effort to establish a consensus on what constitutes best practices. By doing so, greater market clarity could be achieved which would ultimately support the goals of the ARRC for the development of a liquid and robust SOFR-based marketplace.

[1] CME Group offers futures and options on futures for trading, through the CME Globex electronic trading platform, on four separate designated contract markets: Chicago Mercantile Exchange Inc. ("CME"), the Board of Trade of the City of Chicago, Inc. ("CBOT"), the New York Mercantile Exchange, Inc. ("NYMEX"), and the Commodity Exchange, Inc. ("COMEX") (collectively, "the CME Group Exchanges"). The CME Group Exchanges offer the widest range of global benchmark products across all major asset classes based on interest rates, equity indexes, foreign exchange, energy, agricultural products and metals. Each of the CME Group Exchanges is subject to regulation by the US Commodity Futures Trading Commission ("CFTC"). All of the CME Group Exchanges are subject to the rules and regulations of the local jurisdictions in which they conduct business, including the European Securities and Markets Authority ("ESMA") and the UK Financial Conduct Authority ("FCA"). CME Group also offers fixed income trading via BrokerTec and foreign exchange trading on the EBS platform.

Among the operating divisions of CME is CME Clearing, one of the largest central counterparty clearing houses in the world, which provides clearing and settlement services for exchange-traded contracts and for over-the-counter derivatives transactions. CME Clearing is a derivatives clearing organisation subject to regulation by the CFTC. With a range of pre- and post-trade products and services underpinning the entire lifecycle of a trade, CME Group also offers optimization and reconciliation services through TriOptima and trade-processing services through Traiana.

[2] ARRC, Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR, February 7, 2020, available at: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Swaption_Consultation.pdf

CMEG greatly appreciates the efforts by the ARRC in conducting this Consultation. If you have further comments or questions, we would be happy to discuss this matter with you. Please contact me at +1 212 299 2340 or Sean.Tully@cmegroup.com.

Sincerely,

Sean Tully
Senior Managing Director and
Global Head of Financial & OTC Products

FHLB Cincinnati

March 9, 2020

ARRC Consulation on Swaptions Impacted by Central Counterparty Clearing Houses' Discounting Transition to SOFR

FHLB CINCINNATI

Question 1.
In light of considerations discussed Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged
B. The ARRC recommending that voluntary compensation should not be exchanged
C. The AARC not issuing a recommendation regarding voluntary compensation

Please explain:

A -> The ARRC should recommend voluntary compensation so that market participants are made whole based on what they believed the discounting curve would be at the time they entered into the trade. Participants should not be rewarded or penalized because the discounting curve was changed. Voluntary compensation is also appropriate so the swaptions market effectively matches the swap compensation conventions.

Question 2.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The AARC recommending that the compensation exchange be at the trade-level and at the time of swaption expiry
B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop
C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Submitted by the Federal Home Loan Bank of Cincinnati
Contact: Tami L. Hendrickson
Senior Vice President, Treasurer
513-852-7581
Hendricksontl@fhlbcin.com

Please explain:

B-> Compensation should be based on the portfolio level to allow for netting of various positions. Earlier timing is preferred so this issue can be closed and will not linger further into the future.

Question 3.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation
B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions

C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism
D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

C -> Recommendation should only apply to legacy swaptions that were entered into before any changes were announced. The purpose behind the compensation is to make investors whole based on what market conventions were expected to be at the time of trade. Compensation should not be provided to those who are aware of the change at the time of the trade. These changes should already be incorporated into the market trading levels when entering into new swaptions after the announcement date.

**If you selected C, which announcement date would you support for a give CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?

The announcement dates should be the same for each CCP. We have no preference on specific announcement date.

Question 4

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve
B. The ARRC recommending that the default be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)
C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)
D. The ARRC not issuing a recommendation regarding specification of a default discount curve.

C -> The ARRC should support the discount rate that is expected to prevail at the time of expiration rather than what the discounting rate is at a given point in time because we are currently in a transition period and it is reasonable to expect the rate to change.

MetLife

Question 1

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged

B. The ARRC recommending that voluntary compensation should not be exchanged

C. The ARRC not issuing a recommendation regarding voluntary compensation Please explain.

Answer 1

C **–** MetLife does not believe that the ARRC should issue a recommendation regarding voluntary compensation. The topic of compensation for legacy swaption positions arises from a perceived valuation difference that may exist between two bilateral counterparties and is not related to the incorporation of an alternative reference rate in a trade contract. We believe that this is outside the scope of the ARRC.

Question 2

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop

C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Answer 2

C – MetLife does not believe that the ARRC should issue a recommendation regarding the timing of the compensation exchange. The topic of compensation for legacy swaption positions and the timing of that compensation arises from a perceived valuation difference that may exist between two bilateral counterparties and is not related to the incorporation of an alternative reference rate in the trade contract. We believe that this is outside the scope of the ARRC.

Question 3

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions

*C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism*

D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Answer 3

D – MetLife does not believe that the ARRC should issue a recommendation regarding a cut-off trade date for compensation as the concept of voluntary compensation on legacy trades arises from a perceived valuation difference that may exist between two bilateral counterparties and is not related to the incorporation of an alternative reference rate in the trade contract. We believe that this is outside the scope of the ARRC.

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve

B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)

C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)

D. The ARRC not issuing a recommendation regarding specification of a default discount curve

Answer 4

D – MetLife does not believe that the ARRC should issue a recommendation regarding the specification of a default discount curve. The selection of a default discount curve on a bilateral trade contract is an election between bilateral counterparties and is outside the scope of the ARRC.

Morgan Stanley

Morgan Stanley

ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

Morgan Stanley is pleased to respond to the Alternative Reference Rates Committee's Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR (the "**Consultation**"). Please find below our answers to each of the questions posed by the Consultation.

Questions 1-3 refer to legacy swaptions

Question 1.
In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

- *A. The ARRC recommending that voluntary compensation should be exchanged*
- *B. The ARRC recommending that voluntary compensation should not be exchanged*
- *C. The ARRC not issuing a recommendation regarding voluntary compensation*

Please explain.

Morgan Stanley supports option (A): the ARRC recommending that voluntary compensation should be exchanged. We believe that option (A) is appropriate due to the change in economics that will result from the CCP discounting transition to SOFR.

Question 2.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

- *A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry*
- *B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop*
- *C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange*

Please explain.

Morgan Stanley supports option (B): the ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop. We believe that a one-time, portfolio-level approach will be operationally more efficient and will most effectively and comprehensively address changes in economics resulting from the discounting transition across all impacted transactions.

Question 3.
If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

- *A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation*

B. *The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions*
C. *The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism*
D. *The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended*

Please explain.

Morgan Stanley supports option (A): the ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation. However, we believe that the effective date of the ARRC's recommendation should be scheduled for several weeks after the announcement, in order to allow time for the market to adjust to the ARRC recommendation.

***If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that?*

<u>*Question 4 refers to new swaptions traded until the CCP discounting switch date*</u>

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. *The ARRC recommending that the default should be to <u>not</u> specify a discount curve*
B. *The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions <u>traded</u> prior to the CCP discounting switch date and SOFR afterwards)*
C. *The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions <u>expiring</u> prior to the expected CCP discounting switch date and SOFR afterwards)*
D. *The ARRC not issuing a recommendation regarding specification of a the default discount curve*

For new swaptions executed until the CCP discounting switch date, Morgan Stanley supports option (C): the ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry. Note that for swaptions executed after the CCP discounting switch date, the market will require a comprehensive approach from the International Swaps and Derivatives Association.

Toronto Dominion

9 March 2020

ATTN: ARRC Secretariat via email submission to:
arrc@ny.frb.org

RE: Consultation on Swaptions Impacted by the
CCP Discounting Transition to SOFR

TD welcomes the opportunity to respond and invites the U.S. Alternative Reference Rates Committee to consider the following submission:

Question 1: In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support: (a) The ARRC recommending that voluntary compensation should be exchanged, (b) The ARRC recommending that voluntary compensation should not be exchanged, or (c) The ARRC not issuing a recommendation regarding voluntary compensation?

TD supports the ARRC not issuing a recommendation regarding voluntary compensation. While the exchange may be beneficial in theory, we hold several material concerns regarding the practical application of such a recommendation. First, the voluntary nature of the recommendation may allow for the presence of adverse selection. Firms that stand to "lose" from the arrangement, overall, may be incentivised to ignore the best practice or to exploit the optionality on a contract-by-contract or relationship-by-relationship basis. In the absence of a mechanism (e.g. industry protocol) which would hold a participant to account across their full portfolio of impacted swaptions, we perceive that the motion may be exploited. Second, there may be compensation valuation differences between counterparties which would require the involvement of an unbiased third party. The potential benefits of compensation exchange should be weighed against the costs required to arrange for an industry-selected vendor solution. Third, the facilitation of compensation exchange may require additional system upgrades and substantial negotiation with affected counterparties. Again, the potential benefits of compensation exchange should be compared to the all-in implementation cost and consider that the resources of most related vendors are currently devoted to other aspects of benchmark reform.

Question 2: If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support: (a) The ARRC recommending that the compensation exchange be at the trade-level and at the time of swaption expiry, (b) The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop, or (c) The ARRC not issuing a recommendation regarding the timing of the compensation exchange?

TD is in favour of the ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop. Preferably, this amendment would take effect directly following the CCPs' transition in October 2020. The impact to long-dated swaptions may require further consideration from the ARRC, if this approach is selected.

Question 3: If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support: (a) The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation, (b) The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions, (c) The ARRC recommending that this only apply to swaptions traded prior to CCP announcements regarding their plans for the

discounting switch and compensation mechanism, or (d) The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended adjustment?

TD supports the ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for "new" swaptions. Firms may have already started to consider the impact of the discounting switch from the time at which preliminary plans were announced and may already incorporate their own assessment of the transition in the pricing of swaptions. However, given that these plans evolved along multiple timelines, the identification of a single, discrete date may be in the best interest of clarity and application. We perceive that alignment with the anticipated ISDA amendments would lend itself to clarity on this issue and facilitate adoption across market participants.

Question 4: In relation to the amendments that ISDA will publish for new swaptions, do you support: (a) The ARRC recommending that the default should be to <u>not</u> specify a discount curve, (b) The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions <u>traded</u> prior to the CCP discounting switch date and SOFR afterwards), (c) The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions <u>expiring</u> prior to the expected CCP discounting switch date and SOFR afterwards), or (d) The ARRC not issuing a recommendation regarding specification of a the default discount curve products.

Of the presented options, TD is most amenable to the ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry. Although we agree with the use of the expected prevailing discount curve at the time of expiry, we would suggest that the explicit specification of that curve be determined by parties to a contract. Firms may provide contractual surety by using ISDA's proposed swaption confirmation parameter, choosing either to specify the discrete rate that they expect to prevail at expiry or to specify this rate indirectly through reference to the ISDA Collateral Cash Price Matrix.

Wells Fargo

March 9, 2020

To: Alternative Reference Rates Committee

via email submission to: arrc@ny.frb.org

Re: ARRC Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR

The following sets forth Wells Fargo & Co.'s ("**Wells Fargo**") response to the Consultation on Swaptions Impacted by the CCP Discounting Transition to SOFR published by the Alternative Reference Rates Committee on February 7, 2020.[1]

Part IV: Consultation Questions

Questions 1-3 refer to legacy swaptions

Question 1.

In light of considerations discussed in Part II and as it relates to legacy swaptions specifically, do you support:

A. The ARRC recommending that voluntary compensation should be exchanged

B. The ARRC recommending that voluntary compensation should not be exchanged

C. The ARRC not issuing a recommendation regarding voluntary compensation

Please explain.

> Option B. Wells Fargo does not support the voluntary exchange of compensation. These "legacy" swaptions do not contemplate an exchange of payment if there is a discounting change, and any change from existing contractual terms would create additional value transfer. Our concern is that such a recommendation would be legally unenforceable and could lead to situations in which some, but not all market participants follow the ARRC's recommendation. A result like this has the potential to lead to negative consequences for firms, such as Wells Fargo, that conduct a dealing business in swaptions. If only a portion of the market follows an ARRC recommendation (*e.g.*, dealers), dealers could be in the situation of paying compensation on a transaction while not receiving compensation on an

[1] These responses reflect Wells Fargo's current views of the approaches identified in the proposal and not any determinations by Wells Fargo with respect to its own business operations. In that regard, the responses are provided for informational purposes only, are not intended to be comprehensive, and Wells Fargo makes no representation regarding their accuracy or applicability to any particular circumstance, product, or categories of or individual transactions.

offsetting transaction which could result in a concentration of risk at dealers. For this reason, Wells Fargo prefers that the ARRC recommend no voluntary payment of compensation.

Question 2.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that the compensation exchange be at the trade-level and at time of swaption expiry

B. The ARRC recommending that the compensation exchange be a one-time, portfolio-level amendment prior to expiry, with compensation exchange at expiry acting as a backstop

C. The ARRC not issuing a recommendation regarding the timing of the compensation exchange

Please explain.

Option B. If the ARRC chooses to issue a recommendation that voluntary compensation should be exchanged, Wells Fargo prefers that this happen as a one-time, portfolio-level event, to align with a change in CCP discounting.

Question 3.

If the ARRC issues a recommendation that voluntary compensation should be exchanged for legacy swaptions, do you support:

A. The ARRC recommending that this only apply to swaptions traded prior to the date on which the ARRC issues its recommendation

B. The ARRC recommending that this only apply to swaptions traded prior to the effective date of the ISDA amendments described above for “new” swaptions

C. The ARRC recommending that this only apply to swaptions traded prior to CCP announcements** regarding their plans for the discounting switch and compensation mechanism

D. The ARRC not issuing a recommendation regarding a cut-off trade date after which compensation would no longer be recommended

Please explain.

Option B. If the ARRC chooses to issue a recommendation that voluntary compensation should be exchanged, Wells Fargo prefers that such a recommendation apply only to swaptions executed prior to the effective date of the ISDA amendments. This approach would ensure that the valuation of “legacy” and “new” transactions are consistent.

**If you selected C, which announcement date would you support for a given CCP, recognizing that LCH and CME released their final plans on different dates and each of them also released preliminary plans prior to that? Question 4 refers to new swaptions traded until the CCP discounting switch date

Question 4.

In relation to the amendments that ISDA will publish for new swaptions, do you support:

A. The ARRC recommending that the default should be to not specify a discount curve

B. The ARRC recommending that the default should be to specify a discount curve that is the prevailing discount curve at time of trade (i.e. EFFR for all swaptions traded prior to the CCP discounting switch date and SOFR afterwards)

C. The ARRC recommending that the default should be to specify a discount curve that is expected to be the prevailing discount curve at time of expiry (i.e. EFFR for all swaptions expiring prior to the expected CCP discounting switch date and SOFR afterwards)

D. The ARRC not issuing a recommendation regarding specification of a the default discount curve

> Option D. As with other ISDA consultations, Wells Fargo does not believe it is necessary for the ARRC make a recommendation on this issue, as the ISDA process sufficiently captures the interests of participants in the OTC swaption market.

Wells Fargo wishes to thank the ARRC for the opportunity to provide responses to this consultation. We are happy to discuss our responses further or provide any additional information that may be helpful.

Thank you,

Wells Fargo