

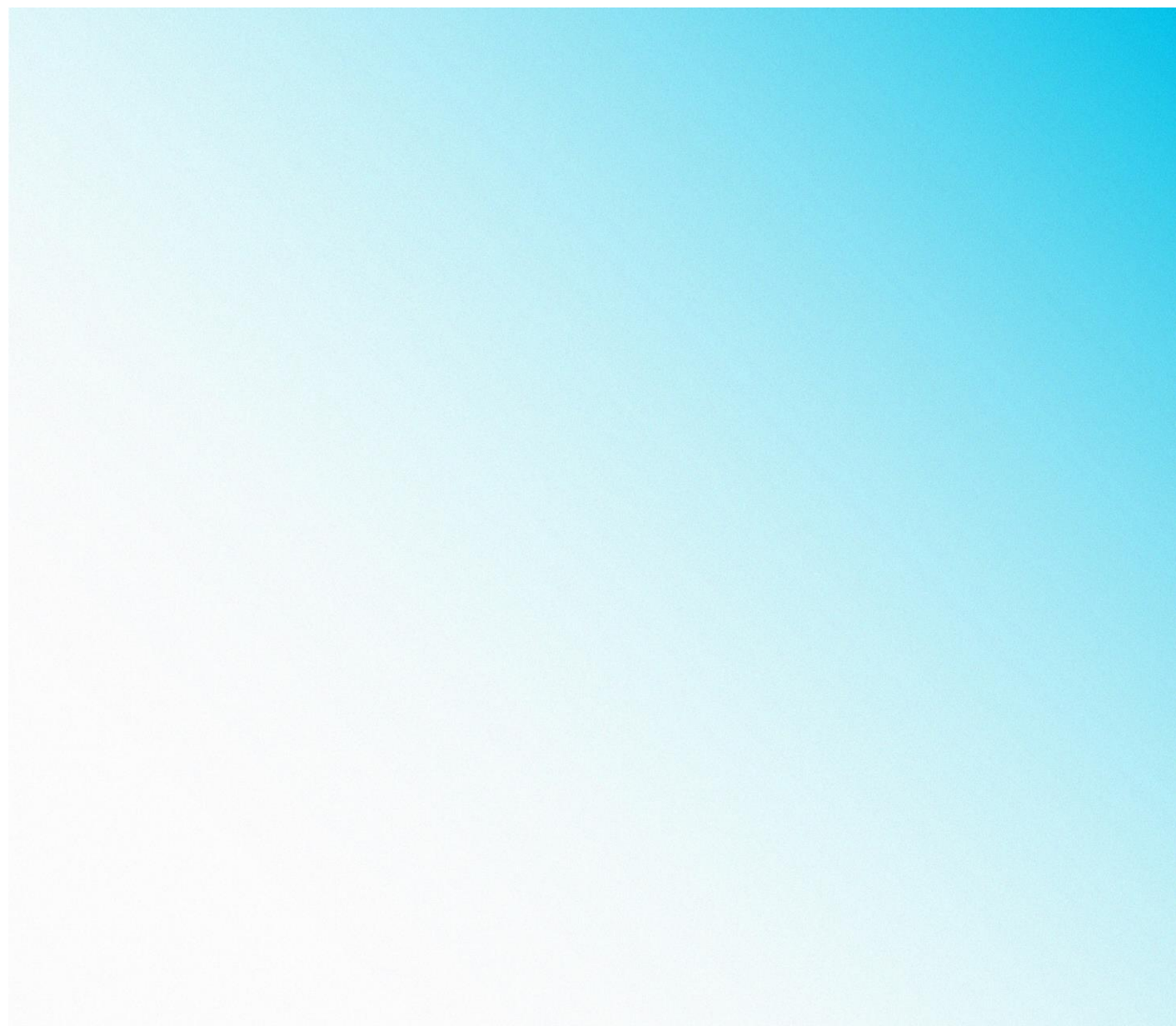
LCH

SwapClear consultation outcome

CAD CDOR contract conversion

October 2023

LCH's approach remains subject to risk governance and legal and regulatory review or approval and may be subject to further change.

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TRADE

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Background

On 16th May 2022, Refinitiv Benchmark Services (UK) Limited (RBSL), CDOR's regulated benchmark administrator, announced the cessation of the publication of all tenors of CDOR after 28th June 2024¹. At the same time, the Ontario Securities Commission² and the Autorité des marchés financiers³ issued decisions authorizing RBSL to cease the publication of CDOR, and ISDA confirmed that such announcement constituted an index cessation event under the ISDA IBOR Fallbacks Supplement and Fallback Protocol⁴.

In this context, on 1st August 2023 LCH Limited ("LCH") issued an invitation to all SwapClear users to respond to a consultation⁵ regarding the treatment of outstanding cleared CAD CDOR SwapClear Contracts at or around the Index Cessation Effective Date and their potential conversion into (or replacement with) corresponding CORRA-based SwapClear Contracts⁶.

In particular, the consultation document⁷ proposed a CAD CDOR conversion approach that was centred on utilising the core conversion functionality deployed by SwapClear in past benchmark transition events, and more recently in relation to the USD LIBOR conversion events occurred in the first half of 2023. LCH then set out SwapClear's proposals in a number of specific areas aimed at addressing the unique specificities of CAD CDOR SwapClear Contracts.

SwapClear requested responses by 29th September⁸, and we experienced active engagement from both members and clients. In each of the areas where we sought feedback, SwapClear participants were able to express agreement with LCH's proposals, as well as to suggest alternative preferences where they disagreed.

We summarise the feedback received and outline the consultation outcome below. We note that there are three areas where LCH will adopt minor modifications to our original proposals based on consultation feedback. The three areas are: (i) Basis Swaps splitting; (ii) CAD CDOR trades that follow the IMM CAD roll convention; and (iii) the timing of the conversion event.

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¹ https://www.refinitiv.com/content/dam/marketing/en_us/documents/methodology/cdor-cessation-notice.pdf

² <https://www.osc.ca/en/securities-law/orders-rulings-decisions/canadian-dollar-offered-rate-and-refinitiv-benchmark-services-uk-limited-1>

³ <https://lautorite.gc.ca/fileadmin/lautorite/professionnels/structures-marche/indice-reference/2022-PDG-0032-cessation-CEDOR.pdf>

⁴ <https://www.isda.org/2022/05/16/isda-statement-on-rbsl-cdor-announcement/>

⁵ <https://www.lch.com/membership/ltm-membership/ltm-member-updates/lch-consultation-conversion-outstanding-cleared-cad>

⁶ "SwapClear Contract" includes an "FCM SwapClear Contract" for the purposes of this circular and the consultation. SwapClear Contract and FCM SwapClear Contract have the meanings assigned to them in the General Regulations or FCM Regulations (as applicable) and made available at <https://www.lch.com/resources/rulebooks/lch-limited>.

⁷ https://www.lch.com/system/files/media_root/lch-cad-cdor-conversion-consultation.pdf

⁸ <https://www.lch.com/membership/ltm-membership/ltm-member-updates/lch-consultation-conversion-outstanding-cleared-cad-0>

Consultation outcome

1. CAD CDOR Conversion event

Respondents to our consultation unanimously supported a CAD CDOR conversion event on or shortly before 28th June 2024, leveraging the core functionality successfully deployed by LCH in past conversions.

In summary, this conversion approach involves:

- i) the generation of Conversion Standard CORRA (Output) contracts, which retain the accrual periods of the original CAD CDOR trade and incorporate the ISDA/BB Spread Adjustment, to maximise cashflow continuity;
- ii) the use of overlay bookings to preserve payments associated with periods based on a CDOR fixing on or prior to cessation;
- iii) cash compensation for the small valuation difference between the original (Input) CDOR contract (valued conforming to ISDA's CORRA-based Fallbacks) and the (Output) Conversion Standard CORRA contract; and
- iv) the use of the same range of LCH Portal functionality and reporting tools that have supported SwapClear users in previous conversions (e.g. REP 315).

2. Input Interest Rate Swap (IRS) Contracts involving CAD CDOR legs with Regular Compounding

As a function of the CAD CDOR swap market, the majority of SwapClear's outstanding CAD CDOR contracts are trades for which the CDOR leg involves compounding. Such legs involve a Payment Frequency higher than their Interest Period Frequency. The most common combinations are: (i) a 3M Interest Period Frequency with 6M Payment Frequency; and (ii) a 1M Interest Period Frequency with 3M Payment Frequency.

All respondents supported the approach proposed by LCH for the conversion of IRS where the CAD CDOR leg involves compounding. Such approach mirrored the methodology taken by SwapClear for the conversion of similar trades in the context of the USD LIBOR conversion.

In summary, LCH's approach is based on the generation of:

- i) an Output Contract in which the CORRA leg adopts the Spread Adjustment corresponding to the interest period frequency of the original CDOR contract (Input contract) and has a payment frequency equal to the payment frequency of the Input contract; and
- ii) overlay bookings to preserve a "truncated" CDOR-based payment running to the end of the irregular compounding period that relies exclusively on period(s) with CDOR fixing(s) on or prior to cessation.

3. Treatment of CAD CDOR/CDOR and CAD CDOR/CORRA Basis Swaps

SwapClear proposed a mandatory service-wide basis swap splitting event whereby all outstanding CAD CDOR/CDOR and CAD CDOR/CORRA basis swaps would be split by LCH into pairs of outright swaps in advance of or coincident with conversion.

Whilst all respondents supported a mandatory basis swap splitting event, some participants expressed the preference for the basis splitting event to not coincide with the conversion due to operational reasons.

As a result, LCH will be moving forward with the following modifications to its original proposals:

- i) SwapClear will extend the Unilateral Basis Splitting Tool (UBST) functionality (developed in the context of USD conversion) to CAD basis swaps. This tool will provide all users with the ability to optimise their portfolios via unilaterally splitting their outstanding CAD basis swaps independently ahead of conversion, enabling control over the process and related timelines;
- ii) any in-scope CAD CDOR/CDOR and CAD CDOR/CORRA basis swaps that are still be outstanding at the point of conversion will be split in a mandatory event occurring on the same date as the CAD CDOR conversion event.

4. CAD CDOR Zero Coupon Swaps (ZCS)

With regards to CAD CDOR swaps in which the CDOR leg involves compounding throughout its life towards a single terminal CDOR-based payment ("ZCS"), LCH proposed to replicate the approach taken for conversion of USD LIBOR ZCS.

All respondents agreed with this approach, which can be summarised as follows:

- i) determination by LCH of the end date of the final floating rate period to which a CDOR fixing on or before cessation applies ("Representative CDOR Accrual End Date");
- ii) LCH will then determine the total floating rate accrued to that date (the "CDOR Accrued");
- iii) LCH will then register Output CORRA Contracts which take the Representative CDOR Accrual End Date as their forward Effective Date. The notional amount of this trade will be the sum of the original notional amount and the CDOR Accrued;
- iv) the fixed leg of the Output CORRA contract will be a fixed known amount that on termination date would be net of the original fixed leg cashflow and CDOR accrued amount up to the end date of the last representative CDOR period;
- v) overlays will also be used as relevant.

5. Treatment of CDOR swaps that follow the IMM CAD roll convention

In its consultation document⁹, LCH proposed an approach based on the preservation of the IMM CAD roll convention and on a combination of output bookings where the (Output) IMM CAD CORRA trade would have a forward effective date different from the original effective date of the (Input) IMM CAD CDOR contract, coupled with an adjusted termination date. LCH also proposed some adjustments to the termination dates of the overlay bookings.

Whilst many respondents agreed with LCH's proposals, several participants with material exposures in this contract type indicated a preference for a different approach, e.g. to persist the original termination date on the converted IMM CAD CORRA trade. In addition, respondents noted ongoing discussions at the industry level in relation to the future of the IMM CAD definitions that are applicable to LCH-cleared swaps as a function of the incorporation of ISDA's definitions in our Rulebook. In this context, SwapClear participants raised comments around potential limitations to the ability of compressing IMM CAD trades in the future and noted that an ideal solution would address not only the IMM CAD CDOR trades in scope for conversion but also any outstanding CORRA trades that follow the IMM CAD roll convention.

In light of the above, LCH will move forward with the following modifications to its original proposals:

- i) LCH will perform the conversion of IMM CAD CDOR trades into IMM CAD CORRA trades by adhering to the standard LCH conversion logic whereby:
 - the (Output) IMM CAD CORRA trade will maintain the original effective date of the (Input) IMM CAD CDOR trade;
 - the termination date of the (Output) IMM CAD CORRA trade will also be the same as the original termination date of the (Input) IMM CAD CDOR trade;
 - the fixed leg of the (Output) IMM CAD CORRA trade will preserve the details of the fixed leg of the original IMM CAD CDOR (Input) trade; and
 - a similar rationale is applied to the overlay bookings to the relevant extent.

- ii) Separately from and likely subsequent to the wider CAD CDOR conversion event, LCH will address the IMM CAD roll convention/definition changes and any related process that would be needed to conform the operational bookings for IMM CAD trades with the applicable definitions.

A worked example in relation to the treatment of CAD CDOR swaps that follow the IMM CAD roll convention for the purpose of the wider CAD conversion event is provided below.

⁹ https://www.lch.com/system/files/media_root/lch-cad-cdor-conversion-consultation.pdf

SwapClear consultation outcome | CAD CDOR contract conversion

Refined Conversion worked example: Floating Leg of IMM CAD CDOR IRS Input Contract

Contractual Feature	Input Contract	Output Contract: Main	Output Contract: Overlay
<i>Notional</i>	CAD 100mn	CAD 100mn	CAD 100mn
<i>Effective Date</i>	13-Mar-2023	13-Mar-2023	13-Mar-2023
<i>Maturity Date</i>	16-Mar-2026	16-Mar-2026	16-Sep-2024
<i>Index</i>	CDOR, 3M	CORRA	CDOR, 3M
<i>Spread</i>	0.00%	0.32138%	0.00%
<i>Period End Dates</i>	Quarterly	Quarterly	Quarterly
<i>Roll Convention</i>	IMM CAD	IMM CAD	IMM CAD
<i>Day Count Fraction</i>	ACT/365	ACT/365	ACT/365
<i>Fixing Lag</i>	0D	0D	0D
<i>First Fixing Date</i>	Effective Date	Effective Date + 1	Effective Date
<i>Last Fixing Date</i>	15-Dec-2025	Termination Date	17-Jun-2024
<i>Fixing Centres</i>	CATO	CATO	CATO
<i>Payment Lag</i>	0D	1D	0D
<i>Payment Calendar</i>	CATO	CATO	CATO

The conversion approach above is supported by the preference to isolate the wider CAD CDOR conversion event, where trades following the IMM CAD roll conventions represent only a subset of the in-scope population, and the need to provide SwapClear participants with certainty in the context of the CAD conversion process for all the trade types in scope.

For the avoidance of doubts, any process that would be needed to conform the operational bookings with the applicable definitions for trades with IMM CAD rolls that span 28th June 2024 will be separate from the CAD CDOR conversion event and with a (different and likely later) timeline that remains to be determined. To this end, LCH intends to further reflect on the various elements raised by our users in relation to how to deal from an operational perspective with relevant changes. In addition, we will monitor progress of discussions at the industry level with regards to the applicable IMM CAD definition (and any potential modifications thereof),

and LCH will continue conversations with all relevant stakeholders with the view of identifying the best way forward as soon as feasible.

As a result, LCH will issue a separate communication on the process needed to conform operational bookings for IMM CAD trades with the applicable definitions in due course, whilst going ahead with the standard approach outlined above for the purpose of converting IMM CAD CDOR trades as part of the wider CAD CDOR conversion event.

6. Timing

LCH proposed a conversion date of Saturday 1st June 2024 and a contingency date of Saturday 15th June 2024.

Whilst some SwapClear participants agreed with the proposed timeline, several respondents expressed concern about the date originally proposed by LCH and expressed a support for a different conversion date due to operational reasons. The majority of these respondents indicated the preference for a marginally later conversion date.

As a result, and having had regards to the relevant calendars, LCH will be moving forward with the following modifications to its original proposals:

- i) LCH CDOR conversion will be scheduled on Saturday 8th June 2024 (i.e. one week later than originally proposed), based on the population of contracts that would be outstanding on EOD Friday 7th June 2024;
- ii) the contingency date will remain Saturday 15th June 2024.

LCH will release in due course more details around the events that will precede the CAD CDOR conversion process, such as the launch of the UBST for CAD Basis swaps and the conversion dress rehearsals that occur in LCH's test environment (UAT). As per standard practices, LCH will provide adequate notice to all SwapClear participants in order to enable them to make the necessary arrangements.

7. Post conversion solutions

In the consultation document, SwapClear proposed not to support the creation of an LCH legacy capability for CAD CDOR contracts post conversion.

The majority of respondents agreed with the approach proposed by LCH. As a result, SwapClear will withdraw the clearing eligibility for CAD CDOR trades following the conversion date, but will provide users with the ability to offset/exit those trades where the last setting before maturity would be based on a CDOR fixing occurring on or prior cessation (e.g. overlays generated as part of the conversion).

Next Steps

Based on the feedback received, LCH intends to move forward with the approaches articulated above, which aim to provide a robust, transparent and standardised back-stop outcome for LCH-cleared CAD CDOR SwapClear Contracts that remain outstanding at or shortly before cessation.

As such, SwapClear participants can now treat LCH's conversion approach and related timeline as final.

LCH reminds all users that the conversion process must be applied consistently to all relevant CAD CDOR contracts and, therefore, cannot provide for any optionality at trade or account level. Customers needing or wanting to use a tailored approach or achieve a tailored outcome should make their own arrangements to close out or transition their CDOR contracts should they wish to avoid the processes outlined here from being applied to them.

LCH also encourages pro-active transition of customers' CDOR trades ahead of LCH's conversion process and believes that providing clarity and certainty over these back-stop outcomes will assist SwapClear participants with their prioritisation and planning.

Further briefing calls will be arranged by LCH to allow users to familiarise themselves with the CAD CDOR conversion process, and LCH will release additional operational details accordingly.

Please note that as with LCH's previous conversion processes, there will be a charge for any CDOR trades subject to it. The applicable pricing structures will be part of a separate communication by LCH.

Finally, LCH will issue in due course a separate communication with regards to the process supporting the operational alignment of IMM CAD trades' bookings with the applicable definitions and roll conventions, which remains subject to further discussions with all relevant stakeholders.

The approach and conversion process described in this document remain subject to risk governance and legal and regulatory review or approval and may be subject to further change.

Should you have any comments or questions on the outcomes of LCH's CAD CDOR conversion consultation, or if you require further information, please do not hesitate to contact CADConversion@lseg.com and lchsales@lseg.com.

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