Swap Package Transactions

CFTC Technology Advisory Committee

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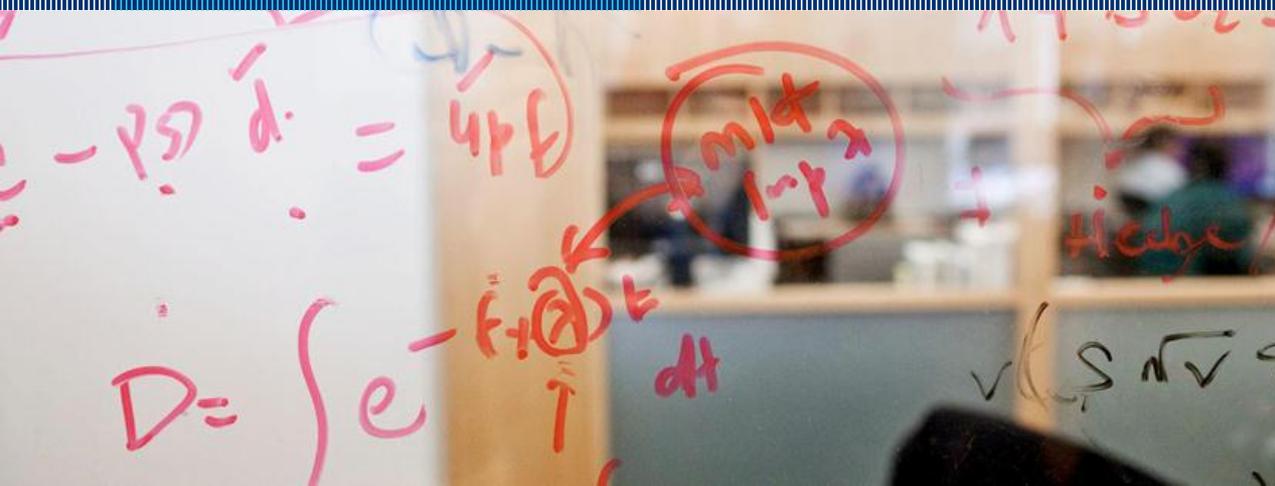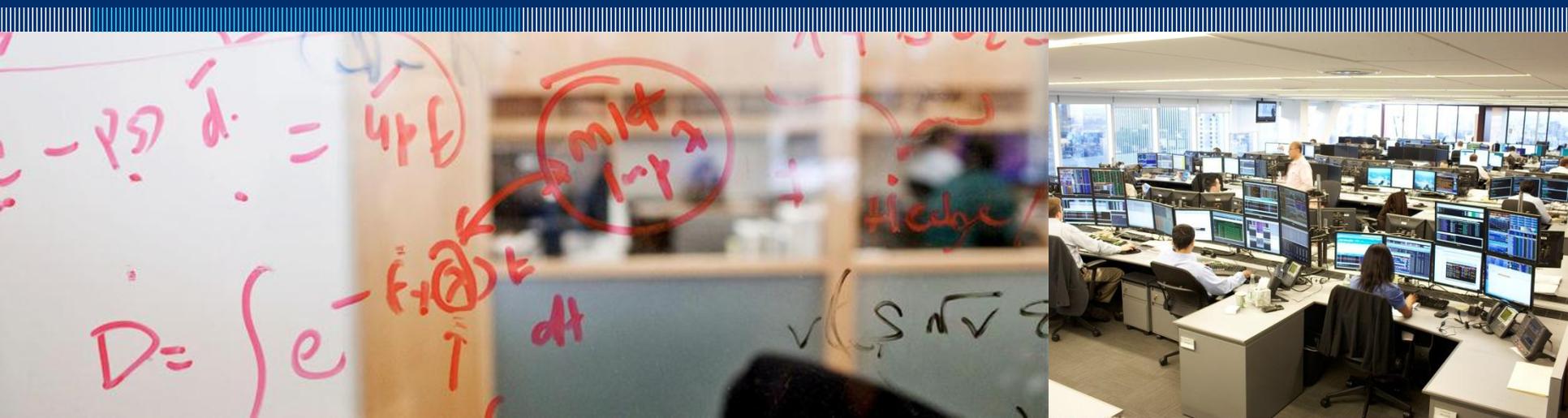
Swap Package Transactions
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Definition

- **Package transactions** involve the simultaneous pricing and execution of two or more component instruments

- **Combination of "buys" and "sells"** (or "payers" and "receivers")

- Reasonable and quantifiable degree of **correlation** between the components

- **Risk** of the offsetting components is approximately **equivalent**

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Examples

- **Swap Curve**: Package of two swaps of differing tenors

- **Swap Butterfly**: Package of three swaps of differing tenors

- **Unwind / Offset packages**: Portfolio of swaps of differing tenors

- **Swap Spreads**: Government bonds vs. swaps typically within similar tenors

- **MBS Basis**: TBAs (Agency MBS) vs. swap spreads

- **Invoice Spreads**: Treasury-note or Treasury-bond futures vs. swaps

- **Cash / Futures Basis**: Eurodollar futures bundles vs. swaps

- **Delta-Neutral Option Packages**: Caps, floors, or swaptions vs. swaps

Economic Benefits

- **Tighter bid-offer spread**

  Package has lower market risk than each outright, directional leg

- **Single vs. multiple bid-offer spreads**

  Separate execution requires paying the bid-offer on each leg

- **More efficient risk transfer and hedging**

  Only net risk is exchanged, rather than outright risk on each leg

- **Elimination of "legging risk"**

  Risk that the market moves between the execution of each leg

Representative Analysis of Transaction Costs
Swap Spread (Swap vs. Treasury)

Execution as Two Separate Legs

- Pay 4.15 bps vs. mid of 3.75 bps

- Effective price = 0.4 bps

- x $90,000 (DV01 per $100mm notional on a 10Y swap spread)

- **Transaction Cost = ~$36,000**

Execution as a Package

- Pay 3.875 bps vs. mid of 3.75bps

- Effective price = 0.125 bps

- x $90,000 (DV01 per $100mm notional on a 10Y swap spread)

- **Transaction Cost = ~$11,250**

Market pricing (as observed the morning of November 20, 2013)

Product	Bid	Ask	Implied Mid
10Y Treasury	2.7045 %	2.7085 %	2.7065 %
10Y Swap	2.742 %	2.746 %	2.744 %
10Y Swap Spread	3.625 bps	3.875 bps	3.75bps

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Representative Analysis of Transaction Costs
Swap Curve (Swap vs. Swap)

Execution as Two Separate Legs

- Pay 132 bps vs. mid of 131.55 bps

- Effective price = 0.45 bps

- x $50,000 (DV01 per $100mm notional on a 5Y swap curve)

- **Transaction Cost = ~$22,500**

Execution as a Package

- Pay 131.7 bps vs. mid of 131.55 bps

- Effective price = 0.15 bps

- x $50,000 (DV01 per $100mm notional on a 5Y swap curve)

- **Transaction Cost = ~$7,500**

Market pricing (as observed the morning of November 20, 2013)

Product	Bid	Ask	Implied Mid
5Y Swap	1.426 %	1.430 %	1.428 %
10Y Swap	2.742 %	2.746 %	2.744 %
5/10 Swap Curve	131.4 bps	131.7 bps	131.55 bps

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Select Items to Address

- **Multi-swap package transactions**

  Communication protocol and credit limit checking of net risk

- **Swap spreads**

  Guaranteeing settlement of the US Treasury leg

- **Invoice spreads**

  Separate regulatory regime for swaps and futures

- **"EFRP" model for swaps**

  Transferability of the futures market's solution for package transactions

Recommendations

- **Do No Harm** – As a threshold matter, avoid breaking up the simultaneous pricing and execution of package transactions

- **Identify Issues & Solutions** – For example:

  For Multi-Swap Package Transactions...

  Collaborative industry enhancements to the execution-to-clearing workflow that support these package transactions

  For Swap vs. Non-Swap Package Transactions...

  Development of execution paradigms / protocols that are viable for these package transactions (including an "EFRP" style process for swaps)

- **Provide Time to Implement Solutions for Package Transactions**

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