

香港場外結算有限公司
(香港交易及結算所有限公司附屬公司)

OTC CLEARING HONG KONG LIMITED
(A subsidiary of Hong Kong Exchanges and Clearing Limited)

通告 CIRCULAR

Subject: SOFR Discounting Switch Notice – CCS, DFX and NDF

Enquiry: OTC Clear Operations Team (OTC_Operations@hkex.com.hk)

OTC Clearing Hong Kong Limited (**OTC Clear**) sets out in this circular (the **SOFR Discounting Switch Notice – CCS, DFX and NDF**) the details of the CCS, DFX and NDF transition to SOFR discounting to be implemented under the SOFR Discounting Switch Supplement¹. All capitalised terms not otherwise defined herein shall have the meanings given to them in the OTC Clear Rates and FX Derivatives Clearing Rules, the Clearing Procedures and the SOFR Discounting Switch Supplement.

1. SOFR Discounting Switch

The switch of USD discount rate from Fed Funds Rate to SOFR will result in a valuation change and a risk profile change to the portfolios with in-scope products. OTC Clear will use Cash Compensation Amounts and Compensating Swaps (SOFR) to address these two changes respectively in accordance to, and pursuant to the SOFR Discounting Switch Supplement.

(a) Cash Compensation Amounts

On the SOFR Discounting Effective Date, in order to neutralise the valuation changes attributable to the use of the new discounting curve in connection with the SOFR Discounting Switch, OTC Clear will make a cash adjustment that is equal and opposite to the resultant change in the Net Present Value (NPV) of each Affected FX and Rates Derivatives Contract as part of a special end-of-day valuation cycle.

(b) Compensating Swap (SOFR)

The switch of the USD discount rate from Fed Funds Rate to SOFR will also result in a risk profile change to portfolios with Affected FX and Rates Derivatives Contracts as Fed Funds Rate discounting risk becomes SOFR discounting risk at the point of conversion.

¹ https://www.hkex.com.hk/-/media/HKEX-Market/Services/Rules-and-Forms-and-Fees/Rules/OTC-Clear/Rules/OTCR_29_Sup-1.pdf?la=en

Compensating Swaps (SOFR) are intended to mitigate any distortion in the spread between the two discount rates at conversion. The Compensating Swaps (SOFR) can hedge against price movements, due to market fluctuation in Fed Funds Rate / SOFR basis. It is cost efficient as the required hedges are determined centrally by OTC Clear and provided to all CMs at no cost.

Opt-in / opt-out elections

OTC Clear recognises that some Clearing Members may not be able to manage the Compensating Swaps (SOFR) due to their own system or trading constraints. An “opt-in / opt-out” option is therefore offered to Clearing Members.

All Clearing Members are required to sign and return the Swap Election Notice setting out their election to opt in or opt out for the Compensating Swaps (SOFR) to OTC Clear by the Swap Election Cut-off Date. If no response is received by the Swap Election Cut-off Date, OTC Clear will consider the Clearing Member as having opted out of the Compensating Swaps (SOFR).

For Clearing Members who have opted in for the Compensating Swaps (SOFR), OTC Clear will book a series of Fed Funds Rate / SOFR basis swaps to Clearing Members' accounts as further described in the SOFR Discounting Switch Supplement.

OTC Clear will assist Clearing Members who have opted out of the Compensating Swaps (SOFR) to liquidate their unwanted Compensating Swap (SOFR) via a centralised auction and the cash amount derived from auction prices will be allocated between the Auction Winner and the Clearing Members who have elected to opt out through payments of the CAP Amounts and Adjusted CAP Amounts as applicable.

To ensure the auction price is competitive, it is mandatory for each Clearing Member who has opted in to participate in the SOFR Discounting Auction in respect of each of its opt-in accounts.

Auction Criteria

The auction will be in an all-or-nothing format. The below auction criteria will be imposed:

1. OTC Clear will impose maximum bid-ask spread based on one-year historical market data from the period 1 April 2020 to 31 March 2021;

Compensating Swap (SOFR) Tenor	2-year	5-year	10-year	15-year
Max bid-ask spread (bps)	4.4	8.1	8.2	8.0

2. Auction Participants are required to submit two-way (bid and ask) price quotes for the Net Auction Swap of each Maturity Bucket;
3. The price quotes should be provided in the format of receive SOFR plus or minus a spread and pay Fed Funds Rate with no spread;
4. The price quotes must be received within the auction period on the Transition Date.

Registration fee

The registration fee of the compensating swaps will be waived in accordance with section 3.8.2.1 of the Clearing Procedures.

2. Rates

For the purposes of the Discounting Switch Supplement read with Clearing Rule 10A01:

“Existing Discount Rate” means Fed Funds Rate.

“New Discount Rate” means SOFR.

3. Timing

“SOFR Discounting Effective Date” means 21 June 2021.

“Swap Election Cut-off Date” means 30 April 2021.

“Swap Portfolio Calculation Date” means 16 June 2021.

“Transition Date (SOFR)” means 18 June 2021.

4. Scope of Affected FX and Rates Derivatives Contracts

For the purposes of the SOFR Discounting Switch Supplement, the following are Affected FX and Rates Derivatives Contracts:

- (a) Cross-currency Swaps;
- (b) Deliverable FX Derivatives; and
- (c) Non-deliverable FX Derivatives.

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