

MANAGING SWAP BOOK RISK

Fast Facts

What is it?

Euro Swapnote[®] is an on-exchange futures contract referenced to the European interbank curve.

Who is it for?

Euro Swapnote[®] futures are for anyone who wishes to gain or hedge exposure to the European interest rate swaps curve via a centrally cleared contract.

What does it provide?

Euro Swapnote[®] provides an open and efficient means of gaining euro swap market exposure in a contract that already meets new regulatory requirements.

Euro Swapnote[®] futures are priced like a bond futures contract, but with the same yield structure as the euro swap curve. Consequently, Euro Swapnote[®] futures are an effective instrument for managing swap book risk.

On 27 March a Swap portfolio consists of the following:

- Pay 2.223% €20m 15 Feb 2021
- Pay 2.135% €40m 17 Feb 2021
- Pay 2.233% €60m 29 Mar 2021 (9 Year Par Swap)

The portfolio has the following values:

- Notional Size: €120,000,000
- Mark to Market Valuation: -€197,680
- Sensitivity or Basis Point Value (BPV): €93,924

The portfolio manager wishes to hedge this portfolio using 10 Year € Swapnote[®] futures. Market values are as follows:

- 10 Year € Swapnote[®] price: 132.51
- 10 Year € Swapnote[®] BPV: €105.65 per lot

PAR SWAP RATES

MATURITY	SPOT	IMM
1*	0.749%	0.676%
2	1.075%	1.088%
3	1.227%	1.269%
4	1.417%	1.478%
5	1.617%	1.681%
6	1.805%	1.870%
7	1.973%	2.035%
8	2.116%	2.173%
9	2.233%	2.286%
10	2.335%	2.385%

* Swapnote[®] follows the ISDAFIX[®] convention which reflects market liquidity, using the 1 year swap rate quoted vs 3m Euribor[®], and all other maturities quoted vs 6m Euribor.

The portfolio manager uses the BPV ratio to calculate the number of futures contracts required to hedge the Swap portfolio:

- Ratio = BPV (swap portfolio) / BPV (future) = 93,924 / 105.65 = 889 contracts

The Swap portfolio is net paying fixed in the swap, akin to being short the bond market. So to hedge the portfolio manager needs to buy Euro Swapnote® futures.

On 14 June, the portfolio manager examines the hedge performance. Market values are now as follows:

- 10 Year € Swapnote® price: 137.55

Further Information

Interest Rate Derivatives

+44 (0)20 7429 4640

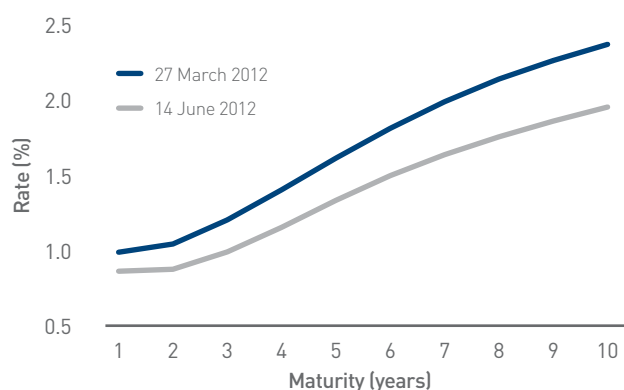
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PAR SWAP RATES

MATURITY	SPOT	IMM
1*	0.672%	0.634%
2	0.919%	0.919%
3	1.025%	1.027%
4	1.175%	1.175%
5	1.340%	1.341%
6	1.491%	1.493%
7	1.619%	1.620%
8	1.728%	1.730%
9	1.824%	1.825%
10	1.910%	1.911%

SPOT SWAP RATES



Yields have fallen over the period of the hedge and the portfolio has fallen in value; now valued at:

- €4,274,606, giving a P&L swing of **-€4,472,286**

As yields have fallen, the Swapnote® futures price will have risen such that the futures hedge will have offset the loss on the Swap portfolio:

- Return on hedge =
No. of Contracts x (Exit Price – Entry Price) x Tick Value / Tick Size
- Return = 889 x (137.55 – 132.51) x €10 / 0.01 = **€4,480,560**

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