A Note on Development

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1 Payoff Decomposition

ELS Payoff, denoted by X is like:

$$\begin{aligned}
X =& \sum_{i=1}^{N}\Big(\prod_{j<i}\mathbb{1}_{S_{T_j}<\mathcal{R}_j}\Big)\mathbb{1}_{S_{T_i}\geq\mathcal{R}_i}C_i + \sum_{i=1}^{L}\Big(\prod_{j<i}\mathbb{1}_{S_{T_j}<\mathcal{R}_j}\Big)\mathbb{1}_{S^*_{(T_{i-1},T_i]}\geq\mathcal{L}_i}C_i^L \\
&+\Big(\prod_{j<N}\mathbb{1}_{S_{T_j}<\mathcal{R}_j}\Big)\Big(\mathbb{1}_{S^*_T<\mathcal{B}}\phi(S_T)+\mathbb{1}_{S^*_T\geq\mathcal{B}}C^B\Big) \\
=& \sum_{i=1}^{N}\Big(\prod_{j<i}\mathbb{1}_{S_{T_j}<\mathcal{R}_j}\Big)\mathbb{1}_{S_{T_i}\geq\mathcal{R}_i}C_i + \sum_{i=1}^{L}\Big(\prod_{j<i}\mathbb{1}_{S_{T_j}<\mathcal{R}_j}\Big)\mathbb{1}_{S^*_{(T_{i-1},T_i]}\geq\mathcal{L}_i}C_i^L \\
&+\Big(\prod_{j<N}\mathbb{1}_{S_{T_j}<\mathcal{R}_j}\Big)\Big(\phi(S_T)+\mathbb{1}_{S^*_T\geq\mathcal{B}}(C^B-\phi(S_T))\Big) \\
=& \sum_{i=1}^{N-1}\Big(\prod_{j<i}\mathbb{1}_{S_{T_j}<\mathcal{R}_j}\Big)\mathbb{1}_{S_{T_i}\geq\mathcal{R}_i}C_i + \Big(\prod_{j<N-1}\mathbb{1}_{S_{T_j}<\mathcal{R}_j}\Big)\Big(\mathbb{1}_{S_{T_N}\geq\mathcal{R}_N}C_N+\mathbb{1}_{S_{T_N}<\mathcal{R}_N}\phi(S_T)\Big) \\
&+\sum_{i=1}^{L}\Big(\prod_{j<i}\mathbb{1}_{S_{T_j}<\mathcal{R}_j}\Big)\mathbb{1}_{S^*_{(T_{i-1},T_i]}\geq\mathcal{L}_i}C_i^L \\
&+\Big(\prod_{j<N}\mathbb{1}_{S_{T_j}<\mathcal{R}_j}\Big)\mathbb{1}_{S^*_T\geq\mathcal{B}}(C^B-\phi(S_T))
\end{aligned} \tag{1.1}$$

Hence there should be $L+2$ grids: one for ranges, L for the lizard barriers, one for the maturity barrier.

2 OIS Schedule

Let us denote the calculation period pair of fixing, value start, value end, payment dates by:

$$I_i = \{\phi_i, \sigma_i, \epsilon_i\}. \tag{2.1}$$

To explain the notation, we usually have $\epsilon_i - \sigma_i = \mathrm{Day}(1)$ in overnight index cases. These periods comprise the swap intervals $\{\{S_i, E_i, \Pi_i\}\}_i$ such that:

$$(S_i, E_i] := (\sigma_{M_i}, \epsilon_{N_i}] = \cup(\sigma_k, \epsilon_k], \tag{2.2}$$

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and Π_i represents the regarding payment date. Then, for a given evaluation date $t \geq 0$, find the earliest payment date and its valu end date:

$$t \mapsto \Pi_{i(t)} \mapsto E_{i(t)}. \tag{2.3}$$

The next step is to find the latest end date of the past data earlier than $E_{i(t)}$:

$$E_{i(t)} \geq \epsilon^*_{i(t)} := \{\epsilon_i \mid (\phi_i, \sigma_i, \epsilon_i) \text{ of the past data}\}. \tag{2.4}$$

In addition, find the earlist value start date (of the fixing data) and fixing date:

$$S_{i(t)} \mapsto (\phi^*_{i(t)}, \sigma^*_{i(t)}) \tag{2.5}$$

Then, the calculation starts from:

$$\sigma^*_{i(t)} \wedge S_{i(t)}. \tag{2.6}$$

For the forcasting, we obtain:

$$[1 + C(0, 0, E_{i(t)})(E_{i(t)} - \epsilon^*_{i(t)})] \tag{2.7}$$

For any case that the next value start date $S_{i(t)+1}$ needs a past data, we calculate:

$$C(t, S_i \vee 0, E_i)(E_i - S_i) \tag{2.8}$$

3 Local Volatility

Note that (S)SVI models represents the total variance with respect to:

$$y = \ln\Big(\frac{K}{F}\Big). \tag{3.1}$$

In other words:

$$w(y) = \sigma^2(T, Fe^k)T. \tag{3.2}$$

Recall the Dupire formula:

$$v_L = \frac{\partial_T w}{1 - \frac{y}{w}\partial_y w + \frac{1}{4}\Big(-\frac{1}{4} - \frac{1}{w} + \frac{y^2}{w^2}\Big)(\partial_y w)^2 + \frac{1}{2}\partial_y^2 w}. \tag{3.3}$$

Hence, recall that $\sigma_L^{BS}(T, Fe^y) = \sqrt{v_L(y)}$, in other words:

$$\sigma_L^{BS}(T, K) = \sqrt{v_L\Big(\ln\Big(\frac{K}{F}\Big)\Big)}. \tag{3.4}$$

For any $T < T_1$ and $T > T_N$, the possible extrapolation may be:

$$\sigma_L^{BS}\Big(T_1,\ K\frac{F_1}{F}\Big) \text{ and } \sigma_L^{BS}\Big(T_N,\ K\frac{F_N}{F}\Big) \tag{3.5}$$