



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Market Oversight

Re: Staff No-Action Relief from the Trade Execution Requirement to Facilitate an Orderly Transition from Inter-Bank Offered Rates to Alternative Risk-Free Rates

Ladies and Gentlemen:

This letter from the Division of Market Oversight (“DMO”) of the Commodity Futures Trading Commission (“CFTC” or “Commission”) responds to a November 5, 2019 letter from the Alternative Reference Rate Committee (“ARRC”)¹ and its member firms that are subject to certain requirements under the Commodity Exchange Act (“CEA” or “Act”) and Commission regulations.² Among other things, the ARRC requested certain clarification from DMO regarding the application of the trade execution requirement under section 2(h)(8) of the CEA, in order to support the industry-wide initiative associated with the transition of swaps that reference the London Interbank Offered Rate (“LIBOR”) and other interbank offered rates (collectively with LIBOR, the “IBORs”)³ to swaps that reference risk-free rates (“RFRs”).

I. Factual Background

In response to significant concerns regarding the reliability and robustness of the IBORs, the Financial Stability Board (“FSB”) called for the identification of alternative benchmarks to the IBORs and transition plans to support implementation of these alternatives.⁴ The U.S.

¹ Authorities representing United States (“U.S.”) banking regulators and other financial sector members, including the Commission, serve as non-voting *ex officio* members of the ARRC.

² The ARRC, Treatment of Swaps Amended or Otherwise Transitioned from IBOR to Alternative Risk Free Rates under the Commodity Exchange Act, (November 5, 2019) (“ARRC November 2019 Letter”). In formulating this letter, DMO considered the ARRC November 2019 Letter, along with prior letters submitted to Commission staff by the ARRC, as well as in-person discussions with the ARRC related to the ARRC’s requested relief.

³ IBORs include, but are not limited to, U.S. dollar (“USD”) LIBOR, British pound (“GBP”) LIBOR, Japanese yen (“JYP”) LIBOR, the Tokyo Interbank Offered Rate (“TIBOR”), the Australian Bank Bill Swap Rate (“BBSW”), the Singapore Interbank Offered Rate (“SIBOR”), the Canadian Dollar Offered Rate (“CDOR”), the Euro Interbank Offered Rate (“EURIBOR”), and the Hong Kong Interbank Offered Rate (“HIBOR”).

⁴ See FSB statement, “Interest rate benchmark reform – overnight risk-free rates and term rates” (July 12, 2018), available at: <https://www.fsb.org/2018/07/interest-rate-benchmark-reform-overnight-risk-free-rates-and-term-rates/> (“Because derivatives represent a particularly large exposure to certain IBORs, and because these prospective RFR-

Financial Stability Oversight Council (“FSOC”) has made repeated calls for member agencies to work closely with market participants to identify and mitigate risks that may arise during an IBOR transition process.⁵ In response to ongoing efforts such as these, central banks in various jurisdictions, including the U.S., United Kingdom (“U.K.”), Japan, Switzerland, and European Union, have convened working groups of official sector representatives and market participants.

In 2014, the Federal Reserve Bank of New York convened the ARRC in order to identify best practices for U.S. alternative reference rates, identify best practices for contract robustness, develop an adoption plan, and create an implementation plan with metrics of success and a timeline.⁶ Similar committees have been established in other jurisdictions, including the U.K., Japan, Switzerland, and European Union.

In June 2017, the ARRC identified a broad Treasuries repo financing rate, the secured overnight financing rate (“SOFR”), as the preferred alternative benchmark to USD LIBOR for certain new USD derivatives and other financial contracts.⁷ The ARRC also published an updated paced transition plan outlining the steps that the ARRC, derivatives clearing organizations, and other market participants intend to take in order to progressively build the liquidity required to support the issuance of, and transition to, contracts referencing SOFR.⁸ In accordance with the ARRC’s plan and similar plans in other jurisdictions, trading of SOFR-

derived term rates can only be robustly created if derivatives markets on the overnight RFRs are actively and predominantly used, the FSB believes that transition of most derivatives to the more robust overnight RFRs is important to ensuring financial stability.”). *See also* See also FSB Reforming Major Interest Rate Benchmarks (July 22, 2014), available at: https://www.fsb.org/wp-content/uploads/r_140722.pdf; IOSCO Principles for Financial Bench-marks: Final Report (July 2013), available at: <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>; and Statement on Communication and Outreach to Inform Relevant Stakeholders Regarding Benchmarks Transition by the Board of the International Organization of Securities Commissions (IOSCO), July 31, 2019, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD636.pdf>.

⁵ *See, e.g.*, FSOC 2018 Annual Report, pages 4-5, 8-9, 108-109 (Dec. 19, 2018), available at: <https://home.treasury.gov/system/files/261/FSOC2018AnnualReport.pdf> (“The uncertainty surrounding LIBOR’s sustainability may threaten individual financial institutions and the U.S. financial system more broadly. Specifically, without advance preparation, a sudden cessation of such a heavily used reference rate could cause considerable disruptions to, and uncertainties around, the large flows of LIBOR-related payments. It could also impair the functioning of a variety of markets, including business and consumer lending The Council recommends that member agencies work closely with market participants to identify and mitigate risks from potential dislocations during the transition process.”); *see also* FSOC 2013 Annual Report, pages 6, 14-15, 137, 140-142 (June 2013) available at: <https://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202013%20Annual%20Report.pdf>.

⁶ In March 2018, the ARRC was reconstituted with expanded participation by additional financial institutions and trade organizations, and with additional government agencies added as *ex officio* members. *See* Alternative Reference Rates Committee, Press Release, March 7, 2018, available at <https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-March-7-2018-press-release.pdf>.

⁷ *See* the ARRC, Press Release, June 22, 2017, available at <https://www.newyorkfed.org/medialibrary/microsites/arrc/files/2017/ARRC-press-release-Jun-22-2017.pdf>.

⁸ In 2019, the ARRC released an incremental objectives document that compliments the paced transition plan, available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC_2019_Incremental_Objectives.pdf.

based derivatives and other financial contracts linked to alternative benchmarks commenced in 2018 and has continued to expand in scope in 2019.⁹

In July 2017, the U.K. Financial Conduct Authority (“FCA”), which regulates ICE Benchmark Administration Limited, the administrator of LIBOR,¹⁰ announced that it has sought commitments from LIBOR panel banks to continue to contribute to LIBOR through the end of 2021, but that the FCA will not use its powers to compel or persuade contributions beyond such date.¹¹ The submissions by panel banks serve as inputs to formulate LIBOR rates in five currencies, namely, USD LIBOR, EUR LIBOR, GBP LIBOR, CHF LIBOR, and JPY LIBOR. In addition, the Singapore dollar (“SGD”) Swap Offer Rate (“SOR”) is computed based on transactions that reference USD LIBOR.

Non-U.S. jurisdictions also have determined that applicable reference rates are no longer representative benchmarks due to a significant impairment as determined by authorized benchmark administrators or the relevant authority in a particular jurisdiction.¹² For example, in the U.K., the Working Group on Risk-Free Reference Rates recommended the Sterling Overnight Index Average (“SONIA”) as the recommended replacement rate for GBP LIBOR.¹³ Similarly, in Japan, the Cross-Industry Committee on Japanese Yen Interest Rate benchmarks has identified the Tokyo Overnight Average Rate (“TONA”) as the preferred replacement rate for JPY TIBOR, where appropriate.¹⁴ In Switzerland, the National Working Group on Swiss Franc Reference Rates has recommended the CHF Swiss Average Rate Overnight (“SARON”) as the alternative rate to replace CHF LIBOR. In Singapore, the Monetary Authority of Singapore (“MAS”) recently announced that SOR will transition to the Singapore Overnight Rate Average (“SORA”), a SGD risk-free rate benchmark.¹⁵ In the European Union, the

⁹ Information regarding the progress of trading SOFR derivatives to date can be found at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/SOFR_Anniversary.pdf and <https://www.isda.org/a/xogME/Benchmarks-Full-Year-2018.pdf>.

¹⁰ ICE Benchmark Administration Limited is the administrator for LIBOR rates in five currencies. The trade execution requirement applies to certain tenors of IRS with LIBOR floating rates in two of those currencies: USD and GBP.

¹¹ See Speech by Andrew Bailey, Chief Executive of the FCA, at Bloomberg London, UK, July 27, 2017, available at: <https://www.fca.org.uk/news/speeches/the-future-of-libor>.

¹² When making such a determination, benchmark administrators and authorities supervising benchmark administrators have considered whether the benchmark (and, by extension, its administrator) satisfies the Principles for Financial Benchmarks published by the Board of the International Organization of Securities Commissions, July 2013, available at: <http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf>.

¹³ The IRS clearing requirement applies to overnight index swaps with a SONIA floating rate and a term between 7 days and 3 years. However, as of the date of this letter, no swaps referencing SONIA floating rates have been made subject to the trade execution requirement.

¹⁴ However, for JPY LIBOR swaps, the Japanese committee noted that either JPY TIBOR or JPY TONA may be an appropriate replacement rate so the committee is monitoring the progress of market-led initiatives and will continue to consult regarding the transition.

¹⁵ See MAS press release (Aug. 30, 2019), available at: <https://www.mas.gov.sg/news/media-releases/2019/mas-sets-up-steering-committee-to-drive-the-interest-rate-benchmark-transition-from-sgd-sor-to-sora>. The industry

working group on euro risk-free rates selected the euro short-term rate (“€STR”) as an alternative benchmark to the euro overnight index average (“EONIA”) and the foundation for fallback rate calculations for EURIBOR-linked contracts.

II. The ARRC’s Request for Relief

The ARRC contends that certainty regarding the application of requirements under the CEA and Commission regulations to mechanisms used by market participants to effect the transition from IBORs to RFRs will help to facilitate the orderly transition away from the use of IBORs. To help ensure continuity of swaps through this transition, and to encourage the early, voluntary transition to RFRs, which the ARRC believes should help to avoid potential operational and market disruptions, and to build liquidity and depth in RFR markets, the ARRC has, among other things, requested that DMO provide clarity regarding the application of the trade execution requirement under section 2(h)(8) of the CEA, when market participants use certain mechanisms to transition swaps and swap portfolios from IBORs to RFRs.¹⁶ In its request, the ARRC states that this transition is expected to take different forms, “depending on the needs of counterparties, the nature of the particular swap or swap portfolio being transitioned, and the liquidity and availability of products referencing new RFRs.”¹⁷ As such, the ARRC asks Commission staff to consider the need for market participants to have certain flexibility to implement transition mechanisms that take into account individual facts and circumstances.

III. IBOR Transition Mechanisms

A. Fallback Amendments

The International Swaps and Derivatives Association, Inc. (“ISDA”) is currently developing an industry protocol as one way to effectuate the transition from IBORs to RFRs. The ISDA protocol will allow market participants to amend IBOR-linked swap contracts to include fallback provisions which, upon the cessation of the relevant IBOR, will replace the IBOR with a new RFR, without the need for extensive, bilateral negotiations. The ISDA protocol is based on consultations with and commentary from the industry. As of the date of this letter, ISDA has not yet finalized the protocol and its associated templates. ISDA expects to finalize such documentation by the end of 2019, with implementation in early 2020.

working group in Singapore, led by the Association of Banks in Singapore and Singapore Foreign Exchange Market Committee, recommended that swaps referencing SGD SOR be transitioned to SORA, a transaction-based overnight interest rate benchmark. The transition is envisaged to take place over the next few years ahead of end-2021. *See* Roadmap for Transition of Interest Rate Benchmarks: From SGD Swap Offer Rate (SOR) to Singapore Overnight Rate Average (SORA) (Aug. 30, 2019) available at: <https://abs.org.sg/docs/library/consultation-report-on-roadmap-for-transition-of-interest-rate-benchmarks-from-sor-to-sora.pdf>.

¹⁶ The ARRC November 2019 Letter also requests relief and guidance from the Commission’s Division of Clearing and Risk (“DCR”) and Division of Swap Dealer and Intermediary Oversight (“DSIO”), which will be addressed separately by DCR and DSIO.

¹⁷ ARRC November 2019 Letter at 3.

The ARRC anticipates that a significant portion of swap contract amendments that serve to replace an IBOR with a new RFR upon – and only upon – the cessation of such IBOR will be effected through the ISDA protocol, but notes that some counterparties may instead enter into such amendments bilaterally. For purposes of this letter, amendments of IBOR-linked swaps to include fallbacks to new RFRs that are triggered when the applicable IBOR is unavailable, permanently discontinued, or is determined to be non-representative by the benchmark administrator or the relevant authority in a jurisdiction - including such amendments that are effected by the ISDA protocol - will be referred to as “**Fallback Amendments**”.

B. Replacement Rate Amendments

According to the ARRC, some market participants may choose to voluntarily amend IBOR-linked swaps to reference RFRs prior to the cessation of the applicable IBOR (“**Replacement Rate Amendments**”). Replacement Rate Amendments will be effected bilaterally between swap counterparties and are expected to be accomplished in a variety of ways to address different facts and circumstances. The ARRC has identified certain methods of conversion considered likely to be used by market participants when effecting Replacement Rate Amendments.¹⁸

C. New RFR Swaps

Market participants also will trade new swaps that reference RFRs (“**New RFR Swaps**”). According to the ARRC, the requested relief will provide enhanced regulatory certainty, which will help to build liquidity in New RFR Swaps, which will support a smooth and orderly transition from IBORs to RFRs.

The ARRC represents that in certain cases, it may be more efficient for counterparties to execute New RFR Swaps to transition swaps or swap portfolios from an IBOR to a new RFR, than to enter into Replacement Rate Amendments. The execution of New RFR Swaps for such purpose, as well as Fallback Amendments and Replacement Rate Amendments, are collectively referred to in this letter as “**IBOR Transition Mechanisms.**”

IV. Applicable Regulatory Requirements

A. Trade Execution Requirement

Pursuant to section 2(h)(8) of the CEA, swap transactions that are subject to the clearing requirement¹⁹ must be executed on a designated contract market (“DCM”), swap execution

¹⁸ See the ARRC, Follow-up Letter Regarding Treatment of Derivatives Contracts Referencing the Alternative Risk-Free Rates, Appendix 2 (May 13, 2019) (for a list of methods of conversion currently conceptualized by the ARRC). For avoidance of doubt, DMO notes that pursuant to Part 37 of the Commission’s regulations multiple-to-multiple execution must be executed through a SEF.

¹⁹ CEA section 2(h)(1)(A) provides that “[i]t shall be unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization that is registered under this Act or a derivatives clearing organization that is exempt from registration under this Act if the swap is required to be cleared.” 7 U.S.C. § 2(h)(1)(A). See also 17 CFR Part 50.

facility (“SEF”) that is registered with the Commission, or a SEF that is exempt from registration under 5h(g) of the CEA (“exempt SEF”),²⁰ unless no DCM or SEF “makes the swap available to trade” or the relevant swap transaction is subject to the clearing exception under CEA section 2(h)(7).²¹ Swaps that are subject to the trade execution requirement must be executed in accordance with one of the methods listed in § 37.9 for SEF-executed transactions or the requirements to provide a “competitive, open and efficient [trading] market” under DCM Core Principle 9.²²

V. No-Action Relief

To facilitate the transition from IBORs to RFRs, the ARRC has requested that DMO confirm that a swap that is modified or created by an IBOR Transition Mechanism will not be subject to the trade execution requirement under section 2(h)(8) of the CEA. In order to further regulatory certainty and to support a smooth and orderly IBOR transition, which is a goal supported by public sector authorities around the world, DMO believes that a position of no-action is warranted. Accordingly, until December 31, 2021, DMO will not recommend that the Commission commence an enforcement action against any person for failure to comply with the trade execution requirement under section 2(h)(8) of the CEA, with respect to an IBOR-linked swap that is amended or created by an IBOR Transition Mechanism, for the sole purpose of accommodating the replacement²³ of the applicable IBOR with an RFR.²⁴

²⁰ CEA section 2(h)(8)(A)(ii) contains a typographical error that specifies CEA section 5h(f), rather than CEA section 5h(g), as the provision that allows the Commission to exempt a SEF from registration. 7 U.S.C. § 2(h)(8)(A)(ii).

²¹ The Commission may determine that swap transactions exempted from the clearing requirement pursuant to other statutory authority, such as section 4(c) of the CEA, 7 U.S.C. § 6(c), may also not be subject to the section 2(h)(8) trade execution requirement, 7 U.S.C. § 2(h)(8). *See* Process for a Designated Contract Market or Swap Execution Facility To Make a Swap Available to Trade, Swap Transaction Compliance and Implementation Schedule, and Trade Execution Requirement Under the Commodity Exchange Act, 78 FR 33606 n. 1 (Jun. 4, 2013).

²² Swaps that are subject to the trade execution requirement, that are not block trades as defined under § 43.2 of the Commission’s regulations, must be executed on a SEF by either (1) an order book, as defined in § 37.3(a)(3); or (2) a request for quote system, as defined in § 37.9(a)(3), that operates in conjunction with an order book. 17 CFR § 37.9. On a DCM, such swaps must be executed pursuant to subpart J of part 38 of the Commission’s regulations, which implements DCM Core Principle 9 under section 5(d)(9) of the CEA, 7 U.S.C. § 7(d)(9).

²³ For purposes of this relief, DMO recognizes that modification of a swap “to accommodate the replacement of an IBOR” may include a number of ancillary changes to existing trade terms to conform to different market conventions, resulting, for example, in different reset dates, fixed/floating leg payment dates, business day conventions, day count fractions, and the like. That said, DMO does not believe that counterparties should be using this relief as an opportunity to renegotiate economic terms of a swap or otherwise engage in price-forming activity.

²⁴ For purposes of this relief, RFRs are those which have been identified by a national level committee or working group in response to the FSB’s Official Sector Steering Group’s report and recommendation that central banks and supervisory authorities should work together with market participants to identify and implement RFRs. DMO believes that scope of this relief should be limited to the incorporation of these RFRs because the relevant working groups have vetted and selected these rates as the most appropriate rates to transition to from existing IBOR-based floating rates.

DMO is providing this time limited no-action relief to further regulatory certainty, and to provide flexibility to help market participants transition from IBORs to RFRs in a manner that accounts for individual circumstances. DMO is not opining on whether any particular IBOR Transition Mechanism, including any particular Fallback Amendment or Replacement Rate Amendment, may otherwise trigger the trade execution requirement under CEA section 2(h)(8).

This letter, and the positions taken herein, represent the views of DMO only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in Commission regulations. It does not create or confer any rights for or obligations on any person or persons subject to compliance with the CEA that bind the Commission or any of its other offices or divisions. Further, this letter and the positions taken herein are based upon the facts and circumstances presented to DMO. Any different, changed, or omitted material facts or circumstances might render the relief provided by this letter void.

Finally, as with all staff letters, DMO retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of relief provided herein, in their discretion.

If you have any questions concerning this correspondence, please contact, Roger Smith, Special Counsel, at (202) 418-5344 or RSmith@CFTC.gov.

Sincerely,

Nancy Markowitz
Deputy Director