U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000

Division of Swap Dealer and
Intermediary Oversight

Joshua B. Sterling
Director

Re: Revised No-Action Positions to Facilitate an Orderly Transition of Swaps from Inter-Bank Offered Rates to Alternative Benchmarks

Ladies and Gentlemen:

This letter is in response to a request received by the Division of Swap Dealer and Intermediary Oversight ("**DSIO**") of the Commodity Futures Trading Commission ("**CFTC**" or "**Commission**") from the Alternative Reference Rates Committee ("**ARRC**") on behalf of its members that are swap dealers ("**SDs**") registered with the Commission and ARRC members that are otherwise subject to Commission regulations. ARRC has requested that DSIO amend CFTC Staff Letter 19-26 ("**Letter 19-26**")[1] to modify certain no-action positions specified therein and to provide additional no-action relief: (1) necessitated by the announced intention of certain central counterparties ("**CCPs**") to transition the discounting and price alignment interest for USD-denominated interest rate swaps from EFFR to SOFR in Q3 2020; and (2) to facilitate the amendment of Credit Support Annexes ("CSAs") to adjust the interest rates paid on posted collateral for uncleared swaps.

This letter revises Letter 19-26 in its entirety. Letter 19-26 is superseded by this letter and no person may rely on Letter 19-26 after the date of this letter.

[1] On December 17, 2019, DSIO issued CFTC Staff Letter 19-26 ("**Letter 19-26**") to facilitate an industry-wide initiative associated with the transition of swaps that reference certain "Impaired Reference Rates" to swaps that reference alternative benchmarks. On November 5, 2019 ARRC requested relief from DSIO, the Division of Market Oversight ("**DMO**"), and the Division of Clearing and Risk ("**DCR**"). All three divisions provided no-action letters in response to ARRC's letter. In formulating this revised letter, DSIO considered a new July 20, 2020 letter, a June 16, 2020 letter, the November 5, 2019 letter, along with other submissions from ARRC, as well as discussions related to ARRC's requested relief. This letter addresses only those ARRC requests that relate to Part 23 of the Commission's regulations, 17 CFR part 23. Other parts of the ARRC's request letters, including new relief requested in the July 20, 2020 letter. CFTC Staff Letters and letters requesting relief are available on the Commission's website at: https://www.cftc.gov/LawRegulation/CFTCStaffLetters/index.htm.

I. Introduction

In connection with an 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**") to swaps that reference alternative benchmarks, ARRC requests DSIO to provide no-action relief for failure to comply with certain Commission regulations in connection with the process of amending certain uncleared swaps referencing the IBORs.

II. 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.[2] The U.S. 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.[3] In response to ongoing efforts such as these, central banks in various jurisdictions, including the United States, the United Kingdom, Japan, Switzerland, and the European Union, have convened working groups of market participant and official sector representatives.

In 2014, the Federal Reserve Bank of New York convened ARRC in order to identify best practices for U.S. alternative reference rates, identify best practices for contract

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[2] *See generally* 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 [risk-free rate] RFR-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."); FSB *Reforming Major Interest Rate Benchmarks* (July 22, 2014), *available at*: https://www.fsb.org/wp-content/uploads/r_140722.pdf, and IOSCO *Principles for Financial Benchmarks: Final Report* (July 2013), available at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf.

[3] *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."); 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.

robustness, develop an adoption plan and create an implementation plan with metrics of success and a timeline.[4]

In June 2017, ARRC identified a broad Treasuries repo financing rate, the secured overnight financing rate ("**SOFR**"), as the preferred alternative benchmark to U.S. Dollar LIBOR for certain new U.S. Dollar derivatives and other financial contracts.[5] It also published an updated "Paced Transition Plan" outlining the steps that ARRC, central counterparties, and other market participants intend to take in order to help build the liquidity required to support the issuance of, and transition to, contracts referencing SOFR.[6] In accordance with ARRC's Paced Transition Plan[7] and similar plans in other jurisdictions, trading of SOFR-based derivatives and other financial contracts linked to alternative benchmarks commenced in 2018 and has expanded in scope in 2019.[8]

In July 2017, the U.K. Financial Conduct Authority ("**FCA**"), which regulates ICE Benchmark Administration Limited, the administrator of ICE LIBOR, 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.

A benchmark rate is a critical term for calculating payments under a swap. Due to the potential discontinuation of LIBOR at the end of 2021, market participants face uncertainty about the way their swaps referencing the LIBOR benchmark and other IBORs will operate after the permanent discontinuation date without a reliable benchmark rate. In many instances, these firms may decide to amend existing swaps to replace an IBOR before the IBOR becomes discontinued. Such amendments may also

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[4] Similar committees have been established in other jurisdictions, including the United Kingdom, Japan, Switzerland, and the European Union. In March 2018, ARRC was reconstituted with an expanded participation by additional financial institutions and trade organizations, and with additional government agencies added as *ex officio* members. ARRC, Press Release, March 7, 2018, *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-March-7-2018-press-release.pdf.

[5] ARRC, Press Release, June 22, 2017, *available at* https://www.newyorkfed.org/medialibrary/microsites/arrc/files/2017/ARRC-press-release-Jun-22-2017.pdf.

[6] ARRC, Second Report, pp.17-24, March 5, 2018, *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Second-report.

[7] ARRC, *2019 Incremental Objectives*, *available at*: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC_2019_Incremental_Objectives.pdf.

[8] ARRC, *SOFR: A Year in Review* (Apr. 2019), *available at*: https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/SOFR_Anniversary.pdf; ISDA, *Interest Rate Benchmarks Review: Full Year 2018 and the Fourth Quarter of 2018* (Jan. 2019), *available at*: https://www.isda.org/a/xogME/Benchmarks-Full-Year-2018.pdf.

trigger follow-on amendments[9] that the counterparties determine are necessary to maintain the economics of the swap.

III. Consideration of ARRC's Request

In order to facilitate the transition from IBORs to alternative reference rates, ARRC requests that DSIO provide the relief discussed below with regard to certain Commission regulations applicable to uncleared swaps.

A. Definitions

For purposes of this letter, the IBORs include, but are not limited to, LIBOR, the Tokyo Interbank Offered Rate (TIBOR), the 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). However, the IBORs may not be the only reference rates that are phased out or become impaired. Thus, in addition to the IBORs, the relief described in this letter also will apply to conversions away from (i) any other interest rate that the parties to a swap reasonably expect to be discontinued or reasonably determines has lost its relevance as a reliable benchmark due to a significant impairment; or (ii) any other reference rate that succeeds any of the foregoing (the IBORs and any other rate meeting either of the foregoing criterion are hereinafter collectively referred to as "**Impaired Reference Rates**" or "**IRRs**").

DSIO recognizes that by defining IRRs in this manner, market participants will be permitted to make more than one amendment to the same swap or portfolio of swaps before settling on an alternative benchmark that adequately meets the counterparties' commercial needs. To that end, this letter is intended to address situations in which an alternative benchmark may become an IRR at some point in the future if the parties to a swap reasonably expect the alternative benchmark to be discontinued or reasonably determine it has lost its relevance as a reliable benchmark due to a significant impairment. But it is also intended to permit further amendment or replacement of such an alternative benchmark even if such rate is not impaired but simply does not meet the counterparties' commercial needs, so long as the original reference rate for the swap was an IBOR or met the other criterion above.[10] DSIO intends to provide this

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[9] Follow-on amendments may include a variety of spread adjustments resulting from the move from a term rate to an overnight rate, from unsecured to secured, or could result from a change in tenor, among others.

[10] This flexibility is also intended to harmonize the relief provided by this letter with certain amendments to the uncleared swap margin rules of the Prudential Regulators related to LIBOR cessation. *See generally* Margin and Capital Requirements for Covered Swap Entities, 85 FR 39754 (Jul. 1, 2020). ("**Prudential Regulators' Amendments**"). For example, § 45.1(h)(3)(i)(C) of the OCC's amended uncleared swap margin rules permits an SD subject to the OCC's rules to replace an IBOR with a

degree of flexibility for the public policy reasons discussed herein. DSIO expects that any replacement rate would be negotiated between the parties after assessing its complexity, safety and soundness, and taking into consideration appropriate risk management practices.

B. Anticipated Amendments

1. Amendments to Replace Impaired Reference Rates

To prepare for the possible permanent cessation of certain IRRs, and in order to facilitate the adoption of alternative reference rates, ARRC represents that market participants will take the following actions:

- **Amendment of Uncleared Swaps to Include IRR Fallback Provisions**. In order to protect against any permanent cessation of IRR publication, market participants are expected to amend IRR-linked uncleared swaps to include new fallbacks to alternative reference rates that are triggered when an IRR is permanently discontinued or is determined to be non-representative by the benchmark administrator or the relevant authority in a jurisdiction. An amendment to a swap solely for the purpose of including such fallbacks triggered only by permanent discontinuation of an IRR or determination that an IRR is non-representative by the benchmark administrator or the relevant authority in a jurisdiction is hereinafter referred to as a "**Fallback Amendment**".

- **Amendment of Uncleared Swaps to Replace IRRs with Alternate Reference Rates**. Some market participants may choose to voluntarily convert IRR-linked uncleared swaps to alternative reference rates prior to any permanent cessation of the applicable IRR or determination that an IRR is non-representative by the benchmark administrator or the relevant authority in a jurisdiction ("**Replacement Rate Amendment**").

DSIO understands that a universal protocol is currently being developed by the International Swaps and Derivatives Association ("**ISDA**") with respect to Fallback Amendments. The protocol will be based on numerous consultations and commentary from the industry.[11] ISDA expects to finalize the protocol and associated templates soon. It is expected that, by adhering to the ISDA protocol, the parties to an uncleared

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temporary interest rate and later replace the temporary interest rate with a permanent interest rate. Prudential Regulators' Amendments, 85 FR at 39771.

[11] *See generally* ISDA publications related to Benchmark Fallbacks, available at https://www.isda.org/tag/benchmark-fallbacks/.

swap would be able to make a Fallback Amendment for multiple swaps without extensive, bilateral negotiations.

To accomplish a large volume of Replacement Rate Amendments, ARRC identified certain methods of conversion considered likely to be used by market participants when effecting a Replacement Rate Amendment, including, but not limited to, the following:

1. **Single trade conversion for equivalent risk:** Converting an IRR referenced in an uncleared swap to an applicable alternative reference rate with a revised spread, an additional spread, or a change to the fixed rate, to achieve equivalent risk.

2. **Single trade conversion with payment:** Converting an IRR referenced in an uncleared swap to an alternative reference rate plus a payment to achieve equivalent risk rather than a change to the ongoing spread or fixed rate.

3. **Single trade conversion (with or without payment) for non-equivalent risk:** Converting an IRR referenced in an uncleared swap to an alternative reference rate, with a change in risk of a hedge (*e.g.*, cash position) for all, or part, of difference.

4. **Bilateral one-for-one swap portfolio conversion:** Converting multiple uncleared swaps referencing an IRR on a one-for-one basis to swaps referencing an alternative reference rate using similar variations on resulting swaps as described in Conversion Models 1 – 3 above, which would not be the same across the swap portfolio (*e.g.*, spread may only need to be changed on one trade).

5. **Bilateral swap portfolio conversion with compression:** Converting multiple uncleared swaps referencing an IRR to a portfolio of uncleared swaps with equivalent risk referencing an alternative reference rate plus a spread (or to an alternative reference rate plus a payment for the basis) resulting in fewer outstanding swaps between the two counterparties.

6. **Bilateral conversion of a swap portfolio involving multiple SDs:** Converting multiple uncleared swaps referencing an IRR with more than one SD to uncleared swaps referencing an alternative reference rate with one or more of those SDs (with or without foregoing adjustments).

Based on discussions with ARRC, DSIO understands that a Fallback Amendment or Replacement Rate Amendment accomplished pursuant to one or more of these conversion methods may require 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, and day count

fractions. However, to ensure that this letter is consistent with no-action letters previously issued by staff[12] and that counterparties are not using the relief provided in this letter as an opportunity to renegotiate economic terms or otherwise engage in price-forming activity, the relief provided by this letter is subject to a limitation on amendments that (i) extend the maximum maturity of a swap or a portfolio of swaps, or (ii) increase the total effective notional amount of a swap or the aggregate total effective notional amount of a portfolio of swaps.[13]

DSIO recognizes that counterparties employing any of the foregoing conversion methods to effectuate Replacement Rate Amendments may complete the necessary amendments by adherence to an ISDA-led protocol, by contractual amendment of an agreement or confirmation, or by execution of new contract(s) in replacement of and immediately upon termination of existing contract(s) (*i.e.*, "tear-ups").

For purposes of this letter, the amendment of an uncleared swap that references an IRR solely to: (i) include new fallbacks to alternative reference rates triggered only by permanent discontinuation of an IRR or determination that an IRR is non-representative by the benchmark administrator or the relevant authority in a jurisdiction; or (ii) accommodate the replacement of an IRR, is referred to as a "**Qualifying IRR Amendment**."

In addition, DSIO understands that some market participants may seek to transition swap portfolios referencing IRRs to an alternative reference rate by means of one or more new basis swaps that would swap the entire IRR basis of a portfolio with an alternative reference rate basis without amending any of the swaps referencing IRRs (such transition method, the "**Basis Swap Method**"). On behalf of SDs that may participate in the Basis Swap Method with a counterparty with respect to a portfolio of Legacy Swaps (as defined below), ARRC is seeking relief that would permit such SDs to treat the resulting basis swaps as Legacy Swaps for purposes of compliance with the Commission's uncleared swap margin requirements.

2. Amendments to Accommodate CCP Discounting Rate Changes

Following issuance of Letter 19-26, ARRC and various market participants have taken additional steps to further progress the LIBOR transition. Consistent with the ARRC's paced transition plan, certain derivatives clearing organizations ("**DCOs**"), in particular

[12] *See, e.g.,* DSIO Staff No-Action Letter 19-13 (no-action relief limited to conducting compression exercises in which the maximum maturity of the swap portfolios is not increased, among other conditions).

[13] These limitations are intended to harmonize the relief provided by this letter with certain amendments to the uncleared swap margin rules of the Prudential Regulators related to LIBOR cessation. *See* Prudential Regulators' Amendments, 85 FR at 39756-58.

the Chicago Mercantile Exchange, Inc ("**CME**"), the LCH Ltd ("**LCH**"), and Eurex Clearing AG ("**Eurex**") announced their intention to change the discount rate that they use for purposes of valuing cleared swaps and the rate (commonly referred to as the Price Alignment Interest rate or the Price Alignment Amount rate, depending on the context) applied to collateral or settlement amounts relating to certain cleared swaps.[14] Specifically, CME and LCH have announced a plan to transition from using the daily effective federal funds rate ("**EFFR**") to the Secured Overnight Financing Rate ("**SOFR"**) as of October, 2020 with respect to USD discounted swaps. LCH and Eurex have transitioned from using the Euro Over Night Index Average ("**EONIA**") to the Euro Short Term Rate ("**€STR**") as of July 2020 with respect to EUR discounted swaps.[15]

These DCO discount rate changes will apply to both existing and new cleared swaps. With respect to the switch from EFFR to SOFR, both CME and LCH will provide a mechanism to compensate clearing members and customers for the change in the value of the existing cleared swaps as a result of the switch and will create and register various EFFR and SOFR basis swaps to hedge clearing members' and customers' change in discounting risk profile as a result of such switch. With respect to the switch from EONIA to €STR, both Eurex and LCH will provide a mechanism to compensate clearing members and customers for the change in the value of the cleared swaps as a result of the switch.

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[14] CME Group, SOFR & €STR Discounting & Price Alignment Transition Process for Cleared Swaps, Q2 2020, *available at:*https://www.cmegroup.com/trading/interest-rates/files/discounting-transition-proposal-mar-2020.pdf; LCH, Letter to All SwapClear Users re: Proposed Next Steps for Transition to USD SOFR Discounting in SwapClear, July 26, 2019, *available at:* https://www.cftc.gov/media/3221/MRAC_LCH_SOFRDiscountingLetter121119/download (transition from EFFR to SOFR as of October 2020); LCH, Ltd Member Updates, Transition to €STR Discounting in SwapClear, September 27, 2019, *available at* https://www.lch.com/membership/ltd-membership/ltd-member-updates/transition-eustr-discounting-swapclear (transition from EONIA to €STR, originally as of June 2020); LCH, Ltd Member Updates, Transition to €STR Discounting: Updated Timing, April 17, 2020, *available at* https://www.lch.com/membership/ltd-membership/ltd-member-updates/transition-to-%E2%82%ACSTR-Discounting-Updated-Timing (moving date of transition from EONIA to €STR to July 2020); Eurex Clearing, Circular 096/19, EurexOTC Clear Service: Discounting Switch from EONIA to €STR for Cleared OTC EUR Derivatives, October 23, 2019, *available at* https://www.eurexclearing.com/clearing-en/resources/circulars/clearing-circular-1653578 (transition from EONIA to €STR, originally as of June 2020); Eurex Clearing, Circular 032/20, EurexOTC Clear: Postponement of EurexOTC Clear Release 10.1, April 17, 2020, *available at* https://www.eurexclearing.com/clearing-en/resources/circulars/clearing-circular-1942440 (moving date of transition from EONIA to €STR to July 2020).

[15] *See generally* LCH announcement at https://www.lch.com/membership/ltd-membership/ltd-member-updates/euro-short-term-rate-eustr-rate-change-notice and Eurex announcement at https://www.eurexclearing.com/clearing-en/find/production-newsboard/Update-on-EONIA-STR-Transition-EurexOTC-Clear-Production-2128458.

ARRC represents that these DCO discount rate changes could also affect the value of many uncleared USD and EUR denominated swaptions that exercise into cleared swaps or that cash settle by reference to the discounting rates employed by CME, Eurex, or LCH after the date on which the change in discounting rate occurs. To facilitate the DCO discounting rate changes and to account for their effect on swaptions, the ARRC issued a public consultation on swaptions impacted by this discounting transition.[16]

On May 14, 2020, the ARRC announced the results of that consultation, recommending, among other things, that market participants:

(i) Amend USD swaptions expiring after October 16, 2020, so that they include ISDA Supplement 64 to the 2006 ISDA Definitions[17] and to specify SOFR as the Agreed Discount Rate; and

(ii) Simultaneously voluntarily exchange compensation for the difference in the value of these swaptions between EFFR discounting and SOFR discounting.[18]

ARRC noted that "[p]rompt determination is recommended to: (a) avoid an extended period of uncertainty; (b) minimize any valuation difference because the market-implied basis between EFFR and SOFR is currently fairly narrow (in absolute value); and (c) promote responsible risk management and market liquidity and resiliency."[19]

While the ARRC consultation and its recommendations apply only to USD-denominated swaptions, the Working Group on Euro Risk Free Rates undertook a similar consultation[20] for EUR-denominated swaptions. The results of that consultation noted that market participants also broadly supported the exchange of voluntary compensation in that context.[21]

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[16] ARRC Releases Consultation on Swaptions Impacted by Central Counterparty Clearing Houses' Discounting Transition to SOFR, February 7, 2020, *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC_Press_Release_Swaptions_Consultation.pdf.

[17] ARRC's announcement, *id.* At n.7, explained that Supplement 64 was released by ISDA on March 30, 2020 and allows parties to specify an Agreed Discount Rate in swaptions.

[18] ARRC Recommendations for Swaptions Impacted by the CCP Discounting Transition to SOFR, May 14, 2020, *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-swaptions-recommendations.pdf

[19] *Id.*

[20] *See generally* Working Group on Euro Risk-Free Rates, Public Consultation by the Working Group on Euro Risk-Free Rates on Swaptions Impacted by the CCP Discounting Transition from EONIA to the €STR, March 13, 2020, *available at* https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.public_consultation_20200313.en.pdf.

[21] *See generally* Working Group on Euro Risk-Free Rates, Public consultation on swaptions impacted by the CCP discounting transition from EONIA to the €STR, May 2020, *available at*

ARRC notes that the exchange of compensation or discount rate modification would occur because of an agreement regarding the discount rate at the applicable DCO, and not because of a change in the reference rate of the swap itself. Thus, ARRC is concerned that these changes to a swap would not clearly meet the definition of "Qualifying Amendment" under Letter 19-26, which is defined to include an amendment made solely to accommodate the replacement of an IRR. Thus, ARRC requests that DSIO grant no-action relief providing that, solely as a result of an announced intention by a CCP to change the discount rate used for purposes of valuing cleared swaps and the rate (commonly referred to as the Price Alignment Interest rate or the Price Alignment Amount rate, depending on the context) applied to collateral or settlement amounts relating to certain cleared swaps, (1) the voluntary exchange of compensation for a swaption; or (2) the amendment of a swaption's terms solely to reflect an agreement regarding the discount rate used by a CCP (each a "**Qualifying Swaption Amendment**"), would be treated as a Qualifying Amendment under Letter 19-26 and that therefore such actions would not result in the swap being newly subject to Commission regulatory requirements covered under Letter 19-26.

3. Amendments to CSAs to Align Interest Rates Paid on Posted Collateral

In addition, ARRC explains that market participants may also choose to align the interest rates paid on posted collateral for uncleared swaps with the discount rate change implemented by the DCOs for cleared swaps described above. For example, an SD may offset the risk of an uncleared swap with a third party by entering into a cleared swap. In such cases, the SD will customarily seek to align the interest rate used in an existing CSA, which may be a non-impaired rate, with the discount rate used by the DCO to avoid basis risk. ARRC's Recommended Best Practices also encourage dealers to amend their interdealer CSAs to use SOFR for USD collateral by December 31, 2020,[22] and, because EONIA will be discontinued in January 2022, market participants will need to amend CSAs referencing EONIA. ARRC argues that amending credit support documents will not only eliminate the potential basis risk that would otherwise exist between the cleared and uncleared swap markets, but will also provide greater liquidity for market participants across both markets.

ARRC believes that market participants would greatly benefit from clarity regarding the status of such CSA amendments in order to ensure a smooth and orderly transition. Thus, ARRC requests that DSIO provide a no-action position such that an amendment

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https://www.ecb.europa.eu/paym/pdf/cons/euro_risk-free_rates/ecb.202005.swaptionsfeedbacksummary.en.pdf.

[22] Alternative Reference Rates Committee, ARRC Recommended Best Practices for Completing the Transition from LIBOR, May 27, 2020, *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2020/ARRC-Best-Practices.pdf.

to a CSA solely to (1) align the interest rate paid on posted collateral for uncleared swaps under a CSA with the discount rate used by a CCP; or (2) replace an IRR that is an interest rate paid on posted collateral for uncleared swaps (each a "**Qualifying CSA Amendment**"), would be treated as a Qualifying Amendment under Letter 19-26 and that therefore such actions would not result in swaps being newly subject to Commission regulatory requirements covered under Letter 19-26.

C. Legacy and Pre-Transition Uncleared Swaps

In order to facilitate the actions described above in support of the IBOR regulatory reform agenda, ARRC requests clarity regarding the regulatory treatment of:

(A) **Legacy Swaps**: Uncleared swaps that were entered into prior to the compliance date of a particular regulatory requirement, with the result that such requirement did not apply to those swaps ("**Legacy Swaps**"). For example, an uncleared swap entered into prior to the applicable compliance date of the CFTC uncleared margin rules would be a Legacy Swap for purposes of the uncleared margin rules;[23] and

(B) **Pre-Transition Swaps**: Uncleared swaps, including, where relevant, Legacy Swaps, that were entered into prior to the effective date of a Qualifying IRR Amendment, Qualifying Swaption Amendment, or Qualifying CSA Amendment ("**Pre-Transition Swaps**").

As detailed below, to facilitate an efficient IBOR transition, ARRC requests that DSIO provide a no-action position with respect to:

(1) SD registration threshold requirements;

(2) SD uncleared swap margin requirements;

(3) SD business conduct requirements;

(4) SD confirmation, documentation and reconciliation requirements; and

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[23] The Commission's Office of the Chief Economist ("OCE") published an analysis to estimate, among other things, the population of uncleared swap positions that constitute Legacy Swaps. *See* Legacy Swaps under the CFTC's Uncleared Margin and Clearing Rules (May 22, 2019), available at: https://www.cftc.gov/node/216426. In particular, OCE analyzed the notional amount of uncleared swaps outstanding as of December 2018. Focusing strictly on the entity pairs covered in phases 1 through 3 of the uncleared margin rule, the three phases implemented as of the December 2018 reference date, OCE estimated that approximately 41% of credit default swaps ("CDS"), 5% of forex products, and 40% of interest rate swaps ("IRS") were Legacy Swaps. OCE notes that many of these Legacy Swaps will be terminated prior to maturity for a variety of reasons. Swaps executed by SDs with counterparties not yet subject to the initial margin requirements (*i.e.*, phases 4 and 5) may become Legacy Swaps as defined above to the extent such are still in effect on the compliance dates for those phases.

(5) Certain regulatory requirements applicable to certain end-users.

ARRC argues that swap amendments required as part of a global reform agenda do not reflect market participants voluntarily assuming risk or exercising independent discretion. With respect to both Legacy Swaps and Pre-Transition Swaps, as detailed below, ARRC concludes that relief from certain Commission regulations would eliminate significant impediments to the efficient processing of large volumes of swaps and would facilitate the orderly transition away from the use of IBORs, which is an action encouraged by authorities around the world.

DSIO supports such transition and has concluded that amendments to swaps necessary to accomplish it should (i) not cause a loss of legacy status resulting in a swap becoming subject to regulatory requirements to which it was previously not subject; and (ii) receive relief appropriate to facilitate an orderly market-wide transition consistent with regulatory expectations.

IV. DSIO No-Action Positions

For purposes of the DSIO no-action positions below, the amendment of an uncleared swap that solely consists of (1) a Qualifying IRR Amendment; (2) a Qualifying Swaption Amendment; (3) a Qualifying CSA Amendment; or (4) any combination of the foregoing is referred to as a "**Qualifying Amendment**." As discussed above, a Qualifying Amendment may include 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, and day count fractions. However, a Qualifying Amendment will not include any amendment that (i) extends the maximum maturity of a swap or a portfolio of swaps beyond what is necessary to accommodate the differences between market conventions for an IRR or discount rate used by a CCP and its replacement, or (ii) increases the total effective notional amount of a swap or the aggregate total effective notional amount of a portfolio of swaps beyond what is necessary to accommodate the differences between market conventions for an IRR or a discount rate used by a CCP and its replacement.[24]

[24] ARRC recommended that any relief permit changes in maturity or total effective notional amount that are directly related to a transition from an IRR to an alternative rate. ARRC argued that the liquidity for alternative rates may develop differently at different ends of the maturity spectrum (as compared to IBOR swaps), such that constructing an amended or replacement position that is economically equivalent to an existing IBOR portfolio may necessitate a shift in the total effective notional amount or maturity. As a further example, ARRC explained that an IBOR conversion may also impact the total effective notional amount as a result of differing day count fraction conventions. If, for example, a fixed-for-floating IBOR swap uses a 30/360 day count fraction convention, but the market standard for an equivalent alternative rate uses an actual/360 day count fraction convention, the notional amount would need to be adjusted to ensure that the payment amounts on the fixed leg of the alternative rate swap are the same compared to the IBOR swap. *See* Comment Letter on Proposed Rulemaking Regarding Margin and Capital Requirements for Covered Swap Entities at 6-7, available at:

A. *De Minimis* Exception to the Swap Dealer Definition

In accordance with the definition of "swap dealer" in section 1a(49)(D) of the Commodity Exchange Act ("**CEA**"),[25] the Commission has excepted from designation as an SD any entity that engages in only a *de minimis* quantity of swap dealing with or on behalf of its customers.[26] Specifically, subparagraph (4) of the definition of "swap dealer" in Commission regulation 1.3 provides that a person shall not be deemed to be an SD until its aggregate gross notional amount of swaps connected with swap dealing activity, during the preceding 12 months, exceeds the *de minimis* threshold.[27] Such Commission regulation further requires that, in determining whether its swap dealing activity exceeds the *de minimis* threshold, a person must include the aggregate notional value of the swaps connected with the dealing activities of its affiliates under common control.[28]

ARRC is concerned that entities that actively monitor and manage their swap dealing activities to stay below the *de minimis* threshold may be reluctant to transition from IRRs voluntarily and early if they must count swaps modified to accommodate either a Fallback Amendment or Replacement Rate Amendment toward such threshold.

In order to support an expeditious and orderly transition away from IRRs, DSIO believes that a position of no-action is warranted. Accordingly, DSIO will not recommend that the Commission take an enforcement action against any person if, for purposes of determining whether it is deemed to be an SD pursuant to the criteria set forth in the Commission's definition of "swap dealer,"[29] it does not include a swap solely

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https://www.federalreserve.gov/SECRS/2019/December/20191210/R-1682/R-1682_120919_137107_439606911591_1.pdf.

To permit changes in maturity or total effective notional amount that are directly related to a transition from and IRR to an alternative rate, DSIO intends that its no-action relief will be available for Qualifying Amendments that make adjustments to maturities and notional amounts, but only to the extent necessary to accommodate the operational differences between an IRR and an alternative rate. SDs relying on such relief for Qualifying Amendments should be prepared to justify any extension of maturity or increase in notional amount of the relevant swaps or portfolios of swaps.

[25] 7 USC § 1 et seq.

[26] 7 U.S.C. 1a(49)(D) (directing the Commission to establish a de minimis exception from the SD definition); paragraph (4) of the definition of "swap dealer," 17 CFR § 1.3; *see generally Further Definition of "Swap Dealer," "Security-Based Swap Dealer," "Major Swap Participant," "Major Security-Based Swap Participant," and "Eligible Contract Participant,"* 77 FR 30596, 30626-35 (May 23, 2012) (hereinafter "**Entity Definitions Rulemaking**").

[27] Subparagraph (4)(i)(A) of the definition of "swap dealer," 17 CFR § 1.3. *See also* subparagraph (6) of the definition of "swap dealer" in 17 CFR § 1.3 (identifying swaps that are not considered in determining whether a person is a swap dealer).

[28] Subparagraph (4)(i)(A) of the definition of "swap dealer," 17 CFR § 1.3.

[29] Subparagraph (4) of the definition of "swap dealer," 17 CFR § 1.3. *See generally* Entity Definitions Rulemaking, 77 FR at 30626-35.

to the extent such swap would be required to be included as a consequence of a Qualifying Amendment to such swap.

B. CFTC Uncleared Swap Margin Requirements

1. Legacy Swaps

Pursuant to section 4s(e) of the CEA,[30] the Commission is required to promulgate margin requirements for uncleared swaps applicable to each SD for which there is no Prudential Regulator, and thus the no-action position provided in this letter with respect to compliance with the Commission's uncleared swap margin requirements is applicable only to such SDs.[31] The Commission published final margin requirements for such SDs in January 2016 (the "**CFTC Margin Rule**").[32]

The CFTC Margin Rule applies only to uncleared swaps of SDs executed after the applicable compliance date set forth in Commission regulation 23.161.[33] Pursuant to Commission regulation 23.161, compliance dates for the CFTC Margin Rule are staggered such that SDs must come into compliance in a series of phases over four years with counterparties depending on the aggregate outstanding notional amounts of uncleared swaps and certain other financial products. The first phase began on September 1, 2016, and required SDs to comply with both the initial and variation margin requirements with counterparties that have the largest aggregate outstanding notional amounts. The second phase began on March 1, 2017, and required SDs to comply with the variation margin requirements of Commission regulation 23.153 with all relevant counterparties not covered in the first phase. On each September 1 thereafter ending with September 1, 2021, SDs began/will begin to comply with the initial margin requirements with counterparties with successively lesser outstanding

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[30] 7 U.S.C. § 6(s).

[31] The Commission's margin requirements for uncleared swaps apply only to SDs and major swap participants for which there is not a prudential regulator. 7 U.S.C. 6s(e)(1)(B). SDs and major swap participants for which there is a prudential regulator must meet the margin requirements for uncleared swaps established by the applicable prudential regulator. 7 U.S.C. 6s(e)(1)(A). *See also* 7 U.S.C. 1a(39) (defining the term "Prudential Regulator" to include the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency). The Prudential Regulators published final margin requirements in November 2015. Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015). There are no major swap participants registered with the CFTC at this time. This letter does not address major swap participants explicitly, but DSIO confirms that the no-action positions taken with respect to SDs in this letter would apply to major swap participants.

[32] Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016). The CFTC Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission's regulations, 17 CFR §§ 23.150-159, 161.

[33] Commission regulation 23.150(a), 17 CFR § 23.150(a).

notional amounts.[34] As discussed above, uncleared swaps entered into prior to the relevant compliance date are not subject to the applicable provisions of the CFTC Margin Rule ("**CFTC Margin Rule Legacy Swaps**").

Generally, pursuant to the CFTC Margin Rule, amendments to CFTC Margin Rule Legacy Swaps following the compliance date applicable to an SD and its counterparty would cause such swaps to be brought into scope and require compliance with the CFTC Margin Rule.[35] Margining in accordance with such rule is a material consideration in determining the terms of a swap, including price. Because CFTC Margin Rule Legacy Swaps were entered into with the assumption that such swaps would not be subject to margining in accordance with the CFTC Margin Rule, bringing such swaps into scope for the rule would likely have a materially adverse effect on the economic obligations of the parties and potentially frustrate the purpose of the swaps.

Because SDs and their counterparties are amending CFTC Margin Rule Legacy Swaps pursuant to a global reform agenda, DSIO is of the view that entering into a Qualifying Amendment should not cause a loss of legacy status resulting in the swap becoming subject to the CFTC Margin Rule. A Fallback Amendment to include a fallback provision is an effort to retain the existing swap following an IRR discontinuation or determination that the IRR is non-representative by the benchmark administrator or the relevant authority in a jurisdiction, rather than a substitute for entering into a new swap. Similarly, entering into voluntary Replacement Rate Amendments prior to permanent discontinuation of an IRR or determination that the IRR is non-representative is an effort to mitigate risks associated with the discontinuation of IRRs as opposed to a decision to enter into a new swap with different economics. Finally, DSIO observes that SDs, as well as their financial end-user counterparties, will be entering into Fallback Amendments and Replacement Rate Amendments in order to advance an important public policy objective and not for the purposes of evading the CFTC's Margin Rule.

Given the foregoing, DSIO believes that a no-action position is warranted with respect to amendments to CFTC Margin Rule Legacy Swaps. Accordingly, DSIO will not recommend that the Commission take an enforcement action against an SD for a failure to comply with the CFTC Margin Rule solely to the extent such compliance would be

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[34] Commission regulation 23.161, 17 CFR § 23.161. The final compliance phase was originally set for September 2020, but subsequently extended to September 2021. *See generally* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 85 FR 19878 (April 9, 2020). The Commission has since proposed to further extend the final phase compliance date to September 2022 due to the COVID-19 pandemic. *See generally* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 85 FR 41463 (July 10, 2020).

[35] CFTC Margin Rule, 81 FR at 675.

required as a consequence of a Qualifying Amendment to a CFTC Margin Rule Legacy Swap.

2. Basis Swap Method Relief

In addition, DSIO recognizes that counterparties may find it more appropriate to their circumstances to accomplish the necessary transition using the Basis Swap Method rather than amendments to individual swaps. DSIO therefore believes that a no-action position is warranted with respect to transition arrangements using the Basis Swap Method, but solely for purpose of the CFTC Margin Rule. Because the Basis Swap Method consists of entering into one or more new swaps, rather than amendments of existing swaps, DSIO does not believe that the other relief provided by this letter is necessary or appropriate.[36] Accordingly, DSIO will not recommend that the Commission take an enforcement action against an SD for failure to comply with the CFTC Margin Rule with respect to a basis swap that meets the following conditions:

1. The basis swap references only one or more CFTC Margin Rule Legacy Swaps;

2. The basis swap is entered into solely to achieve substantially the same effect as would be obtained by an amendment to the referenced CFTC Margin Rule Legacy Swap(s) to accommodate the replacement of an IRR; and

3. The basis swap does not have the effect of (i) extending the maturity of the referenced CFTC Margin Rule Legacy Swap(s) beyond what is necessary to accommodate the differences between market conventions for an IRR and its replacement, or (ii) increasing the total effective notional amount of the referenced CFTC Margin Rule Legacy Swap(s) or the aggregate total effective notional amount of a portfolio of the referenced CFTC Margin Rule Legacy Swap(s) beyond what is necessary to accommodate the differences between market conventions for an IRR and its replacement.[37]

C. SD Business Conduct Requirements

The Commission's business conduct requirements for SDs under subpart H to part 23 of the Commission's regulations, which sets forth business conduct standards for SDs in

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[36] DSIO recognizes however that an amendment to a basis swap referencing an IRR, including one entered into for purposes of the Basis Swap Method that is subsequently amended, would qualify for all applicable relief provided by this letter.

[37] DSIO intends that a basis swap entered into in compliance with these conditions would retain its relief from the CFTC Margin Rule in the event that it is subsequently amended solely to accommodate the replacement of an IRR and such subsequent amendment is entered into in compliance with these conditions.

their dealings with counterparties (the "**Counterparty BCS**"),[38] require SDs to provide or obtain specific information from their counterparties, to obtain specific representations in writing from their counterparties, and to perform certain due diligence inquiries with respect to their counterparties prior to entering into (or in some cases, offering to enter into) a swap with such counterparties.[39] Certain safe harbors under the Counterparty BCS permit SDs to rely on written representations from their counterparties and standardized disclosures, each of which may require amendments or supplements to an SD's relationship documentation with such counterparties prior to entering into a swap with such counterparties.[40]

In the preamble to the Counterparty BCS final rule adopting release, the Commission noted that the Counterparty BCS will not apply to swaps executed before the effective date of the Counterparty BCS final rules if the requirement does not impose an ongoing duty on the swap dealer (such swaps, "**Counterparty BCS Legacy Swaps**").[41] However, the Commission also stated that if Counterparty BCS Legacy Swaps were materially amended, such swaps would be subject to the requirements of the Counterparty BCS as if they were new swaps.[42]

ARRC requests a no-action position from SD compliance with the Counterparty BCS when entering into a Qualifying Amendment to a Counterparty BCS Legacy Swap, arguing that such swaps are being amended pursuant to a global reform agenda rather than as a substitute for entering into a new swap.

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[38] 17 CFR §§ 23.400 through 23.451, § 23.701. *See generally* Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 FR 9734 (Feb. 17, 2012).

[39] Commission regulation 23.402(b) (requiring SDs to obtain essential facts about their counterparty prior to execution of a transaction); § 23.430(a) (requiring SDs to verify that a counterparty meets the eligibility standards for an eligible contract participant before offering to enter into or entering into a swap with such counterparty); § 23.431(a) (requiring SDs to provide material information concerning the risks and characteristics of a swap to its counterparty at a reasonably sufficient time prior to entering into the swap); § 23.431(b) (requiring SDs to provide notice to counterparties that they can request and consult on the design of a scenario analysis); § 23.431(d) (requiring SDs to provide notice to counterparties of the right to receive the daily mark from a derivatives clearing organization for cleared swaps); § 23.432 (requiring SDs to provide notice to counterparties of the right to select clearing and the derivatives clearing organization on which a swap is to be cleared); § 23.434 (requiring SDs that recommend a swap to have a reasonable basis to believe that the swap is suitable for the counterparty); § 23.440 (requiring SDs that act as an advisor to a Special Entity to act in such entity's best interest); § 23.450 (requiring SDs to inquire into the knowledge and status of a representative of a counterparty that is a Special Entity); § 23.451 (prohibiting SDs from entering into swaps with certain governmental entities if it has made political contributions to an official of such entity); and § 23.701 (requiring SDs to provide counterparties with notice of the right to require any initial margin provided to the SD be segregated with a custodian).

[40] Commission regulations 23.402(d), (e), and (f), 17 CFR § 23.402(d), (e), and (f).

[41] Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 Fed. Reg. 9734, 9741 (Feb. 17, 2012).

[42] *Id.*

With respect to Pre-Transition Swaps, ARRC further argues that certain of such swaps are already subject to the Counterparty BCS, and SDs should not be required to re-perform obligations to counterparties under such rules in order to address the regulatory-driven reform agenda.[43] ARRC states that re-performance of certain of these obligations may result in terminations of swaps with counterparties that cannot make the necessary representations due to a change in circumstances since originally entering into the swap. For example, an SD may be unable to obtain or re-verify a counterparty's eligible contract participant status, including because the counterparty may no longer be an ECP.[44] Similarly, for the external business conduct requirement related to suitability,[45] a counterparty may not be able to provide the representation an SD needs to rely on the applicable safe harbor and the SD may not be able to reasonably determine that the counterparty is capable of independently evaluating investment risks with regard to the amendment. In such cases, the swap may have to be terminated rather than continue.

Because SDs and their counterparties are amending Counterparty BCS Legacy Swaps and Pre-Transition Swaps pursuant to a global reform agenda, DSIO is of the view that entering into a Fallback Amendment or a Replacement Rate Amendment should not cause a loss of legacy status or require re-performance of the full complement of Counterparty BCS. However, DSIO does not believe that relief is appropriate for an SD's obligation under Commission regulation § 23.431(a) to provide material information concerning the risks and characteristics of a swap to its counterparty at a reasonably sufficient time prior to entering into the swap, though DSIO does believe that relief is appropriate for the requirement to provide the mid-market mark of the swap pursuant to Commission regulation 23.431(a)(3)(i). Pursuant to the IRR transition, counterparties to SDs will often be moving from familiar reference rates to newly created rates. DSIO therefore believes SDs should be required to provide material information about such new rates in order for counterparties to better understand the amendments into which they are entering.[46]

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[43] ARRC states that at least with respect to the pre-trade disclosure requirements of Commission regulation 23.431(a), 17 CFR § 23.431(a), SDs have already begun taking steps to revise the risk disclosures for Pre-Transition Swaps as appropriate in the context of the transition to RFRs.

[44] The requirement that swap counterparties be ECPs, and that a swap dealer verify ECP status, in Commission regulation 23.430 applies prior to offering to enter into or entering into a swap with a counterparty. It is not a continuous obligation that applies throughout the duration of the swap. 17 CFR § 23.430.

[45] *See* Commission regulation 23.434. 17 CFR § 23.434.

[46] DSIO notes the Commission's view when adopting Commission regulation 23.431(a) that "the disclosure rules are intended to level the information playing field by requiring swap dealers and major swap participants to provide sufficient information about a swap to enable counterparties to make their own informed decisions about the appropriateness of entering into the swap." Business Conduct

DSIO agrees that a Fallback Amendment to include a fallback provision is an effort to retain the existing swap following an IRR discontinuation or determination that the IRR is non-representative by the benchmark administrator or the relevant authority in a jurisdiction, rather than a substitute for entering into a new swap. Similarly, entering into voluntary Replacement Rate Amendments prior to permanent discontinuation of an IRR or determination that the IRR is non-representative is an effort to mitigate risks associated with such changes to an IRR as opposed to a decision to enter into a new swap with different economics. Finally, DSIO observes that SDs, as well as their financial end-user counterparties, will be entering into Fallback Amendments and Replacement Rate Amendments in order to advance an important public policy objective and not for the purposes of evading the CFTC's Counterparty BCS.

Given the foregoing, DSIO believes that a no-action position is warranted. Accordingly, DSIO will not recommend that the Commission take an enforcement action against an SD for a failure to comply with the Counterparty BCS (excluding Commission regulation 23.431(a), but including the mid-market mark requirement of 23.431(a)(3)(i)), solely to the extent such compliance would be required as a consequence of a Qualifying Amendment to an uncleared swap.

D. CFTC Documentation and Swap Processing Requirements

1. Confirmation

The Commission's swap confirmation rules require SDs to confirm amendments to swaps within certain time frames.[47]

The Commission's swap trading relationship documentation ("**STRD**") rules require SDs to enter into STRD with each counterparty prior to entering in to an uncleared swap transaction with such counterparty.[48] However, SDs are not required to enter into STRD with respect to uncleared swaps entered into prior to the date an SD was required to be in compliance with the STRD rule (such uncleared swaps, "**STRD Legacy Swaps**").[49]

Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 FR 9734, 9758-59 (Feb. 17, 2012).

[47] Commission regulation 23.500, 17 CFR § 23.500 (defining a "swap transaction" to include amendments to swaps); Commission regulation 23.501, 17 CFR § 23.501 (requiring SDs to issue a confirmation for any swap transaction).

[48] Commission regulation 23.504(a)(2), 17 CFR § 23.504(a)(2).

[49] Commission regulation 23.504(a)(1)(i), 17 CFR § 23.504(a)(1)(i).

As discussed above, ARRC expects that the Fallback Amendments will be accomplished by means of one or more multilateral protocols that are currently being developed by ISDA. ARRC contemplates that many Replacement Rate Amendments could also be accomplished by the protocol methodology. By adhering to an ISDA protocol, the counterparties could relatively easily amend multiple swaps without extensive, bilateral negotiations. Given that through adherence to a protocol, multiple swaps could be legally amended, and confirmed, simultaneously, ARRC seeks confirmation that SDs will not be required to issue new confirmations for STRD Legacy Swaps and Pre-Transition Swaps that are amended via a multilateral protocol.

Similarly, ARRC expects that the Fallback Amendments may be accomplished for portfolios of swaps between certain counterparties via a bilateral agreement that amends multiple swaps simultaneously. Given that through such a bilateral agreement, multiple swaps could be legally amended, and confirmed, simultaneously, ARRC seeks confirmation that SDs will not be required to issue new confirmations for STRD Legacy Swaps and Pre-Transition Swaps that are amended via such a bilateral agreement.

Given the foregoing, DSIO believes that a no-action position is warranted. Accordingly, provided that the amendment is accomplished pursuant to a multilateral protocol or a bilateral agreement that amends multiple swaps, DSIO will not recommend that the Commission take an enforcement action against an SD for a failure to comply with the confirmation requirement of Commission regulation 23.501 solely to the extent such compliance would be required as a consequence of a Qualifying Amendment to an uncleared swap.

2. Swap Trading Relationship Documentation

With respect to STRD requirements, as noted above, Commission regulation § 23.504(a)(2) requires SDs to enter into swap trading relationship documentation prior to entering into any "swap transaction." Commission regulation 23.500(l) defines "swap transaction" as "any event that results in a new swap or in a change to the terms of a swap, including execution, termination, assignment, novation, exchange, transfer, amendment, conveyance, or extinguishing of rights or obligations of a swap."[50] Thus, an amendment of a STRD Legacy Swap would be a new "swap transaction" causing the swap to lose its status as an STRD Legacy Swap and an SD would be required to enter into documentation conforming to the rule.

For the same reasons recognized above with respect to the confirmation requirement of Commission regulation 23.501, DSIO believes that a no-action position is warranted. Accordingly, DSIO will not recommend that the Commission take an enforcement action against an SD for a failure to comply with the STRD requirement of Commission

[50] 17 CFR § 23.500(l).

regulation 23.504 solely to the extent such compliance would be required as a consequence of a Qualifying Amendment to an STRD Legacy Swap.

3. Reconciliation

The Commission's portfolio reconciliation rules require SDs to resolve discrepancies in "material terms" of their swaps with other SDs "immediately,"[51] and discrepancies with other counterparties "in a timely fashion."[52] ARRC states that it expects that in certain circumstances, SDs and market participants may book Fallback Amendments or Replacement Rate Amendments to their Pre-Transition Swaps differently and at different times, creating potential discrepancies across counterparties' books that will appear in the counterparties' reconciliation processes. Given the potential volume of such discrepancies, ARRC requests clarification that SDs may engage in good faith compliance efforts to resolve any such discrepancies during a transitionary phase.

Given the foregoing, DSIO believes that a no-action position is warranted. Accordingly, DSIO will not recommend that the Commission take an enforcement action against an SD for a failure to comply with the discrepancy resolution timing requirements of Commission regulation 23.502(a)(4) and (b)(4) solely to the extent such compliance would be required as a consequence of a Qualifying Amendment to an uncleared swap.

E. Relief Requested Related to End-Users

1. Exceptions and Exemptions from Compliance with the CFTC Margin Rule

Commission regulations 50.50(c) and 50.51(b)(2) provide the basis for an exception for non-financial entities (*i.e.*, commercial end-users eligible to elect an exception under Commission regulation 50.50(c)) and an exemption for cooperatives from the Commission's clearing requirement promulgated pursuant to section 2(h)(1)(A) of the CEA and codified in Part 50 of the Commission's regulations ("**Clearing Requirement**"), as well as the CFTC Margin Rule pursuant to Commission regulation 23.150(b), provided that certain conditions are satisfied, including the requirement that the swap is used to "hedge or mitigate commercial risk."

ARRC states that, as the market transitions to alternatives to the IBORS, there are likely to be situations where commercial end-users and cooperatives will have to amend their swaps that reference IRRs that are subject to the CFTC's Clearing Requirement or CFTC Margin Rule to include Fallback Amendments or Replacement Rate Amendments, but have not yet amended their IRR-linked loan agreements, debt instruments, and other

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[51] Commission regulation 23.502(a)(4); 17 CFR § 23.502(a)(4).

[52] Commission regulation 23.502(b)(4); 17 CFR § 23.502(b)(4).

agreements or transactions to include new fallbacks or alternative reference rates. The reverse may also be true (*i.e.*, amendments to such financial agreements may be completed before the related swaps are amended). Therefore, ARRC requests that DSIO provide relief for a transitional period to allow commercial end-users and cooperatives to maintain the status of swaps that are "used to hedge or mitigate commercial risk" pursuant to Commission regulations 50.50(c) and 50.51(b)(2) respectively, even if amended to include a Fallback Amendment or Replacement Rate Amendment.[53] Where such swaps of these end-users and cooperatives have been entered into with SDs, the SDs are also relying on the status of the swaps as being "used to hedge or mitigate [the] commercial risk" of such end-users and cooperatives for an exception/exemption from the Clearing Requirement and/or the CFTC Margin Rule.

For purposes of the relief in this section, DSIO will use the term "Eligible End-User" to refer to the following types of entities: (1) a non-financial entity electing an exception under Commission regulations 50.50(a)-(c); (2) a financial entity electing an exception under Commission regulation 50.50(a)-(d); (3) an exempt cooperative electing an exemption under Commission regulation 50.51; and (4) an entity identified by the Commission in its recent notice of proposed rulemaking under proposed regulations 50.77 (community development financial institutions), 50.78 (bank holding companies), and 50.79 (savings and loan holding companies).[54]

Further, for purposes of the relief in this section, DSIO will use the term "Covered IRS" to include any interest rate swap that (1) qualified as a swap used to hedge or mitigate commercial risk pursuant to regulation 50.50(c) at the time of execution; (2) qualified as a swap for which an Eligible End-User (a) elected an exception or exemption from the IRS Clearing Requirement pursuant to regulations 50.50, 50.51, or any prior no-action position taken by DCR; and (b) notified its swap counterparty of such an election; and (3) was reported to a swap data repository at the time an applicable exception or exemption was elected, pursuant to regulation 50.50(a)(1)(iii), 50.51, or applicable condition in a prior DCR staff letter.[55]

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[53] In addition to the ARRC letter requesting the relief discussed in this letter, Commission staff also received a letter from the National Association of Corporate Treasurers, which among other things, set forth certain requests for staff action on behalf of the end-user community.

[54] *See* Swap Clearing Requirement Exemptions, 85 FR 27955, 27973-74 (May 12, 2020) (proposing to codify in Commission regulations a number of DCR no-action positions and describing such no-action positions). The definition of "Covered IRS" is consistent with the use of the term in the revised DCR no-action letter issued concurrently with this letter.

[55] DSIO is using the defined terms "Eligible End-User" and "Covered IRS" to ensure that the relief in this section is consistent with relief provided by DCR to Eligible End-Users pursuant to the revised DCR no-action letter issued concurrently with this letter.

In defining the terms Eligible End-User and Covered IRS, DSIO is electing to provide a no-action position covering a broad group of end-users and the Covered IRS that they have elected not to clear. The objective in issuing this relief is to avoid being under-inclusive and thus forcing ARRC's membership to make additional requests for relief on behalf of commercial end-users. Nothing in this letter imposes new obligations or burdens that would be inconsistent with prior Commission action or staff no-action positions.

With respect to Fallback Amendments and Replacement Rate Amendments, DSIO recognizes that a temporary mismatch in the interest rates referenced in commercial arrangements and the Covered IRS used to hedge the risk of such arrangements may lead Eligible End-Users and their SD counterparties to question whether one or more Covered IRS still qualify as instruments used to hedge or mitigate commercial risk as prescribed by Commission regulations 50.50(c) and 50.51(b)(2), and therefore continue to qualify for the exception from the CFTC Margin Rule.

To alleviate any question in this regard, DSIO believes that a no-action position is warranted. Accordingly, DSIO will not recommend the Commission commence an enforcement action against an SD for failure to comply with the CFTC Margin Rule with respect to a Covered IRS entered into with an Eligible End-User if compliance with the CFTC Margin Rule would be required solely as a consequence of a Qualifying Amendment to such Covered IRS, or, with respect to the related commercial arrangement upon which an Eligible End-User is relying for purposes of electing an exception or exemption from the Clearing Requirement, solely as a consequence of an amendment to such commercial arrangement solely for the purpose of: (a) including new fallbacks to alternative reference rates triggered only by permanent discontinuation of an IRR or determination that an IRR is non-representative by the benchmark administrator or the relevant authority in a jurisdiction; or (b) accommodating the replacement of an IRR.[56] [57]

DSIO expects that the Covered IRS documentation and the documentation for any related commercial arrangement documentation will be amended as soon as commercially practicable after the Qualifying Amendment is made so that the documentation again reflects that the Covered IRS qualifies as a swap used to hedge or mitigate the commercial risk of an Eligible End-User pursuant to Commission regulation 50.50(c), 50.51(b)(2), or applicable condition in a prior DCR staff letter.

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[56] Consistent with the definition of a "Qualifying Amendment" discussed above, DSIO recognizes that any such amendment to a commercial arrangement referencing an IRR may include ancillary changes to existing terms to conform to different market conventions for an IRR and any alternative rate.

[57] DCR is providing comparable relief for Eligible End-User counterparties to SDs pursuant to a revised no-action letter issued concurrently with this letter.

SDs and their Eligible End-User counterparties should use their best efforts to work toward amending the reference rate provisions in both Covered IRS documentation and the related commercial arrangement documentation so that the rates referenced therein are aligned again by December 31, 2021.

2. Status as Eligible Contract Participants ("ECPs")

Related to the foregoing, some end-users identify themselves as ECPs based on a swap's purpose "to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred" by the end-user in the conduct/operation of the end-user's business.[58] ARRC argues that a swap with such purpose should maintain its status as such despite a Fallback Amendment or Replacement Rate Amendment for the purpose of the eligible contract participant representations given to SDs pursuant to Commission regulation 23.430(a). A temporary mismatch in the interest rates referenced in an "asset or liability owned or incurred" and the swaps used to hedge the risk of such asset or liability may lead end-users to question whether they continue to qualify as an eligible contract participant.

To alleviate any question in this regard, DSIO will not recommend that the Commission commence an enforcement action against any person for failure to comply with section 2(e) of the CEA or to qualify as an eligible contract participant pursuant to section 1a(18) of the CEA solely to the extent such status is relevant as a consequence of a Qualifying Amendment to an uncleared swap.

3. End-User Documentation Requirements

Finally, DSIO recognizes that an SD entering into swaps with an Eligible End-User that uses swaps to hedge or mitigate commercial risk pursuant to Commission regulations 50.50(b) or 50.51(c) may be required to obtain documentation from the Eligible End-User counterparty pursuant to Commission regulation 23.505(a)(4) that provides the SD with a reasonable basis to believe that the counterparty is hedging or mitigating commercial risk.

In light of the foregoing, DSIO believes that a no-action position is warranted. Accordingly, DSIO will not recommend that the Commission commence an enforcement action against an SD for failure to obtain documentation meeting the requirements of Commission regulation 23.505(a)(4) from an Eligible End-User for which it has previously obtained such documentation solely to the extent such would be required as a consequence of a Qualifying Amendment to an uncleared swap.

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[58] Section 1a(18)(A)(xi) of the CEA, 7 U.S.C 1a(18)(A)(xi).

It is important that SD counterparties to Eligible End-Users may continue to have independent monitoring, recordkeeping, and reporting obligations, including but not limited to compliance with other parts of Commission regulation 23.505 and Part 45 obligations. SD counterparties to Eligible End-Users are reminded that they may remain subject to requirements under Parts 23, 45, or 50, as applicable, when entering into Qualifying Amendments to Covered IRS with Eligible End-Users. Specifically, such SDs may be required to:

1. Maintain records of the election by an Eligible End-User not to clear a Covered IRS that would otherwise be subject to the IRS Clearing Requirement pursuant to regulation 23.505(a)(1)-(3), (5), and keep records pursuant to regulation 23.505(b);

2. Ensure that in making and maintaining such an election by an Eligible End-User, it is relying on the most recently filed documents meeting the requirements of Commission regulation 50.50(b), 50.51(c), or similar provision under prior staff no-action letter; and

3. Comply with all reporting requirements under Part 45 related to Qualifying Amendments made to Covered Swaps.

For the avoidance of doubt, this no-action position does not alter the responsibilities of any reporting counterparty to report swaps for which an exception or exemption is elected by an Eligible End-User under Part 45 of the Commission's regulations. Nor does it alter any independent obligations that SDs may have under Part 23 of the Commission's regulations, including requirements to know their counterparties, keep records of their swaps, and report such swaps to swap data repositories.

V. Conclusion

This letter, and the positions taken herein, represent the views of DSIO only, and does 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. Further, this letter, and the positions taken herein, are based upon the facts and circumstances presented to DSIO. Any different, changed, or omitted material facts or circumstances might render the relief provided by this letter void.

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

If you have any questions concerning this correspondence, please contact Frank Fisanich, Chief Counsel, DSIO, at (202) 418-5949 or ffisanich@cftc.gov.

Very truly yours,

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Joshua B. Sterling
Director
Division of Swap Dealer and Intermediary Oversight

cc: Regina Thoele, Compliance
National Futures Association, Chicago