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

Division of Market Oversight

Dorothy D. DeWitt
Director

Christopher K. Bowen
Managing Director, Chief Regulatory Counsel
CME Group
NYMEX World Headquarters
World Financial Center
300 Vesey Street
New York, NY 10282

Re: Staff No-Action Relief from Certain Reporting Requirements in Connection with the Transition From Effective Federal Funds Rate to Secured Overnight Financing Rate for Price Alignment and Discounting for Certain CME Cleared U.S. Dollar Interest Rate Swap Products

Dear Mr. Bowen:

This letter responds to a request for relief from Chicago Mercantile Exchange, Inc. ("CME")[1] to the Commodity Futures Trading Commission's ("CFTC" or "Commission") Division of Market Oversight ("DMO").[2] As described in the CME Letter, on October 16, as part of an industry-wide initiative "[t]o support the market adoption of [the Secured Overnight Financing Rate ("SOFR")] on an accelerated basis and promote the further development of SOFR liquidity," CME will switch from Effective Federal Funds Rate ("EFFR") to SOFR for price alignment ("PA") calculations and as "the applicable discounting rate used for the discount curve to calculate current swap value (together, "PA/Discounting")" for cleared U.S. dollar interest rate swaps ("USD IRS") in Affected Contracts.[3] As part of the process for PA/Discounting switchover, counterparties with open positions in Affected Contracts, as part of

[1] Note that CME operates a derivatives clearing organization ("DCO") through its clearing division.

[2] CME, Request for No-Action Relief from Part 43 Real-Time Reporting for Certain Basis Swap Transactions in Connection with the Transition From Effective Federal Funds Rate to Secured Overnight Financing Rate for Price Alignment and Discounting for Certain CME Cleared U.S. Dollar Interest Rate Swap Products, at 1 (September 29, 2020) ("CME Letter").

[3] *Id*. at 2. For purposes of this letter, the Affected Contracts are as follows: (i) Fixed / Float IRS, (ii) Zero Coupon Swaps, (iii) Overnight Index Swaps, (iv) Basis Swaps, and (v) Forward Rate Agreements.

a mandatory re-hedging process, will be allocated EFFR vs SOFR basis swaps ("Basis Swaps").[4] However, according to the CME Letter, some market participants would prefer to liquidate these Basis Swaps, instead of holding them going forward. On October 19 ("Auction Date"), in order to facilitate the liquidation or close-out of these Basis Swaps in an efficient and competitive fashion, CME, as a DCO, will hold a one-time voluntary centralized auction. As part of the auction process, CME will "net down gross payer and receiver Basis Swap discounting risks" of the unwanted Basis Swaps and "auction the residual risk exposures as an [auction portfolio]."[5] However, the CME Letter represents that CME believes that if the resulting swap transactions of the winning bidder(s)[6] for the auction portfolios from the October 19 auction are publicly disseminated as soon as technologically practicable after execution pursuant to Part 43 of the Commission's regulations, such public dissemination may hinder the winning bidders' ability to hedge the resulting swap transactions and may allow the winning bidders' competitors to derive information regarding the winning bidders' risk positions as the winning bidders try to hedge their auction portfolio positions.[7] Therefore, CME is requesting relief from certain Part 43 real-time reporting requirements in order to permit delayed reporting of the swap transaction and pricing data related to the auction portfolio positions for up to four weeks.

I. Factual Background

In response to significant concerns regarding the reliability and robustness of the interbank offered rates ("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.[8] The U.S. Financial Stability Oversight Council ("FSOC")

---

[4] *See* Modifications to USD-Denominated Interest Rate Swap Products to Support Transition to SOFR Price Alignment and Discounting (Aug. 25, 2020) ("CME Submission 20-379"). In addition to the mandatory re-hedging exercise, there will also be offsetting cash adjustments. CME Submission 20-379 is available at: *https://sirt.cftc.gov/sirt/sirt.aspx?Topic=ClearingOrganizationRulesAD&Key=44458*.

[5] CME Letter at 3.

[6] Per the CME SOFR Basis Swap Auction Protocol, the auction may be conducted in a winner-take-all format or a Dutch auction format. *See* CME SOFR Basis Swap Auction Protocol at 5, available at: *https://www.cmegroup.com/trading/interest-rates/files/sofr-basis-swap-auction-protocol.pdf*.

[7] CME Letter at 6.

[8] *See generally* FSB statement, "Interest rate benchmark reform – overnight risk-free rates and term rates" at 1, (July 12, 2018), available at: *https://www.fsb.org/wp-content/uploads/P120718.pdf* ("Because derivatives represent a particularly large exposure to certain IBORs, and because these prospective 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*; 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*.

has repeatedly called for member agencies to work closely with market participants to identify and mitigate risks that may arise during an IBOR transition process.[9]

In 2014, the Federal Reserve Bank of New York convened the Alternative Reference Rate Committee ("ARRC")[10] 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.[11]

In June 2017, the ARRC identified a broad Treasuries repo financing rate, SOFR, as the preferred alternative benchmark to USD London Interbank Offered Rate ("LIBOR") for certain new USD derivatives and other financial contracts.[12] 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.[13]

An essential piece of the ARRC's paced transition plan is that DCOs, such as CME, "should cease to accept for clearing new [IRS] contracts that use EFFR [for PA/Discounting], and should instead use SOFR for those purposes."[14] Therefore, in order "to support the market adoption of SOFR on an accelerated basis and promote the further development of SOFR liquidity, CME developed a process to transition CME cleared USD IRS products from EFFR to SOFR PA/discounting."[15]

Under CME's transition process[16] "CME will apply SOFR PA/discounting in lieu of EFFR PA/discounting to all positions in cleared CME USD IRS products that are Affected

---

[9] *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*.

[10] Authorities representing United States banking regulators and other financial sector members, including the Commission, serve as non-voting *ex officio* members of the ARRC.

[11] 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. 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*.

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

[13] The ARRC's Paced Transition Plan for Developing SOFR Markets is available at: *https://www.newyorkfed.org/medialibrary/microsites/arrc/files/paced-timeline-plan.pdf*.

[14] CME Letter at 2.

[15] *Id.*

[16] *See generally* CME Submission 20-379.

Contracts and that are open at the close of business on October 16, 2020 (the "Transition Date")."[17] As part of its transition plan, "CME will implement certain measures to reduce the valuation sensitivity to the closing curve marks on the Transition Date and mitigate potential re-hedging costs for market participants with open positions in Affected Contracts on the Transition Date resulting from the discounting change."[18] Specifically, CME will undertake two measures: (i) "a mandatory cash adjustment process to neutralize value transfers attributable to the change in the discounting basis from EFFR to SOFR[;]" and (ii) "a mandatory re-hedging process that will result in booking of CME cleared [Basis Swaps] at the position account level for cleared trades subject to the transition."[19]

CME represents "that some market participants that receive Basis Swaps allocated to them as a result of the mandatory re-hedging process may not wish to hold such Basis Swaps [("Close-Out Participants")]."[20] Therefore, on the Auction Date, CME, as a DCO, intends to conduct "a one-time voluntary centralized auction to provide such market participants with an efficient means to liquidate those positions."[21] As a result, CME will net down all Basis Swaps that Close-Out Participants want to liquidate as a result of the mandatory re-hedging process. Once the Basis Swaps are netted down, CME will "auction the residual risk exposures as an "Auction Portfolio" by soliciting bids from a range of auction bidding participants ("Auction Bidders") to close out the Basis Swaps of Close-Out Participants at a single fill price for each relevant swap tenor (2Y, 5Y, 10Y, 15Y, 20Y and 30Y) ("Auction Clearing Price")."[22]

In order to reduce dislocation risks and promote an efficient auction, CME will not publish the size of the auction portfolio ahead of the auction and will not reveal the direction of the portfolio, instead requiring bidders to submit two-sided bids.[23] During the auction, bidders will be able to view the auction portfolio.

Provided that the auction process is successful,[24] CME, in the end-of-day clearing cycle on the Auction Date, "will (i) execute and book CME cleared Basis Swaps to the account of each Close-Out Participant to close-out Basis Swaps in the account acquired in the mandatory re-

---

[17] CME Letter at 3.

[18] *Id.*

[19] *Id.*

[20] *Id.*

[21] *Id.*

[22] *Id*. at 3-4.

[23] CME SOFR Basis Swap Auction Protocol at 8, available at: *https://www.cmegroup.com/trading/interest-rates/files/sofr-basis-swap-auction-protocol.pdf*.

[24] CME explains that "[t]he auction process will include a price protection limit for the Auction Clearing Price, representing a maximum USD amount that a participant seeking to close-out Basis Swaps could incur within the auction ("Maximum Loss Limit"). If bids received from Auction Bidders would result in an Auction Clearing Price where the cost to liquidate the Basis Swaps exceeds the Maximum Loss Limit, CME will not execute the auction and the participants' Basis Swaps will not be closed out." *See* CME Letter at 4.

hedging process, and (ii) execute and book Basis Swaps to the account of each successful Auction Bidder…[(collectively, "Auction Basis Swaps")]."[25]

However, as noted above, CME represents that it believes if the Auction Basis Swaps of the winning Auction Bidder(s)[26] are publicly disseminated as soon as technologically practicable after execution, as is required under Part 43 of the Commission's regulations, this may hinder the winning Auction Bidders' ability to hedge these Auction Basis Swaps, may increase trading costs, and may allow the winning Auction Bidders' competitors to derive information regarding the winning Auction Bidders' risk positions as the winning Auction Bidder(s) are trying to hedge their auction portfolio positions.[27] Therefore, CME is requesting relief from certain Part 43 real-time reporting requirements in order to permit delayed reporting of the swap transaction and pricing data related to the Auction Basis Swaps as required under Part 43 of the Commission's regulations for up to four weeks, as CME believes that such a delay will aid the auction, which "will foster the success of the transition to SOFR PA/discounting."[28]

Specifically, CME is requesting, on its own behalf, and on behalf of participants in the auction, the following relief from:

1. The real-time public reporting requirements in Commission regulations 43.3(a)(1) and (3), to allow a four-week reporting delay for swap transaction and pricings data for each Auction Basis Swap transaction for the reasons discussed above; and
2. The reporting hierarchy in Commission regulation 43.3(a)(3) "to permit CME to serve as the reporting party for each Auction Basis Swap transaction."[29] Specifically, CME believes that is it "operationally more efficient" for CME to serve as the reporting counterparty and is consistent with the recently adopted, but not yet effective, amended requirements under Commission regulation 43.3(a)(5), which would require DCOs, such as CME, to serve as the reporting counterparty for such transactions.[30]

---

[25] CME Letter at 4.

[26] Per the CME SOFR Basis Swap Auction Protocol, the auction may be conducted in a winner-take-all format or a Dutch auction format. *See* CME SOFR Basis Swap Auction Protocol at 5, available at: *https://www.cmegroup.com/trading/interest-rates/files/sofr-basis-swap-auction-protocol.pdf*.

[27] CME Letter at 6.

[28] *Id.* at 5.

[29] *Id*. CME also explains that "[t]he Auction Basis Swaps will be clearing swaps as defined in CFTC Regulation 45.1, as they will be created pursuant to a CME DCO auction conducted pursuant to the Advisory Notice. In contrast to [current] Part 43, Part 45 assigns responsibility to CME (as a DCO) to submit Part 45 reports to an SDR for clearing swaps for which there is no original swap, and thus CME is the reporting party for Part 45 purposes with respect to the Auction Basis Swaps. Thus, granting this part of our request aligns with CME's Part 45 reporting obligations. CME also notes that the CFTC has proposed to add Regulation 43.3(a)(5), under which CME, in its capacity as a DCO, would have to report the Auction Basis Swaps as clearing swaps."

[30] *See* Real-Time Public Reporting Requirements (Sept. 17, 2020), *available at: https://www.cftc.gov/media/4776/federalregister091720a/download*.

II. No-Action Relief

Based on the representations in the CME Letter, DMO believes that time-limited no-action relief is warranted, and is providing such relief from certain real-time reporting obligations under Part 43 of the Commission's regulations in order to help facilitate a successful transition to SOFR PA/Discounting, which is an essential step to support the market adoption of SOFR on an accelerated basis and promote the further development of SOFR liquidity.

Pursuant to this relief, DMO will not recommend that the Commission take any enforcement action against CME or any participants in CME's Basis Swap auction for failure to comply with the real-time reporting requirements prescribed in Commission regulations 43.3(a)(1) and 43.3(a)(3) and the reporting hierarchy prescribed in Commission regulation 43.3(a)(3) for the relevant Auction Basis Swaps, provided that the following conditions are met:

1. The swap transaction and pricing data for each Auction Basis Swap is reported to a swap data repository and publicly disseminated by that swap data repository no later than November 19, 2020; and
2. The relief granted in this letter applies only to the Auction Basis Swaps of each successful Auction Bidder executed on the Auction Date as part of the auction on that date described in the CME Letter.

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. 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 its discretion.

If you have any questions concerning this correspondence, please contact Benjamin DeMaria, Special Counsel, at (202) 418-5988 or BDeMaria@CFTC.gov; or Roger Smith, Associate Chief Counsel, at (202) 418-5344 or RSmith@CFTC.gov.

Sincerely,

Dorothy D. DeWitt

Director