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Division of Clearing and Risk

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Director

Re: Revised Staff No-Action Relief from the Swap Clearing Requirement for Amendments to Legacy Uncleared Swaps to Facilitate an Orderly Transition from Inter-Bank Offered Rates to Alternative Risk-Free Rates

Ladies and Gentlemen:

This letter responds to a request to revise Letter No. 20-25[1] issued on August 31, 2020, by the Division of Clearing and Risk (DCR) of the Commodity Futures Trading Commission (CFTC or Commission). DCR issued Letter No. 20-25 in response to a letter from the Alternative Reference Rates Committee (ARRC)[2] on behalf of its members that are subject to certain Commission regulations.[3] Among other things, ARRC requested and DCR granted no-action relief for failure to comply with certain provisions of the swap clearing requirement promulgated pursuant to section 2(h)(1)(A) of the Commodity Exchange Act (CEA)[4] and codified in Part 50 of the Commission's regulations (Clearing Requirement).[5] This letter, like prior letters, applies only to uncleared interest rate swaps (IRS) that were executed prior to an applicable Clearing Requirement compliance date and for which swap counterparties subsequently amend certain terms solely as part of an industry-wide initiative to amend swaps that reference the London Interbank Offered Rate (LIBOR) and other interbank offered rates (collectively with LIBOR, the IBORs)[6] to reference alternative benchmarks, including risk-free rates (RFRs).

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[1] CFTC Letter No. 20-25 (Aug. 31, 2020), available at https://www.cftc.gov/csl/20-25/download.

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

[3] ARRC also requested relief from the Division of Market Oversight (DMO) and the Division of Swap Dealer and Intermediary Oversight (DSIO) (now the Market Participants Division or (MPD)). Both divisions provided no-action letters in response to ARRC's letter. In formulating this revised letter, DCR considered all prior no-action letters, along with all prior submissions from ARRC, as well as discussions related to ARRC's requested relief.

[4] 7 U.S.C. § 2(h).

[5] 17 CFR part 50.

[6] IBORs include, but are not limited to, U.S. dollar (USD) LIBOR, British pound (GBP) LIBOR, Japanese yen (JYP) LIBOR, the Tokyo Interbank Offered Rate (TIBOR), the Australian Bank Bill Swap Rate (BBSW), the Singapore Interbank Offered Rate (SIBOR), the Canadian Dollar Offered Rate (CDOR), Euro Interbank Offered Rate (EURIBOR), and the Hong Kong Interbank Offered Rate (HIBOR). The Singapore dollar rate overnight rate, the SOR-VWAP, also would be considered to be an IBOR in the context of this letter.

In a letter dated December 2, 2021, ARRC represents that, while non-U.S. dollar LIBOR settings and the one-week and two-month U.S. dollar LIBOR settings will cease to be provided or will no longer be representative of the underlying market as of December 31, 2021, all other U.S. dollar LIBOR settings will continue to be published on the basis of panel bank submissions until June 30, 2023 (the 2023 USD LIBOR Settings). Accordingly, ARRC requests an extension of certain relief provided by DCR in Letter No. 20-25 that would expire on January 1, 2022 to June 30, 2023 for swaps otherwise covered by such letters to the extent that they reference one of the 2023 USD LIBOR Settings.[7] In addition, ARRC requests that the expectation concerning the end-user exception stated in DCR Letter No. 20-25 be updated to provide that eligible end users should use their best efforts to work toward amending the reference rate provisions in both Covered IRS (as defined in such letters) documentation and the related commercial arrangement documentation so that the rates referenced therein match again by June 30, 2023 to the extent that the Covered IRS references one of the 2023 USD LIBOR Settings.

This letter sets forth a revised no-action position with regard to those requests.[8] This letter revises Letter No. 20-25 in its entirety. Letter No. 20-25 is superseded by this letter and no person may rely on Letter No. 20-25 after December 31, 2021.

I. FACTUAL BACKGROUND

In response to significant concerns regarding the reliability and robustness of the IBORs, the Financial Stability Board (FSB) called for the identification of alternative benchmarks to the IBORs and transition plans to support implementation.[9] 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.[10] In

[7] CFTC Staff Letters and letters requesting relief are available on the Commission's website at: https://www.cftc.gov/LawRegulation/CFTCStaffLetters/index.htm.

[8] This letter addresses only those ARRC requests that relate to Part 50 of the Commission's regulations. Other parts of the ARRC's request letters are being addressed separately by MPD and DMO in letters issued concurrently with this letter.

[9] *See* FSB statement, "Interest rate benchmark reform – overnight risk-free rates and term rates" (July 12, 2018), available at https://www.fsb.org/2018/07/interest-rate-benchmark-reform-overnight-risk-free-rates-and-term-rates/ ("Because derivatives represent a particularly large exposure to certain IBORs, and because these prospective [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."). In addition, the FSB's July 2014 recommendation to move to RFRs is available at https://www.fsb.org/wp-content/uploads/r_140722.pdf. *See also* 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.

[10] *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

response to ongoing efforts such as these, central banks in various jurisdictions, including the United States, United Kingdom, Japan, Switzerland, and European Union, have convened working groups of official sector representatives and market participants.

In 2014, the Federal Reserve Bank of New York convened the ARRC in order to identify best practices for U.S. alternative reference rates, identify best practices for contract robustness, develop an adoption plan, and create an implementation plan with metrics of success and a timeline.[11] Similar committees have been established in other jurisdictions, including the European Union, Japan, Switzerland, and the United Kingdom.

In June 2017, the ARRC identified a broad Treasuries repo financing rate, the secured overnight financing rate (SOFR), as the preferred alternative benchmark to U.S. dollar (USD) LIBOR (USD LIBOR) for certain new U.S. dollar derivatives and other financial contracts. It also published an updated paced transition plan outlining the steps that the ARRC, derivatives clearing organizations (DCOs), 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.[12] In accordance with the ARRC's plan and similar plans in other jurisdictions, the clearing and trading of SOFR-based derivatives and other financial contracts linked to alternative benchmarks commenced in 2018 and has continued to expand.[13]

In July 2017, the U.K. Financial Conduct Authority (FCA), which regulates ICE Benchmark Administration Limited, the administrator of LIBOR,[14] 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.[15] The submissions by panel banks serve as inputs to formulate LIBOR rates in five currencies, namely, USD LIBOR, EUR LIBOR, GBP LIBOR, CHF LIBOR, and JPY LIBOR.

Non-U.S. jurisdictions also have determined that applicable reference rates are no longer representative benchmarks due to a significant impairment as determined by authorized

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(June 2013) available at ttps://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202013%20Annual%20Report.pdf.

[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. *See* Alternative Reference Rates Committee, Press Release, March 7, 2018, available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-March-7-2018-press-release.pdf.

[12] In 2019, ARRC released an incremental objectives document that compliments the paced transition plan, available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC_2019_Incremental_Objectives.pdf. The Paced Transition Plan was completed in July 2021.

[13] Information regarding the progress of trading SOFR derivatives to date can be found at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/SOFR_Anniversary.pdf and https://www.isda.org/a/xogME/Benchmarks-Full-Year-2018.pdf. *See also* section III.C for an update on industry-led efforts to launch a protocol that will promote the transition from IBORs to RFRs for uncleared swaps and section III.E for a discussion of efforts by certain clearinghouses to promote the transition from IBORs to RFRs for new and existing cleared swaps.

[14] ICE Benchmark Administration Limited is the administrator for LIBOR rates in five currencies, four of which are subject to the IRS clearing requirement: USD, British pound (GBP), Swiss franc (CHF), and Japanese yen (JPY).

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

benchmark administrators or the relevant authority in a particular jurisdiction.[16] For example, in the United Kingdom, the Working Group on Risk-Free Reference Rates recommended the Sterling Overnight Index Average (SONIA) as the replacement rate for GBP LIBOR.[17] Similarly, in Japan, the Cross-Industry Committee on Japanese Yen Interest Rate benchmarks has identified the Tokyo Overnight Average Rate (TONA) as the preferred replacement rate for JPY TIBOR, where appropriate. In Switzerland, the National Working Group on Swiss Franc Reference Rates has recommended the CHF Swiss Average Rate Overnight (SARON) as the alternative reference rate to replace CHF LIBOR. Other jurisdictions have conducted similar work to identify and recommend appropriate replacement rates for the remaining IBORs.[18]

II. APPLICABLE REGULATORY REQUIREMENTS AND PRIOR DCR STAFF NO-ACTION POSITIONS

A. IRS Clearing Requirement

The Commission adopted its initial IRS Clearing Requirement under Commission regulations 50.2 and 50.4(a) in 2012, and compliance with the regulations was phased in over the course of 2013.[19] The initial IRS Clearing Requirement included fixed-to-floating IRS denominated in four currencies, U.S. dollar (referencing USD LIBOR), Euro (referencing EURIBOR), British pound (referencing GBP LIBOR), and Japanese yen (referencing JPY LIBOR). The 2012 Clearing Requirement covered basis swaps and forward rate agreements denominated in the same currencies and reference rates, as well as overnight index swaps denominated in U.S. dollars, Euros, and British pounds.[20]

In 2016, the Commission expanded the IRS Clearing Requirement to include fixed-to-floating IRS in nine additional major currencies (Australian dollars, Canadian dollars, Hong

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[16] When making such a determination, benchmark administrators and authorities supervising benchmark administrators have considered whether the benchmark (and, by extension, its administrator) satisfies the Principles for Financial Benchmarks published by the Board of IOSCO, July 2013, available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf. *See also* discussion of impaired rates below.

[17] The CFTC's Clearing Requirement applies to overnight index swaps with a SONIA floating rate and a term between 7 days and 3 years.

[18] For further details about jurisdictions' progress on reforming interest rate benchmarks, *see generally* the FSB's Progress Report on Reforming Major Interest Rate Benchmarks, December 18, 2019, available at https://www.fsb.org/wp-content/uploads/P181219.pdf. *See also* FSB's Report to the G20 on Supervisory issues associated with benchmark transition, July 9, 2020, available at https://www.fsb.org/2020/07/supervisory-issues-associated-with-benchmark-transition-report-to-the-g20/.

[19] *See generally* Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284 (Dec. 13, 2012) (2012 Clearing Requirement). Phased implementation of the 2012 Clearing Requirement took place in three phases based on type of market participant. *See generally* subpart B of Part 50 of the Commission's regulations. For ease of reference, market participants are invited to consult Table 1 Commission regulation 50.26, which sets forth specific compliance dates for each type of swap asset class required to be cleared.

[20] The 2012 Clearing Requirement also included two classes of credit default swaps, which were subject to separate phased implementation based on type of market participant and availability of clearing at specific derivatives clearing organizations.

Kong dollars, Mexican pesos, Norwegian krone, Polish zloty, Singapore dollars, Swedish krone, and Swiss franc), as well as other modifications to the scope of the 2012 Clearing Requirement.[21]

In the 2012 Clearing Requirement adopting release, the Commission clarified that the Clearing Requirement applies to all new swaps, as well as changes in the ownership of a swap, including by assignment, novation, exchange, transfer, or conveyance.[22] Notably, the Commission did not address amendments, material or otherwise, to existing swaps.[23]

In response to questions from comments about whether the new IRS Clearing Requirement applied to swaptions, the Commission explained, "The Commission is thus clarifying that the clearing requirement only applies to swaps resulting from the exercise of a swaption . . . if the clearing requirement would have been applicable to the underlying swap . . . at the time the counterparties executed the swaption."[24] In other words, for those swaptions executed after an applicable compliance date under subpart B of Part 50, the IRS resulting from the exercise of a swaption may be subject to the IRS Clearing Requirement.

B. Existing DCR No-Action Relief for Compression Exercises

In March 2013, during the implementation of the 2012 Clearing Requirement, DCR staff issued Letter 13-01 providing no-action relief from Part 50 when counterparties amend and replace swaps resulting from multilateral compression exercises consisting only of swaps entered into prior to the compliance date for the Commission's Clearing Requirement, provided that certain conditions are met.[25] Under Letter 13-01, legacy swaps executed prior to any applicable compliance date would not become subject to Part 50 when included in a multilateral compression exercise. DCR staff took this no-action position at that time in order to "promote the benefits of compression for uncleared swaps." DCR recognized that amending swaps entered into prior to a relevant compliance date for the Clearing Requirement was warranted in light of the public policy objectives of reducing outstanding notional exposures and reducing operational and counterparty credit risk.

In Letter No. 13-01, DCR set forth five conditions under which legacy swaps could be amended and a replacement swap generated. The portfolio compression exercise must: (1) meet the definition set forth in Commission regulation 23.500(h) and must involve more than two participants; (2) the exercise may not include cleared swaps; (3) the exercise may include only

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[21] *See generally* Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps, 81 FR 71202 (Oct. 14, 2016) (2016 Clearing Requirement) (expanding all four classes of IRS under regulation 50.4(a)).

[22] 2012 Clearing Requirement, 77 FR at 74316.

[23] In its 2012 Clearing Requirement adopting release, the Commission discussed certain negotiated swap provisions that counterparties may undertake based on the goal of reducing counterparty credit risk. The Commission stated that these changes to a swap would be viewed as "legitimate business considerations . . . on a case-by-case basis in conjunction with all other relevant facts and circumstances" and would be an affirmative defense to any charges of evasion of the clearing requirement. *See id*. at 74319. DCR believes that this preamble discussion of public policy considerations by the Commission offers additional support for the no-action position taken by staff in this letter.

[24] 2012 Clearing Requirement, 77 FR at 74316.

[25] DCR No-Action Relief from Required Clearing of Swaps Resulting from Multilateral Compression Exercises, CFTC Letter No. 13-01 (Mar. 18, 2013), available at https://www.cftc.gov/csl/13-01/download.

swaps executed prior to an applicable clearing requirement compliance date; (4) the compression exercise must have established rules, the original counterparties to the swaps cannot be altered, the material terms of the swap, including the maximum maturity of the swap and average weighted maturity of the swap cannot change, and the sole purpose of the exercise must be reducing operational or counterparty credit risk; and (5) the compression exercise methodology cannot allow participants to specify which swaps will be amended or replaced.

The no-action position taken by DCR in Letter 13-01 is consistent with Commission rules promoting the use of multilateral compression as a means of operational and risk management.[26] More recently, citing DCR's Letter 13-01, DSIO issued a similar no-action letter related to uncleared margin requirements to allow compression exercises.[27]

C. Existing DCR No-Action Relief for Partial Novations and Terminations

In March 2013, DCR staff subsequently issued Letter 13-02 that provided no-action relief from Part 50 when swap counterparties partially novate or partially terminate swaps that were executed prior to the date on which counterparties were required to begin complying with the clearing requirement, *i.e.*, uncleared legacy swaps.[28]

Letter No. 13-02 clarified that any change in the ownership of a swap would result in a new swap that may be subject to the Clearing Requirement. As explained in the letter, "All new swaps, including those that offset the risk of original swaps, are subject to required clearing, unless an exception or exemption under part 50 of the Commission's regulations applies."[29]

Letter 13-02 explained that fully novated swaps entered into after the compliance date for the Clearing Requirement would be subject to required clearing because they are new swaps. Likewise, partial novations, meaning a transfer of the ownership of a stated portion of the notional amount of an original swap from one of the original counterparties to a third party, result in a new swap that is required to be cleared. However, DCR took a position of no-action for partial terminations and partial novations of uncleared legacy swaps so long as records related to the partially terminated or novated swaps reflect that the action is undertaken solely to reduce the notional amount of the original swap and all other terms of the original swap remain the same. Stub swaps, as defined in Letter 13-02, and novated swaps resulting from partial novations must be submitted for clearing pursuant to section 2(h)(1)(A) of the CEA and Part 50.

D. Size of Legacy IRS Uncleared Swaps Portfolios

DCR estimates that the number of swaps in uncleared legacy IRS portfolios is relatively small given that a significant number of IRS referencing LIBOR rates were moved into clearing by the end of 2013 (in accordance with the 2012 Clearing Requirement) and by the end of 2018 (in accordance with the 2016 Clearing Requirement). In addition, presumably some number of

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[26] *See, e.g.*, Commission regulations 23.503 and 39.13(h)(4).

[27] DSIO No-Action Letter No. 19-13 (June 6, 2019).

[28] DCR No-Action Relief from Required Clearing for Partial Novation and Partial Termination of Swaps, CFTC Letter No. 13-02 (Mar. 20, 2013), available at https://www.cftc.gov/csl/13-02/download.

[29] *Id.*, at page 4-5 (citing the Commission's 2012 Clearing Requirement).

uncleared IRS referencing LIBOR rates have been terminated or expired given the passage of time.

In May 2019, the CFTC's Office of the Chief Economist (OCE) published an analysis estimating, among other things, the population of uncleared swap positions that constitute legacy swaps.[30] In this report, OCE noted that "legacy swaps with respect to the clearing requirement constitute a trivial portion of swaps markets."[31]

DCR worked with OCE to review the data presented in the May 2019 report, and DCR's own analysis regarding the number of swaps in uncleared legacy IRS portfolios supports OCE's conclusions. After reviewing swap transaction data reported to swap data repositories, DCR found that the total number of swaps expected to be eligible for the relief under the terms of this letter is small. Most swap counterparties have a discrete and manageable portfolio of outstanding uncleared swaps that qualify as IRS legacy swaps for the purposes of the 2012 Clearing Requirement. DCR calculated the number of swaps in these legacy portfolios. In an overwhelming majority of cases, including for CFTC-registered swap dealers, an entity's uncleared legacy IRS portfolio contains fewer than 1,000 swaps. Nonetheless, DCR understands the importance of providing legal and operational certainty in the context of global IBOR reform efforts.

Being able to track this type of data through swap data repository information has been tremendously helpful to DCR in formulating policy recommendations for the Commission and responding to requests for relief from market participants.

III. ARRC'S REQUESTS FOR RELIEF FROM THE CLEARING REQUIREMENT

ARRC's requests focus primarily on (1) swaps that were executed prior to the relevant compliance date on which swap counterparties were required to comply with the CFTC's IRS Clearing Requirement and thus have not been cleared (Uncleared Legacy IRS); and (2) uncleared swaptions that, upon exercise, would result in an IRS of a type subject to the CFTC's IRS Clearing Requirement, but where the swaption was executed prior to the relevant compliance date on which swap counterparties would have been required to comply with the IRS Clearing Requirement applicable to such IRS (Uncleared Legacy Swaptions).

ARRC members seek to amend their portfolios of Uncleared Legacy IRS and Uncleared Legacy Swaptions without such amended swaps, or swaps resulting from exercise of an Uncleared Legacy Swaption, becoming subject to the IRS Clearing Requirement under section 2(h)(1)(A) of the CEA and CFTC regulations 50.2 and 50.4(a).

In recognition of the public policy importance of facilitating a transition away from the use of certain IBORs, as set forth below, DCR is continuing to provide a position of no-action for failure to comply with the CFTC's IRS Clearing Requirement when counterparties amend

[30] Legacy Swaps under the CFTC's Uncleared Margin and Clearing Rules (May 22, 2019), available at https://www.cftc.gov/node/216426.

[31] *Id.* at 2 (presenting conclusions drawn from regulatory data collected on open uncleared swap positions to identify and analyze swaps that hold legacy status under the CFTC's uncleared margin and clearing requirement rules).

certain terms of an Uncleared Legacy IRS or an Uncleared Legacy Swaption, solely as part of a transition away from IBORs to alternative reference rates, subject to certain conditions outlined below.

This letter applies to Uncleared Legacy IRS and Uncleared Legacy Swaptions referencing (i) IBORs; (ii) any other interest rate that the parties to a swap reasonably expect to be discontinued or reasonably determine has lost its relevance as a reliable benchmark due to a significant impairment; or (iii) any other reference rate that succeeds any of the foregoing (the IBORs and any other rate meeting either of the foregoing criterion in (ii) or (iii) are hereinafter collectively referred to as Impaired Reference Rates or IRRs).

DCR recognizes that by defining IRRs in this manner, market participants will be permitted to make more than one amendment to the same Uncleared Legacy IRS or Uncleared Legacy Swaptions before settling on an alternative benchmark that adequately meets the counterparties' needs. That is, this revised no-action letter is meant to anticipate 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, so long as the original reference rate for the swap was an IBOR or met the other criterion above and the amendment satisfies the conditions set forth in this letter.[32]

A. ARRC's Initial Request for Relief

In order to facilitate the transition from IBORs – or other reference rates that may be phased out or become impaired – to RFRs and protect against any permanent cessation of IBOR publication, ARRC requested that DCR provide relief from certain regulations under Subparts A and C of Part 50 in its November 5, 2019 letter.[33] ARRC asked that relief from the Clearing Requirement be granted when swap counterparties amend any term of a swap that refers to, or is based upon a reference rate, where such amendment to the term is done solely as part of an IBOR transition. AARC also asked for relief for certain commercial end-users and co-operatives under regulations 50.50 and 50.51.

Based on representation made by ARRC in its November 5, 2019 letter and discussions with ARRC representatives, DCR issued Letter No. 19-28.

B. ARRC's Subsequent Request for Relief

In its July 20, 2020 letter, ARRC requested that the relief granted under Letter No. 19-28 be broadened to allow swap counterparties more discretion in amending the fallback provisions in Uncleared Legacy IRS and Uncleared Legacy Swaptions. ARRC stated that certain market participants might be hesitant to move forward with the transition from IBORs to alternative reference rates if all rates contemplated as possible alternative reference rates are not covered by DCR's no-action position.

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[32] This flexibility is intended to harmonize with terms of the original and revised MPD staff letters providing relief related to the IBOR transition under Part 23 of the Commission's regulations.

[33] All relevant letters requesting relief, along with staff responses, are available on the Commission's website at: https://www.cftc.gov/LawRegulation/CFTCStaffLetters/index.htm

Second, in addition to expanding the relief specific to amendments made to change fallback provisions, ARRC requested that relief should be granted for amendments made to Uncleared Legacy IRS to replace IRRs with an alternative reference rate. Third, ARRC requested new relief for amendments to the terms of Uncleared Legacy Swaptions based on expected changes to applicable discount rates that are used to value the swaptions.[34]

Fourth, ARRC sought clarification from DCR that the relief provided would apply to ancillary modifications and follow-on amendments to Uncleared Legacy IRS and Uncleared Legacy Swaptions. Specifically, ARRC requested that the revised no-action letter permit (i) extensions of maturity of a swap or a portfolio of swaps necessary to accommodate the differences between market conventions for an IRR and its replacement; and (ii) increases in the total effective notional amount of a swap or the aggregate total effective notional amount of a portfolio of swaps necessary to accommodate the differences between market conventions for an IRR and its replacement.

Finally, ARRC requested an expansion of the relief provided to entities relying on the end-user exception and the exemption for co-operatives under Part 50 of the Commission's regulations.[35]

C. Qualifying IRR Amendments - Fallback Amendments

In existing ISDA Master Agreement documentation between swap counterparties, including ISDA definitions incorporated by reference, there are fallback provisions that become relevant only if the floating rate term is not available or becomes impaired (including because the rate is permanently discontinued or is determined to be non-representative by the benchmark administrator or the relevant authority in a particular jurisdiction).[36] As part of the transition from IRRs to alternative reference rates, specified reference rates will be introduced into fallback provisions to the underlying ISDA Master Agreement documentation. For purposes of this letter, the amendment of such fallback provisions (or addition of contractual terms)[37] to modify the process for selecting a new reference rate of an IRS that is not available because the rate is unavailable, permanently discontinued, or determined to be non-representative by the benchmark

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[34] As discussed in more detail below, ARRC is requesting relief for amendments to the terms of interest rate swaptions based on expected changes to applicable discount rates that are used to value the swaptions.

[35] This letter is intended to be a comprehensive overview of the relief provided by DCR. It is not an attempt to address every item included in the evolving list of issues raised by ARRC's membership.

[36] Existing ISDA Master Agreement documentation between swap counterparties generally contains fallback provisions to determine a floating rate term of an IRS if the rate becomes impaired or is unavailable. According to the 2006 ISDA Definitions, the current fallback provisions for LIBOR and other key IBORs require a poll of four major banks in a relevant interbank market to determine the rate. If fewer than two major banks in the interbank market respond, the fallback provision may require the calculation agent to poll major banks in the relevant city. Finally, if rates are unavailable, the fallback provision may require the calculation agent to determine the rate. All of these fallback instructions may vary or may be difficult to implement in practice. *See also* Development of Fallbacks for LIBOR and Other Key IBORs – FAQs, available at https://www.isda.org/2017/11/28/development-fallbacks-libor-key-ibors-faqs/.

[37] The addition of new contract terms would be applicable only in situations where the underlying documentation is not based on the ISDA definitions, which contain specific fallback provisions. This letter is intended to apply regardless of the underlying master agreement documentation chosen by the counterparties.

administrator or the relevant authority in a particular jurisdiction, will be referred to as the **Fallback Amendment**.[38]

In its July 20, 2020 letter and discussions with staff, ARRC states that greater certainty about the application of CFTC regulations to Uncleared Legacy IRS will eliminate significant impediments to the efficient amendment of large volumes of swaps and facilitate the orderly transition away from the use of IRRs, which is a goal supported by public sector authorities around the world. Importantly, the Fallback Amendment process for Uncleared Legacy IRS is one piece of a global reform agenda and does not reflect market participants voluntarily assuming risk or exercising independent discretion.

ISDA developed an industry protocol, the ISDA 2020 IBOR Fallbacks Protocol, with respect to Fallback Amendments (ISDA Protocol). By adhering to the ISDA Protocol, the counterparties are able to add a Fallback Amendment to an Uncleared Legacy IRS or Uncleared Legacy Swaption without extensive, bilateral negotiations.

Counterparties relying on ISDA documentation with outstanding IRS are able to adopt Fallback Amendments voluntarily. ARRC represents that most counterparties adhere to the ISDA benchmark rate fallback supplement because it reduces uncertainty by specifying which alternative reference rate will replace which IRR, as well as how any new swap rate will be determined if such a rate becomes unavailable.

ARRC requested that DCR confirm that a Fallback Amendment would not cause a swap that is currently not required to be cleared pursuant to section 2(h)(1) of the CEA, as implemented in Part 50 of the Commission's regulations, to become subject to the Commission's IRS Clearing Requirement. DCR has concluded that adding a Fallback Amendment to an Uncleared Legacy IRS or Uncleared Legacy Swaption[39] should not cause the loss of legacy status resulting in the swap becoming subject to the IRS Clearing Requirement.

When adding a Fallback Amendment to an Uncleared Legacy IRS or Uncleared Legacy Swaption, the swap counterparties are permitted to select any alternative reference rate as the fallback that the parties believe appropriate after assessing its complexity, safety, and soundness, and taking into consideration appropriate risk management practices.

DCR continues to take this no-action position based on representations from ARRC that "a significant portion of the Fallback Amendments will be effected by the multilateral ISDA Protocol, although some counterparties may enter into Fallback Amendments bilaterally." DCR is not specifying that swap counterparties must rely upon an industry protocol. Bilateral

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[38] In swaps that have no reference rate fallback provision currently, a Fallback Amendment would consist of new provisions in the master agreement or other appropriate swap documentation. Whether adopting a new Fallback Amendment provision or updating a current fallback provision through a Fallback Amendment, this letter refers to that process as "adding a Fallback Amendment."

[39] The term "Uncleared Legacy IRS" in this letter is used to refer to interest rate swaps that otherwise would be required to be cleared pursuant to section 2(h)(1)(A) of the CEA and regulations 50.2 and 50.4(a), but for the fact that such swaps were entered into prior to an applicable compliance date. The term "Uncleared Legacy Swaption" in this letter is used to refer to a swaption that, upon exercise, would result in an IRS of a type subject to the CFTC's IRS Clearing Requirement, but where the swaption was executed prior to the relevant compliance date on which such an IRS would have been required to be cleared, but amended after an applicable compliance date.

negotiation and addition of Fallback Amendments to Uncleared Legacy IRS or Uncleared Legacy Swaptions also would be permissible under the terms of this letter.

For the avoidance of doubt, DCR notes that swap counterparties are not required to add Fallback Amendments to Uncleared Legacy IRS or Uncleared Legacy Swaptions and could instead choose to: (1) clear the swap, or (2) terminate the swap.

D. Replacement Rate Amendments

Some market participants may choose voluntarily to convert Uncleared Legacy IRS or Uncleared Legacy Swaption referencing an IRR to instead reference an alternative reference rate prior to any permanent cessation of the applicable IRR or determination that the IRR is non-representative by the benchmark administrator or the relevant authority in a jurisdiction (**Replacement Rate Amendment**).

DCR recognizes that counterparties may use a number of methods to effectuate Replacement Rate Amendments.[40] These methods may include completing the necessary amendments by adherence to a future ISDA-led protocol, by bilateral contractual amendment of an agreement or confirmation, or by execution of a new swap(s) in replacement of and immediately upon termination of an existing swap(s) (*i.e.*, "tear-ups"). Counterparties engaging in a Replacement Rate Amendment also may find it necessary to make additional follow-on amendments to maintain the economics of the swap. These follow-on amendments, so long as they are necessary for the successful completion of a Replacement Rate Amendment, will be permitted under the terms of relief included in this letter.[41]

DCR continues to take this no-action position based on representations from ARRC that "[t]he absence of relief for Replacement Rate Amendments creates precisely the hurdles to a transition that the relief is meant to avoid. For example, it could deter market participants from taking early, voluntary steps to transition such legacy swaps."[42] Given this representation and in an effort to be consistent with relief provided by MPD, DCR is expanding its previous no-action position to permit Uncleared Legacy IRS and Uncleared Legacy Swaptions to maintain their legacy status after a Replacement Rate Amendment if the alternative reference rate selected as the replacement rate would otherwise subject the swap to the IRS Clearing Requirement.[43]

For the avoidance of doubt, swap counterparties are not required to amend their Uncleared Legacy IRS or Uncleared Legacy Swaptions as part of the IBOR transition and could instead choose to: (1) clear the swap, or (2) terminate the swap.

For purposes of this letter, the amendment of an Uncleared Legacy IRS or Uncleared Legacy Swaption that references an IRR solely to: (i) include new fallbacks to alternative

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[40] These methods are discussed in more detail in DSIO no-action letter issued concurrently with this letter.

[41] 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.

[42] Attachment to ARRC request letter dated July 20, 2020, at page 4.

[43] For example, Uncleared Legacy IRS that are amended into new overnight index swaps that reference SONIA may otherwise be subject to the IRS Clearing Requirement, but under the terms of this letter such swaps would continue to be treated as Uncleared Legacy IRS.

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**.

E. Qualifying Swaption Amendment

Certain CFTC-registered DCOs, including the Chicago Mercantile Exchange, Inc. (CME), LCH Ltd. (LCH), and Eurex Clearing AG (Eurex) changed 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. Specifically, CME and LCH transitioned from using the daily effective federal funds rate (EFFR) to SOFR with respect to USD discounted swaps. LCH and Eurex have transitioned from using the Euro OverNight Index Average (EONIA) to the Euro Short Term Rate (€STR) with respect to EUR discounted swaps.

These DCO discount rate changes affect both existing and new cleared swaps. With respect to the switch from EFFR to SOFR, both CME and LCH 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 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 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.

Based on ARRC representations,[44] DCR understands that changes by DCOs to the discount rate that they use for purposes of valuing cleared swaps and the rate applied to collateral or settlement amounts relating to certain cleared swaps, could, in certain cases, affect the value of uncleared USD- and EUR-denominated swaptions that exercise into uncleared swaps after the date on which the change in discounting rate occurs. Some of these swaptions may be Uncleared Legacy Swaptions that would require amendments or modifications to accommodate the exchange of compensation or a discount rate modification 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. To the extent that such an amendment to an uncleared USD- or EUR-denominated swaption could exercise into a swap subject to the IRS Clearing Requirement, DCR is addressing the matter in this letter.

For purposes of this letter, if, solely as a result of a public announcement by a DCO of an impending change the discount rate used for purposes of valuing cleared swaps and the rate applied to collateral or settlement amounts relating to certain cleared swaps, the counterparties to a swaption either: (1) voluntarily exchange compensation for a swaption; or (2) amend a swaption's terms solely to reflect an agreement regarding the discount rate used by a central

[44] ARRC letter to DSIO, dated June 16, 2020, at page 4, note 14 ("It is the ARRC's view that so long as the rate being transitioned into represents an RFR, and the purpose of the transition is to facilitate the IBOR transition an enhance market stability, **similar relief from the DSIO and applicable other CFTC divisions should apply**.") (emphasis added). In formulating this letter, DCR staff discussed the need for Part 50 relief related to uncleared swaptions that exercise into swaps that may be subject to the IRS Clearing Requirement with ARRC representatives.

counterparty (CCP), then such actions under (1) or (2) shall be referred to as a **Qualifying Swaption Amendment**.

F. Qualifying Credit Support Annexes (CSA) Amendments

ARRC has explained that market participants also may 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, a swap dealer may offset the risk of an uncleared swap with a third party by entering into a cleared swap. In such cases, the swap dealer customarily will 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.

Under ARRC's Recommended Best Practices, swap dealers were encouraged to amend their interdealer CSAs to use SOFR for USD collateral by December 31, 2020,[45] and, because EONIA will be discontinued in January 2022, market participants will need to amend CSAs referencing EONIA. ARRC states 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 also will 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 from IBORs.

For purposes of this letter, an amendment 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, is referred to as a **Qualifying CSA Amendment**.

IV. GRANT OF NO-ACTION RELIEF AND APPLICABLE CONDITIONS

For purposes of the DCR no-action positions set forth below, the amendment of an Uncleared Legacy IRS or Uncleared Legacy Swaption 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**.

Consistent with the approach taken by MPD in its no-action letter issued concurrently with this letter, a Qualifying Amendment to an Uncleared Legacy IRS or Uncleared Legacy Swaption **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.[46]

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[45] *See* 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.

[46] ARRC requested 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 contends 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 also may 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

However, a Qualifying Amendment **may not** include any amendment that (i) changes the counterparties to the original Uncleared Legacy IRS or Uncleared Legacy Swaption, (ii) extends the maximum maturity of a Uncleared Legacy IRS or Uncleared Legacy Swaption or a portfolio of such 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 (iii) increases the total effective notional amount of a Uncleared Legacy IRS or Uncleared Legacy Swaption or the aggregate total effective notional amount of a portfolio of such swaps beyond what will accommodate the differences between market conventions for an IRR or a discount rate used by a CCP and its replacement.

In issuing this letter, DCR reminds interested market participants that swap counterparties retain responsibility for determining which of their swaps qualify as Uncleared Legacy IRS or Uncleared Legacy Swaptions. This letter does not apply to swaps that have been submitted to clearing voluntarily.

The terms and conditions used in this letter are generally consistent with relief provided by MPD and the prudential regulators with regard to margin for uncleared swaps.[47] DCR is taking the no-action position set forth in this letter to help facilitate an orderly market-wide transition away from the use of IBOR floating rates to RFRs selected by ARRC and similar working groups convened in other jurisdictions.

As set forth in detail above, the relief described in this letter is consistent with statements made by the Commission in the 2012 Clearing Requirement and with prior no-action letters issued by DCR related to the Clearing Requirement. Nevertheless, counterparties should not view this letter as an opportunity to renegotiate economic terms or otherwise engage in price-forming activity. For all of these reasons, certain conditions are appropriate.

Given the foregoing, DCR believes that a no-action position with respect to Qualifying Amendments is warranted. Accordingly, until June 30, 2023 for swaps to the extent that they reference one of the 2023 USD LIBOR Settings, DCR will not recommend that the Commission take an enforcement action against any person for a failure to comply with the IRS Clearing Requirement under section 2(h)(1)(A) of the CEA and Commission regulations 50.2 and 50.4(a) when such person makes a Qualifying Amendment to an Uncleared Legacy IRS or Uncleared Legacy Swaption, provided that such an amendment is made for the sole purpose of transitioning from an IRR to an alternative reference rate.

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

[47] The term "prudential regulators" refers to 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 are responsible for implementing margin rules for uncleared swaps entered into by swap dealers subject to prudential regulation for purposes of margin and capital.

DCR recognizes the challenges associated with an industry-wide transition from IRRs to alternative reference rates, especially in the context of amending both swap documentation and other commercial documentation referencing IBORs. Nonetheless, DCR continues to believe that retaining an expiration date for this portion of its no-action position aligns with the deadline set by global authorities and serves as an incentive to meet that deadline. In addition, this expiration date affords DCR the opportunity to ensure that its no-action position remains tailored and appropriate to the needs of the industry.[48]

This relief does not apply to the Commission's trade execution requirement, implemented via the "made available to trade" determination process in 2013, which took effect in 2014 and currently applies to fixed-to-floating IRS contracts with benchmark tenors denominated in U.S. dollars, euros, and British pound sterling.[49]

This relief also does not alter any independent obligations that swap dealers may have under Part 23 of the Commission's regulations,[50] including requirements to know their counterparties, keep records of their swaps, and report such swaps to swap data repositories. Similarly, this relief does not alter any independent obligations that swap counterparties may have under Part 45 of the Commission's regulations[51] to report their swaps to a swap data repository.

V. RELIEF REQUESTED BY CERTAIN END-USERS

A. Factual Background

Commission regulation 50.50 sets forth an exception from the Clearing Requirement for non-financial entities (*i.e.*, commercial end-users eligible to elect an exception under section 2(h)(7)(A) of the CEA and Commission regulation 50.50(a)) using swaps to hedge or mitigate commercial risk, as defined under regulation 50.50(c). Similarly, Commission regulation 50.51 sets forth an exemption from the Clearing Requirement for cooperatives that (1) meet the definition of "exempt cooperative" under regulation 50.51(a); and (2) are using swaps to hedge or mitigate commercial risk, in accordance with regulation 50.50(c), related to loans to members. The same definition of hedging and mitigating commercial risk thus applies to both non-financial entities and cooperatives electing not to clear swaps that would otherwise be subject to the Clearing Requirement.[52]

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[48] *See, e.g.*, Exemption From the Swap Clearing Requirement for Certain Affiliated Entities – Alternative Compliance Frameworks for Anti-Evasionary Measures, 85 FR 44170, 44171-72 (July 22, 2020) (codifying expanded and revised staff no-action positions taken over the course of six years with regard to regulation 50.52)). Similarly, DCR recognizes that an eventual amendment to regulation 50.4(a) will be necessary to reflect the cessation of particular IBORs.

[49] *See* Commission regulation 37.10 and Commission regulation 38.12; *see also* CFTC, Industry Filings – Swaps Made Available to Trade, available at https://www.cftc.gov/idc/groups/public/@otherif/documents/file/swapsmadeavailablechart.pdf. *See also* CFTC Letter 19-27 (granting relief from the trade execution requirement) and DMO's revised no-action letter issued concurrently with this letter.

[50] 17 CFR part 23.

[51] 17 CFR part 45.

[52] These rules and the statutory provisions upon which they are based also apply in the context of the Commission's uncleared margin requirements pursuant to Commission regulation 23.150(b), 17 CFR § 23.150(b).

Both regulations 50.50 and 50.51 have reporting requirements, for which the reporting counterparty generally would be a swap dealer.[53] Reporting the election of an exception or exemption from required clearing to a swap data repository allows the Commission access to accurate data regarding uncleared swaps subject to section 2(h)(1)(a) of the CEA and Part 50 of the Commission's regulations.[54]

The end-user exception under regulation 50.50 also is available to certain small financial entities, including banks, savings associations, farm credit system institutions, and credit unions, provided such institutions have total assets of $10 billion or less on the last day of the institution's most recent fiscal year, pursuant to regulation 50.50(d).[55] These financial entities must meet the requirements of regulation 50.50(c) regarding hedging and mitigating their commercial risk in order to elect the exception under regulation 50.50, as well.

B. ARRC's Initial Request

ARRC members that are commercial end-users and cooperatives have stated that, due to the operational constraints and timing difficulties, they may not be able to simultaneously amend both their swap documentation and the related commercial agreements (upon which such entities rely in electing not to clear swaps subject to Part 50) by the December 31, 2021 deadline set by global authorities. For example, a commercial end-user or cooperative may have a reference rate mismatch between its swap documentation and its commercial documentation if one set of documents is amended before the other. More specifically, ARRC has stated that, as the IBOR-linked IRS market transitions to alternative reference rates, there are likely to be situations where commercial end-users and cooperatives will have to amend their swaps that reference IRRs and

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[53] *See, e.g.*, regulations 50.50(a)(1)(iii), 50.50(b), and 50.51(c) (generally setting forth the framework that an entity that elects an exception or exemption from the Clearing Requirement is the "electing counterparty" while the other counterparty is the "reporting counterparty.") The Commission explained in the preamble to the End-User Exception to the Clearing Requirement for Swaps, 77 FR 42560, 42566 (July 19, 2012) (2012 End-User Exception Final Rulemaking) that the reporting counterparty would report the following information regarding such swaps on a swap-by-swap basis or an annual basis: "(1) Whether the electing counterparty is a financial entity or a finance affiliate (*i.e.*, is a financial entity electing the end-user exception by virtue of Sections 2(h)(7)(C)(ii) or (iii) or 2(h)(7)(D) of the CEA); (2) whether the swap hedges or mitigates commercial risk (the annual filing will state that the electing counterparty will only elect the end-user exception for swaps that hedge or mitigate commercial risk); (3) how the electing counterparty generally expects to meet its financial obligations; and (4) information related to whether the electing counterparty is an issuer of securities with board approval to not clear the swaps for which the end-user exception is elected." Swap counterparties could choose the most cost-effective option. *See id.* DCR has reviewed non-public swap data repository data that indicate it is primarily registered swap dealers and a handful of other large financial entities that make reports on a swap-by-swap basis when their end-user counterparties elect an exception or exemption from the Clearing Requirement.

[54] *See* Commission regulation 50.50(b) and regulation 50.51(c), 17 CFR 50.50(b) and 50.51(c).

[55] In November 2020, the Commission codified several no-action letters that DCR previously issued for the holding companies of small banks and savings and loan associations because it is frequently the holding company that enters into swaps on behalf of the financial institution (Letter No. 16-01); for community development financing institutions (CDFIs) (Letter No. 16-02); and for certain statements made by the Commission in the 2012 End-User Exception final rulemaking exempting swaps entered into by central banks, central governments, the Bank of International Settlements, and 22 international financial institutions (IFIs) from the Clearing Requirement (codifying Commission statements from the 2012 End-User Exception Final Rulemaking, 77, FR at 42561-62, and four staff no-action letters, namely, Letter Nos. 13-25, 17-57, 17-58, and 17-59)). Swap Clearing Exemptions, 85 FR 76428 (Nov. 30, 2020).

are subject to the CFTC's IRS Clearing Requirement, but have not yet amended their IRR-linked loan agreements, debt instruments, and other agreements or transactions to include new fallbacks or alternative reference rates. The reverse also may be true (*i.e.*, amendments to commercial agreements may be completed before the related swaps are amended). This timing mismatch means commercial end-users and cooperatives may not be able to make, or keep making, the required representations under regulations 50.50(a)(1)(ii) and 50.51(b) regarding "hedging or mitigating commercial risk" as that concept is defined in regulation 50.50(c).

Therefore, in its November 5, 2019 letter, ARRC requested that DCR 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 the underlying swap documentation or commercial documentation is amended and the two sets of documentation no longer reference the same rate or have different rates for some period of time.[56] DCR issued Letter No. 19-28 in response to this request.

C. ARRC's Subsequent Request for Relief

ARRC's July 20, 2020 request letter raised a number of concerns with the no-action position taken by DCR in Letter No. 19-28. ARRC requested that the time limit on the no-action letter be eliminated, and the relief not be conditioned on commercial end-users amending their commercial agreements by a date certain. ARRC also requested DCR clarify that (1) commercial end-users be able to rely upon the representations made to their swap counterparties[57] at the time such end-users elected an exception or exemption from the IRS Clearing Requirement; and (2) commercial end-users do not have an ongoing obligation to monitor compliance with such an election.

ARRC also requested no-action relief for entities that **were** eligible to elect not to clear IRS subject to the Clearing Requirement at the time they entered into the IRS, **but are no longer eligible** to elect an exception or exemption under Part 50 because they no longer meet all the conditions under the rule. ARRC provided the example of a small bank that qualified for, and elected an exemption under regulation 50.50(d), when such a bank entered into an uncleared IRS, but "would no longer be eligible for such exception (*e.g.*, a bank that previously had total assets of $10 billion or less, and that now exceeds that threshold)."[58]

Finally, in addition to requesting relief from ongoing obligations under Part 50's exceptions and exemptions in the context of making Fallback Amendments to swaps otherwise

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[56] In addition to the November 5, 2019 ARRC letter requesting the relief discussed in this letter, Commission staff also received a letter from the National Association of Corporate Treasurers (NACT), which set forth certain requests for staff action on behalf of the entire end-user community. NACT, in support of ARRC's request, stated that "[d]uring this transitional phase, such derivatives contracts should maintain their status as swaps that are 'used to hedge or mitigate commercial risk' as they will still 'remain economically appropriate to the reduction of risks' in connection with the management of a commercial enterprise.'" NACT letter to DMO and DCR, Summary of LIBOR-SOFR Transition Issues, page 4, dated June 5, 2019 (quoting Commission regulation 50.50(c)).

[57] As explained above, in many if not most instances, this counterparty is likely to be a swap dealer subject to regulations under Part 23 of the Commission's regulations. Specific requests for relief related to Part 23's requirements for swap dealers are being addressed in a revised staff letter issued concurrently by MPD.

[58] *See* Attachment to ARRC request letter dated July 20, 2020, at page 8.

subject to the IRS Clearing Requirement, ARRC asked DCR to expand its no-action position to include making Replacement Rate Amendments to swaps subject to the IRS Clearing Requirement but for which an exemption has been previously elected.

D. DCR Revised No-Action Position Under Part 50

DCR recognized that a temporary mismatch between the rates referenced in commercial agreements and the rates referenced in the swap documentation for IRS used to hedge or mitigate the risk of such commercial agreements may lead certain end-users to question whether the IRS for which they previously elected an exception or an exemption under Part 50 still qualify as instruments used to hedge or mitigate commercial risk, as prescribed by Commission regulations 50.50(c), 50.51(b)(2) or applicable condition of staff no-action relief. These entities also may have concerns about whether they must reassess their status as commercial end-users when making amendments as part of the IBOR transition process given the passage of time since the original election of an exception or exemption. Lastly, the entities may be uncertain about their ongoing recordkeeping and reporting obligations.

For purposes of this letter, DCR 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; (4) a community development financial institution under Commission regulation 50.77; (5) a bank holding company under Commission regulation 50.78; and (7) a savings and loan holding company under Commission regulation 50.79.

ARRC has not requested no-action relief for swaps entered into by the other types of entities, namely central banks, central governments, the Bank of International Settlements, and 22 international financial institutions (IFIs). Generally speaking, the swaps entered into by these entities are excluded from the IRS Clearing Requirement by action of the Commission in the 2012 End-User Rulemaking.[59] Accordingly, these entities would not require a no-action position similar to that provided in this letter when making amendments to their IRS as part of the IBOR transition process. However, to the extent that these entities believe that such relief is needed with regard to moving from IBORs to alternative reference rates, DCR staff stands ready to address such concerns.

For the avoidance of doubt, by issuing this letter, DCR is not taking a position regarding whether the entities defined as Eligible End-Users require the relief requested by ARRC. Rather, DCR is making such relief available should Eligible End-Users believe it is needed.

Further, for purposes of this letter, DCR 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 as defined pursuant to Commission 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

[59] *See generally* 2012 End-User Exception Final Rulemaking, 77 at 42562. For example, a foreign central bank entering into a Qualifying Amendment for swaps with its swap dealer counterparty is unlikely to require the relief offered in this letter because the Commission has recognized that the swaps entered into by central banks are not be subject to the Clearing Requirement in keeping with considerations of comity and the traditions of the international system.

Clearing Requirement pursuant to Commission regulations 50.50, 50.51, or any applicable no-action position taken by DCR; and (b) notified its swap counterparty of such an election; and (3) was to the best of the Eligible End-User's knowledge reported to a swap data repository at the time an applicable exception or exemption was elected, pursuant to Commission regulation 50.50(a)(1)(iii), 50.51, or applicable condition in a prior DCR staff letter.

In defining the terms Eligible End-User and Covered IRS, DCR is electing to provide a no-action position for a broader group of end-users and the IRS that they have elected not to clear than was covered by Letter No. 19-28. The objective in issuing this relief is to avoid being under-inclusive and thus forcing ARRC's membership to make additional requests for relief. Eligible End-Users should independently determine whether to avail themselves of this relief based on their own facts and circumstances. Nothing in this letter imposes new obligations or burdens that would be inconsistent with prior Commission action or staff no-action positions.

DCR will not recommend the Commission commence an enforcement action against an Eligible End-User for failure to comply with section 2(h)(1)(A) and 2(h)(7) of the CEA, and Commission regulations 50.2, 50.4(a), 50.50, or 50.51, as applicable, when seeking to remain in compliance with the hedging or mitigating risk prong of regulation 50.50(c), 50.51(b)(2), or applicable condition in a prior DCR staff letter, when such an Eligible End-User enters into a Qualifying Amendment[60] to a Covered IRS, provided that such an amendment is made for the sole purpose of transitioning from an IRR to an alternative reference rate.

DCR also will not recommend the Commission commence an enforcement action against an Eligible End-User for failure to remain in compliance with the hedging or mitigating risk prong of Commission regulations 50.50(c), 50.51(b)(2), or applicable condition in a prior DCR staff letter, when electing an exception or exemption from the IRS Clearing Requirement when such an Eligible End-User amends its underlying commercial agreement, provided that the amendment to such commercial agreement is done for the sole 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.

Because DCR recognizes that amendments to Covered Swaps and amendments to related commercial agreements may not occur at the same time and one amendment may occur before the other, DCR will not recommend an enforcement action be taken against an Eligible End-User in these instances for failure to remain in compliance with the hedging or mitigating risk prong of Commission regulations 50.50(c), 50.51(b)(2), or applicable condition in a prior DCR staff letter, provided that the amendments are being made for the sole purpose of transitioning from an IRR to an alternative reference rate.

DCR expects that the Covered IRS documentation and any related commercial agreement 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

[60] To maintain consistency with the definition of a "Qualifying Amendment" discussed above, DCR acknowledges that any such amendment to a Covered IRS may include ancillary changes to existing terms to conform to different market conventions.

swap used to hedge or mitigate the commercial risk of an Eligible End-User pursuant to Commission regulations 50.50(c), 50.51(b)(2), or applicable condition in a prior DCR staff letter.

Eligible End-Users and their swap 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 match again by June 30, 2023 to the extent that the Covered IRS references one of the 2023 USD LIBOR Settings.

This relief also does not alter any independent obligations that swap dealers 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.

E. DCR No-Action Relief Related to Eligible End-User Representations, Reporting, and Ongoing Monitoring

DCR recognizes that Eligible End-Users may not be in a position to ensure that their swap counterparties are maintaining records of the Eligible End-User's election not to clear its IRS subject to Part 50 of the Commission's regulations, as well as maintaining records of the representations made by the Eligible End-User necessary to make such an election. Nor will Eligible End-Users be able to ensure that their swap counterparties are accurately and regularly reporting such elections or material amendments to a Covered Swap to a swap data repository, pursuant to Commission regulations 45.3 and 45.4, because this data is not publicly available.

For these reasons, DCR will not recommend the Commission commence an enforcement action against an Eligible End-User making a Qualifying Amendment to a Covered IRS, for failure to comply with sections 2(h)(1)(A) and 2(h)(7) of the CEA, and Commission regulations 50.2, 50.4(a), 50.50, 50.51, or any applicable conditions in prior DCR staff letters, when such an Eligible End-User is relying on prior representations made to their swap counterparties at the time such end-users originally elected an exception or exemption from the IRS Clearing Requirement, provided such a Qualifying Amendment is made for the sole purpose of transitioning from an IRR to an alternative rate.

Similarly, DCR will not recommend an enforcement action against Eligible End-Users for failure to monitor ongoing compliance with an election of exception or exemption from the Clearing Requirement, including pursuant to the requirements under regulation 50.50(b)(2), 50.50(c), 50.51, or any applicable conditions in prior DCR staff letters when entering into a Qualifying Amendment to a Covered IRS, provided such a Qualifying Amendment is made for the sole purpose of transitioning from an IRR to an alternative reference rate.

Swap counterparties to Eligible End-Users may continue to have independent monitoring, recordkeeping, and reporting obligations, including but not limited to compliance with regulation 23.505 and Part 45 obligations. Swap 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 swap counterparties must:

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 Commission 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 regulations 50.50(b), 50.51(c), or similar provision under prior staff no-action letter;

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 swap dealers 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. [61]

Finally, the terms and conditions used in this letter are generally consistent with relief provided by MPD and the prudential regulators with regard to margin for uncleared swaps.[62]

[61] In Letter No. 19-26, DSIO provided swap dealers limited no-action relief with regard to regulation 23.505 in December 2019. DSIO has not provided no-action relief from all recordkeeping and documentation requirements under regulation 23.505. The Commission must be able to monitor the transition from IBORs based on data that is accurately reflected through Part 45 reporting to a swap data repository.

[62] The Prudential Regulators cited to CFTC Letter No. 19-28 and CFTC Letter No. 19-26 such that swap transactions subject to the Prudential Regulators' margin rules would continue to be eligible for an exemption from margin for uncleared swaps when swap dealers subject to prudential regulation amend their swaps with a commercial or cooperative end user. Margin and Capital Requirements for Covered Swap Entities, 85 FR 39754 at 39758 (Jul. 1, 2020). DCR understands that Commission staff consulted with the Prudential Regulators regarding the issuance of revised CFTC staff no-action letters as part of the ongoing implementation of uncleared margin rules.

VI. CONCLUSION

This letter, and the positions taken herein, represent the views of DCR only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in Commission regulations. It does not create or confer any rights for or obligations on any person or persons subject to compliance with the CEA that bind the Commission or any of its other offices or divisions. Further, this letter and the positions taken herein are based upon the facts and circumstances presented to DCR. Any different, changed, or omitted material facts or circumstances might render the relief provided by this letter void. Finally, as with all staff letters, DCR retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of relief provided herein, in their discretion.

If you have any questions concerning this correspondence, please contact Sarah E. Josephson, Deputy Director, at (202) 418-5684 or sjosephson@cftc.gov.

Sincerely,

M. Clark Hutchison III