August 10, 2023

Ms. Amanda L. Olear
Director, Market Participants Division
U.S. Commodity Futures Trading Commission
Three Lafayette Center
1155 21st Street, N.W.
Washington, DC 20581

Re: Request seeking extension of CFTC no-action letter 12-58 to overnight index swaps referencing the Secured Overnight Financing Rate

Dear Ms. Amanda L. Olear,

The Alternative Reference Rates Committee (**ARRC**) regulatory working group sub-committee (**WG**) and its member firms submit this letter requesting confirmation that the Market Participants Division (the **Division** or **MPD**) will not recommend enforcement action against registered swap dealers (**SD**) and major swap participants (**MSP**) (**Swap Entities**) for a failure to disclose, with respect to the price of an overnight index swap (**OIS**) referencing the Secured Overnight Financing Rate (**SOFR**) with the specifications set out in CFTC Regulation 50.4, the "pre-trade mid-market mark of the swap"[1] (**PTMM**) to a non-Swap Entity counterparty.

The ARRC WG makes this request to ensure the PTMM relief currently afforded to certain swaps referencing the now ceased USD LIBOR panel is extended to the swap market's predominant reference rate, SOFR OIS, in the wake of LIBOR's cessation.

I. Background

a. Overview of the LIBOR transition

The ARRC was convened in 2014 by the Federal Reserve Board and Federal Reserve Bank of New York in cooperation with other federal and state regulators and bodies, including the Commodity Futures Trading Commission (**CFTC** or **Commission**), to "identify risk-free alternative reference rates for USD LIBOR and best practices for contract robustness, as well as create an implementation plan with metrics of success and a timeline to support an orderly adoption."[2]

[1] 17 C.F.R. § 23.431(a)(3)(i).

[2] *See* "ARRC Endorses Decision to Sign New York State LIBOR Legislation into Law" (April 07, 2021), *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2021/20210407-arrc-press-release-nys-legislation.

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In June 2017, the ARRC identified SOFR as the preferred alternative benchmark to USD LIBOR for new U.S. dollar-denominated derivatives and other financial contracts. Soon after, the Financial Conduct Authority (**FCA**), the regulatory supervisor for the administrator of LIBOR, announced the phase-out of LIBOR. SOFR has since emerged as a benchmark used to price commercial and personal loans[3] and is now commonly linked to or referenced in financial contracts and hedging instruments, such as uncleared swaps.

The U.S. and other countries adopted measures to phase out LIBOR in favor of risk-free rates (**RFR**), including SOFR. In July 2021, prior to the first scheduled LIBOR cessation, the CFTC's Market Risk Advisory Committee's Interest Rate Benchmark Reform Subcommittee (**MRAC Subcommittee**) adopted the SOFR First initiative, focused on prioritizing inter-dealer trading in SOFR rather than LIBOR. For example, the MRAC Subcommittee recommended in July 2021 that interdealer brokers replace the trading of USD LIBOR linear swaps with the trading of SOFR linear swaps and that, beginning in October 2021, "interdealer broker screens for USD LIBOR linear swaps should be turned off altogether" so as to not remain visible for informational purposes.[4] The guidance follows an earlier declaration from the Federal Reserve Board, OCC, and FDIC encouraging banks to transition from USD LIBOR "as soon as practicable" in light of safety and soundness risks that could emerge from usage of the reference rate after December 21, 2021.[5]

Subsequent to these efforts, the first LIBOR cessation occurred on December 31, 2021, which included the one week and two-month tenors of the USD-LIBOR reference rate. Most recently, a second LIBOR cessation took place on June 30, 2023, and all remaining USD-LIBOR tenors, including overnight, one-month, three-month, six-month, and 12-month rates, are no longer published or deemed non-representative by the FCA.

b. Commission efforts to transition from LIBOR to SOFR

In addition to launching the MRAC Subcommittee and the resulting SOFR First Initiative, the Commission has acted to ease the transition from LIBOR to SOFR by updating and revising regulations, as well as issuing several no-action letters. The CFTC recently updated CFTC Regulation 50.4 (**Updated Clearing Mandate**) by, in relevant

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[3] Forbes Advisor, "What Is SOFR? How Does It Work?" (Sept. 06, 2022), providing that, "SOFR is a benchmark that financial institutions use to price loans for businesses and consumers." *Available at* https://www.forbes.com/advisor/investing/secured-overnight-financing-rate-sofr/.

[4] CFTC Press Release Number 8394-21: "CFTC's Interest Rate Benchmark Reform Subcommittee Recommends July 26 for Transitioning Interdealer Swap Market Trading Conventions from LIBOR to SOFR", June 08, 2021, *available at* https://www.cftc.gov/PressRoom/PressReleases/8394-21.

[5] Board of Governors of the Federal Reserve System, Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency, "Statement on LIBOR Transition" (Nov. 30, 2020), *available at* https://www.federalreserve.gov/supervisionreg/srletters/SR2027a1.pdf.

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part, subjecting certain SOFR OIS swaps to mandatory clearing requirements, effectively replacing LIBOR-referencing swaps.[6]

The CFTC also implemented a series of no-action letters to ease the transition from LIBOR-referencing interest rate swaps, promoted the adoption of a SOFR-linked interest rate swaps market,[7] and acknowledged the similarities between SOFR and other RFRs.[8] These no-action letters have generally permitted swaps to be amended to reference RFRs (including SOFR) without triggering additional CFTC requirements, including but not limited to uncleared margin and external business conduct standards,[9] trade execution,[10] clearing[11] and trade reporting requirements.[12] A separate no-action letter permitted FCMs to invest customer funds "in permitted investments that contain an adjustable rate of interest that is benchmarked to SOFR," effectively expanding the list of permissible investment opportunities to include SOFR-linked products.[13]

In taking these steps, the Commission and its various Divisions have expressly recognized the market's widespread transition to SOFR and its emergence as a prevailing benchmark. The ARRC regulatory WG subcommittee remains extremely appreciative of the careful thought and efforts of the CFTC staff in considering regulatory issues around the transition from LIBOR to SOFR.

c. The pre-trade mid-market mark requirement and subsequent no-action letters

CFTC Regulation 23.431(a)(3) requires that a Swap Entity disclose to its non-Swap Entity counterparty, at a reasonably sufficient time prior to entering into a swap:

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[6] *See* Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps To Account for the Transition From LIBOR and Other IBORs to Alternative Reference Rates, 87 Fed. Reg. 52812 (Aug. 24, 2022), modifying the Commission's interest rate swap clearing requirement by removing the requirement to clear interest rate swaps referencing LIBOR and other IBORs and replacing them with clearing mandates for interest rate swaps referencing overnight RFRs, including OIS referencing SOFR.

[7] *See* for example, CFTC No-Action Letters 21-26, 21-27, 21-28, 21-30 and 22-21.

[8] CFTC No-Action Letter 21-02.

[9] CFTC Letter 21-26.

[10] CFTC Letter 21-27.

[11] CFTC Letter 21-28.

[12] CFTC Letter 21-30.

[13] CFTC Letter 21-02, as extended by CFTC Letter 22-21, effectively expanded the list of "permitted investments" under CFTC Regulation 1.25 to include otherwise qualifying investments that feature an adjustable rate of interest benchmarked to SOFR.

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> material information concerning the swap in a manner reasonably designed to allow the counterparty to assess…[t]he material incentives and conflicts of interest that the [Swap Entity] may have in connection with a particular swap, which shall include: (i) with respect to disclosure of the price of the swap, the price of the swap and the mid-market mark of the swap….

In describing the purpose of requiring Swap Entities to disclose the PTMM, the Commission stated that "the spread between the quote and mid-market mark is relevant to disclosures regarding material incentives and provides the counterparty with pricing information that facilitates negotiations and balances historical information asymmetry regarding swap pricing."[14]

Since finalizing PTMM requirements, the CFTC has issued three separate no-action letters (**PTMM No-Action Letters**).[15] The PTMM No-Action Letters generally recognize that PTMMs do not provide meaningful benefits to end-users for liquid swaps for which prices are readily obtainable in the market. These letters provide relief from PTMM requirements across liquid foreign exchange, interest rate, and credit derivative asset classes where rates are "widely quoted" by dealers, real-time tradable bid and offer prices are available electronically to the marketplace, and publicly available information exists.

One of the PTMM No-Action Letters, CFTC Letter 12-58, provides that Swap Entities, when satisfying certain conditions, are not required to disclose the PTMM in connection with, among other swaps, certain fixed-for-floating interest rate swaps referencing LIBOR (**Covered Rates Swaps**). In requesting the no-action statement, ISDA noted that minimal benefit would result from providing a PTMM for the Covered Rates Swaps as compliance with the requirement "does not provide any significant informational value" in light of the "ready availability of reliable pricing information in the market, the transparency of the pricing information, the competitiveness and tightness of spreads and ongoing liquidity." ISDA also noted that requiring the disclosure of the PTMM for the Covered Rates Swaps at a reasonably sufficient time prior to trading, may even "adversely affect counterparties by delaying the trade time" and therefore invite adverse price movements.

CFTC Letter 12-58 was conditioned on (1) real-time executable bid and offer prices being made available on a DCM or SEF; and (2) an agreement in writing from the Swap Entity's counterparty that the Swap Entity does not need to provide a PTMM.

II. Market Transition from LIBOR to SOFR

[14] CFTC External Business Conduct Rules Adopting Release, 77 Fed. Reg. at 9766.

[15] CFTC Letter 12-42 (Dec. 6, 2012); CFTC Letter 12-58 (Dec. 18, 2012); CFTC Letter 13-12 (May 1, 2013).

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Publicly available data confirm that SOFR continues to operate as the prevailing interest rate benchmark.

- ***SOFR remains the prevailing interest rate derivatives benchmark.*** In the months leading up to the June 2023 complete cessation of USD-LIBOR, SOFR-linked interest rate swaps constituted the majority of USD-denominated interest rate derivative (**IRD**)[16] trading activity. For example, the percentage of IRD trading activity in USD-denominated SOFR in May 2023 was 65.6% of total USD IRD DV01,[17] which is a commonly used metric.[18]

  Publicly available statistics devoted to tracking the transition also evidence that SOFR-linked interest rate swaps have "consistently accounted for more than 85% of daily average risk traded" in the interest rate swaps market by all market participants (i.e., Swap and non-Swap Entities, alike) since June 2022. Usage of the LIBOR benchmark for swaps volumes has experienced a significant decline in usage over the same period, accounting for less than 10% of overall swaps volume.[19]

- ***SOFR's prevalence in derivatives markets continues to grow.*** SOFR-specific data show significant growth in the benchmark's swaps market usage. For example, approximately 80% of interest rate swaps executed in Q1 of 2023 referenced SOFR, an increase from 74% in Q4 of 2022 and from 55% during Q1 2022.[20] Available data also indicate that usage of RFR-linked IRD within the rates market has continued to increase, more than doubling in size on a year-over-year basis. For example, the notional amount of RFR-linked IRD transacted in

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[16] We adopt the ISDA-Clarus RFR Adoption Indicator definition of interest rate derivatives (IRD), which includes cleared over-the-counter interest rate products (swaps, OIS, forward rate agreements, basis swaps) and exchange-traded interest rate derivatives (such as short-term futures contracts).

[17] *See* the ISDA-Clarus RFR Adoption Indicator for May 2023, evidencing that 65.6% of cleared over-the-counter and exchange-traded USD-denominated interest rate derivatives referenced SOFR (rather than alternative indices) for transactions executed in the month of May 2023, as measured by maturity agnostic notional data (DV01), *available at* https://www.isda.org/a/9NXgE/ISDA-Clarus-RFR-Adoption-Indicator-May-2023.pdf.

[18] The ISDA-Clarus RFR Adoption Indicator Whitepaper explains that the DV01 of an interest rate derivative is the "discounted value of a basis point" and provides a detailed description of calculating approximate DV01s from notional volumes traded. *Available at* https://cdn.aws.isda.org/a/iKNTE/ISDA-Clarus-RFR-Adoption-Indicator-Whitepaper.pdf?_zs=2NF791&_zl=9A7A6.

[19] *See* "Alternative Reference Rates Committee: March 9 Meeting Readout", finding that SOFR-linked interest rate swaps have consistently accounted for more than 85% of daily average risk traded in the interest rate swaps market since June 2022 and that LIBOR swaps accounted for less than 10% of overall swaps volumes over the same period, *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2023/ARRC-Readout-March-2023-Meeting.pdf.

[20] *See* Appendix A for additional data evidencing the growth of SOFR's usage in swaps markets.

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January 2023 ($98.1 trillion) was roughly 130% more than the January 2022 notional amount of $42.8 trillion transacted immediately following the first LIBOR cessation.[21]

- ***SOFR-linked swaps are the pre-dominant rates benchmark for on-SEF activity.*** Data analysis provided by ISDA[22] highlights the depth of SEF-traded SOFR activity that has developed over the preceding two years. On a trade count basis, the number of SOFR-linked IRD transactions executed on SEFs in Q1 2023 exceeded the number of SEF-traded IRD LIBOR transactions executed in Q2 2021 (i.e., prior to the SOFR First for Linear Swaps initiative commenced on July 26, 2021).[23]

  On a quarterly basis since Q1 2022, more SOFR-linked swaps have been executed on-SEF than all other rates benchmarks combined, including LIBOR. Notional amounts transacted in SOFR on-SEF also exceeded LIBOR-referencing swaps, beginning in Q4 2022. In addition to being the current dominant benchmark rate, SOFR's market capture of SEF-executed rates transactions continues to grow. For example, on-SEF SOFR swap execution increased by roughly 8% from Q4 2022 to Q1 2023 (from 74.0% to 82.1% of the rates market, respectively). Similar growth was observed for on-SEF SOFR activity as measured by notional volumes, which increased by about 9% over the same time period (from 44.6% to 53.7% of the rates market, respectively).[24]

III. Request for No-Action Letter Extension

The ARRC submits that the rationale underlying CFTC Letter No. 12-58 and the no-action statement afforded to Swap Entities entering into Covered Rates Swaps is equally applicable to SOFR OIS. Specifically, the rationale underlying CFTC Letter 12-58—that the benefits of a PTMM are minimal for liquid swaps with publicly-available price

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[21] *See* ISDA-Clarus RFR Adoption Indicator, providing January 2023 RFR-linked IRD data, *available at* https://www.isda.org/a/v5ygE/ISDA-Clarus-RFR-Adoption-Indicator-January-2023.pdf. *See also* ISDA-Clarus RFR Adoption Indicator, providing January 2022 RFR-linked IRD data, *available at* https://www.isda.org/a/a1kgE/ISDA-Clarus-RFR-Adoption-Indicator-January-2022.pdf.

[22] The ISDA data analysis provided in Appendix A covers USD-denominated SEF and off-SEF IRD traded notional and trade count split by underlying reference rates (USD LIBOR, SOFR, FED Funds and other benchmarks) for the period from Q1 2021 to Q1 2023. Data includes, and is based on, transactions reported to the DTCC SDR pursuant to CFTC regulations and made publicly available.

[23] SOFR First, developed by the MRAC's Interest Rate Benchmark Reform Subcommittee, was designed to help market participants decrease reliance on USD LIBOR and reinforce U.S. banking regulator guidance that banks cease entering into new contracts that reference USD LIBOR after December 31, 2021. *Available at* www.cftc.gov/PressRoom/PressReleases/8409-21.

[24] *See* Appendix A for additional data regarding SOFR's on- and off-SEF swap trade execution count and notional volumes.

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information—are now true of SOFR OIS[25] and will be increasingly true in the wake of the transition to SOFR OIS.[26]

The SOFR OIS market continues to serve as the prevailing benchmark of the interest rate swaps market[27] and is widely quoted by dealers on- and off-facility, with real-time tradable bid and offer prices made available electronically via trading facilities, including via multiple SEFs. In addition, the implementation and familiarity of market participants with Part 43 real-time reporting requirements developed since the issuance of the PTMM No-Action Letters provides an additional source for readily available pricing data to market participants.[28]

The Commission itself has affirmed that SOFR OIS is highly traded, liquid, and produces or makes available accessible pricing data, therefore recognizing significant similarities with the Covered Rates Swaps in CFTC Letter 12-58. Specifically, by extending swap clearing requirements to SOFR OIS in the Updated Clearing Mandate, the Commission considered and affirmed that SOFR OIS presents, in relevant part, "the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data."[29]

The Commission issued previous relief from the PTMM requirement (including for LIBOR-referencing swaps under 12-58) with the understanding that delivery of the PTMM may "adversely affect counterparties" by delaying the trade time[30] and allowing the market to move against the customer. Similarly, the ARRC WG submits that adverse price movements would result from execution delays caused by PTMM issuance. In addition, significant adaptations would be required to implement PTMM requirements on

[25] *See*, for example, the Updated Clearing Mandate at 52,185, citing to J.P. Morgan, "SOFR Takes Over, Mar. 30, 2022," stating that "SOFR First spurred a significant shift in liquidity toward USD SOFR, particularly in the interbank market."

[26] The CFTC has formally recognized its expectation that SOFR OIS trading volumes (and liquidity) will continue to grow. *See* CFTC No-Action Letter 22-21 (extending CFTC No-Action Letter 21-02), finding that "continued migration to SOFR" is expected by no-action petitioners as "future phase-out measures are implemented."

[27] "Alternative Reference Rates Committee: March 9 Meeting Readout", finding that SOFR-linked interest rate swaps have consistently accounted for more than 85% of daily average risk traded in the interest rate swaps market since June 2022, *available at* https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2023/ARRC-Readout-March-2023-Meeting.pdf.

[28] 17 C.F.R. § 43.3(a)(2), (3). Established Part 43 requirements make executed trades and pricing information, including the interest rate benchmark (i.e., the "spread" data element) publicly available "as soon as technologically practicable" after execution. Real-time reporting creates a publicly accessible and historical record of pricing data for SOFR OIS promptly after trade execution.

[29] CEA Section 2(h)(2)(D)(ii).

[30] CFTC Letter 12-58 at p. 3, citing to the ISDA Letter to Gary Barnett (Nov. 30, 2012).

a permanent basis, marking a significant deviation from market convention for the most liquid interest rate swap benchmark.

As a result, the ARRC WG is requesting an expansion of CFTC Letter 12-58 to cover SOFR OIS transactions. Specifically, the ARRC WG requests that a Swap Entity not be required to disclose pre-trade mid-market marks in connection with: (1) interest rate swaps (A) in the "overnight index swap class" (as such term is used in Regulation 50.4(a)) denominated in USD, (B) referencing the SOFR floating rate index, (C) for which the remaining term to the scheduled termination date is no more than 50 years, and (D) that have the specifications set out in CFTC Regulation 50.4.

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Thank you very much for your consideration of this matter. The ARRC appreciates the Commission and staff's continued engagement on IBOR transition issues. Please feel free to contact Simon Winn (simon.winn@us.bnpparibas.com), Maria-Ines Raij (Maria-Ines.Raij@morganstanley.com), Micah Green (mgreen@steptoe.com), Ryan Hayden (rhayden@steptoe.com), or Gabriel D. Rosenberg (gabriel.rosenberg@davispolk.com) if you would like to discuss this letter in greater detail.

Respectfully submitted,

Peter M. Phelan

Peter Phelan
Chair
Alternative Reference Rates Committee

Cc: Mr. Bruce Fekrat, Designated Federal Officer, CFTC Market Risk Advisory Committee
Cc: Mr. Frank Fisanich, Chief Counsel, Market Participants Division
Cc: Mr. Jacob Chachkin, Associate Chief Counsel, Market Participants Division

Appendix A: ISDA analysis based on DTCC SDR Data