

**SUBMISSION COVER SHEET**

**IMPORTANT:** Check box if Confidential Treatment is requested

Registered Entity Identifier Code (optional): 21-412

Organization: Chicago Mercantile Exchange Inc. ("CME")

Filing as a:  DCM  SEF  DCO  SDR

Please note - only ONE choice allowed.

Filing Date (mm/dd/yy): 09/09/21 Filing Description: Modification and Withdrawal of Clearing Support for Cleared OTC GBP and JPY Interest Rate Basis Swaps Referencing LIBOR

**SPECIFY FILING TYPE**

Please note only ONE choice allowed per Submission.

**Organization Rules and Rule Amendments**

- Certification § 40.6(a)
- Approval § 40.5(a)
- Notification § 40.6(d)
- Advance Notice of SIDCO Rule Change § 40.10(a)
- SIDCO Emergency Rule Change § 40.10(h)

Rule Numbers: See filing.

**New Product**

Please note only ONE product per Submission.

- Certification § 40.2(a)
- Certification Security Futures § 41.23(a)
- Certification Swap Class § 40.2(d)
- Approval § 40.3(a)
- Approval Security Futures § 41.23(b)
- Novel Derivative Product Notification § 40.12(a)
- Swap Submission § 39.5

**Product Terms and Conditions (product related Rules and Rule Amendments)**

- Certification § 40.6(a)
- Certification Made Available to Trade Determination § 40.6(a)
- Certification Security Futures § 41.24(a)
- Delisting (No Open Interest) § 40.6(a)
- Approval § 40.5(a)
- Approval Made Available to Trade Determination § 40.5(a)
- Approval Security Futures § 41.24(c)
- Approval Amendments to enumerated agricultural products § 40.4(a), § 40.5(a)
- "Non-Material Agricultural Rule Change" § 40.4(b)(5)
- Notification § 40.6(d)

Official Name(s) of Product(s) Affected:

Rule Numbers:

September 9, 2021

**VIA ELECTRONIC PORTAL**

Mr. Christopher J. Kirkpatrick  
Office of the Secretariat  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street, N.W.  
Washington, D.C. 20581

**Re: CFTC Regulation 40.6(a) Certification. Modification and Withdrawal of Clearing Support for Cleared Over-the-Counter (“OTC”) British Pound (“GBP”) and Japanese Yen (“JPY”) Denominated Interest Rate Basis Swaps Referencing the London Interbank Offered Rate (“LIBOR”).  
CME Submission No. 21-412**

Dear Mr. Kirkpatrick:

Pursuant to Commodity Futures Trading Commission (“CFTC” or “Commission”) Regulation 40.6(a), Chicago Mercantile Exchange Inc. (“CME” or the “Clearing House”), a registered derivatives clearing organization (“DCO”) under the Commodity Exchange Act, as amended (“CEA” or “Act”) hereby certifies to the Commission:

- modifications applicable to certain CME cleared over-the-counter (“OTC”) British Pound (“GBP”) and Japanese Yen (“JPY”) denominated Interest Rate Basis Swap products that reference, respectively, GBP and JPY London Interbank Offered Rate (“LIBOR”) rates (the “Basis Swaps”), to convert each such cleared Basis Swap into corresponding CME cleared fixed-floating interest rate swaps (the “Conversion”), to take effect at close of business on Friday, September 24, 2021 (the “Conversion Date”); and
- the withdrawal of clearing support for the Basis Swaps following the Conversion.

The Conversion is necessary as part of the wider process to complete the transition of cleared trades in CME cleared interest rate swap (“IRS”) products referencing GBP and JPY LIBOR rates to nominated successor interest rate benchmarks ahead of the scheduled discontinuation and or “non-representativeness” (as applicable) of the GBP and JPY LIBOR rates by the administrator of ICE LIBOR, ICE Benchmark Administration Limited (“IBA”), following publication on December 31, 2021.<sup>1</sup> The Conversion is a preliminary step in CME’s proposed transition process for GBP, JPY and Swiss Franc (“CHF”) IRS products referencing LIBOR which is due to take place in December 2021, subject to regulatory review (the “GBP/CHF/JPY LIBOR Transition”).<sup>2</sup>

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<sup>1</sup> On March 5, 2021, the UK Financial Conduct Authority (“FCA”), responsible for supervision of IBA as administrator of ICE LIBOR, announced the scheduled permanent discontinuation of certain GBP and JPY LIBOR settings to take place following final publication by IBA on December 31, 2021 and the “non-representativeness” of all other GBP and JPY LIBOR settings from the same date, notwithstanding any further publication into 2022 that may be determined in the future. See <https://www.fca.org.uk/news/press-releases/announcements-end-libor>

<sup>2</sup> In January 2021, as part of regulatory and industry initiatives to transition away from certain key interbank offered rates (“IBORs”) and interest rate benchmarks, CME implemented certain changes to the CME Rulebook to incorporate “fallback” provisions into CME  
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CME will convert CME cleared Basis Swaps in GBP and JPY into the corresponding CME cleared GBP or JPY fixed/floating IRS, as applicable, to take effect on the Conversion Date. The Conversion will not have an economic impact on position holders and CME will remain neutral from a risk perspective.<sup>3</sup>

The modification to implement the Conversion is set out in the Clearing Advisory Notice attached as Exhibit 1, effective September 24, 2021. No amendments to the CME Rulebook are required to effect the Conversion.

From the Conversion Date, CME's open interest in the Basis Swaps will be zero. With effect from close of business on the Conversion Date, CME will withdraw clearing support for the Basis Swaps and will therefore cease to accept for clearing trades in GBP or JPY basis swaps from that time. No amendments to the CME Rulebook are required to effect the withdrawal of clearing support for the Basis Swaps. CME will make public the withdrawal of clearing support for the Basis Swaps by publishing a Clearing Advisory Notice to the marketplace.<sup>4</sup> The list of basis swap contracts accepted for clearing by CME will be updated on the CME Group website to reflect the delisting of the Basis Swaps.

CME is a systemically important derivatives clearing organization ("SIDCO")<sup>5</sup> and offers clearing for all products traded on the CME exchange, The Board of Trade of the City of Chicago, Inc., New York Mercantile Exchange, Inc., and Commodity Exchange, Inc. as well as other cleared products, and provides clearing services to third parties.

## **Background**

### **Scheduled Discontinuation / Non-Representativeness of GBP and JPY LIBOR**

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cleared IRS to provide for contractual fallback to a relevant alternative spread and term adjusted RFR on the permanent discontinuation or "non-representativeness" of certain key IBORs, including GBP and JPY LIBORs. See <https://www.cmegroup.com/content/dam/cmegroup/notices/clearing/2021/01/Chadv21-039.pdf>. However, following extensive engagement with cleared derivatives industry participants in 2021, market participants have indicated a significant preference for a CCP-led conversion from certain LIBOR rates before the implementation of the contractual fallback provisions in CCP rulebooks. This is because reliance on the contractual fallback provisions in the CME Rulebook (and other CCP rulebooks) will generate fallback trades that have certain characteristics that means that the resulting fallback trades referencing the relevant RFR will not be directly fungible with standard overnight index swaps in the relevant RFR, making them relatively illiquid which, in turn, would create challenges for market participants in managing those positions and for CCPs in managing a default of an account holding those positions.

As a result, subject to regulatory review, as part of the proposed GBP/CHF/JPY LIBOR Transition, CME proposes: (i) on December 3, 2021, to convert all CME cleared CHF and JPY IRS to reference the respective successor "risk-free" reference rates ("RFR") that are the nominated successor to CHF LIBOR and JPY LIBOR respectively; and (ii) on December 17, 2021, to convert all CME cleared GBP IRS currently referencing GBP LIBOR to reference SONIA, the nominated RFR successor to GBP LIBOR, in each case ahead of the scheduled permanent discontinuation of GBP, CHF and JPY LIBOR rates following final publication by IBA on December 31, 2021. For further details, see <https://www.cmegroup.com/trading/interest-rates/files/cme-ibor-conversion-for-chf-jpy-and-gbp-cleared-swaps.pdf>. CME will publicize and submit for Commission review necessary changes to the CME Rulebook to effect the GBP/CHF/JPY LIBOR Transition in due course ahead of implementation in December 2021.

For the avoidance of doubt, the Conversion process for Basis Swaps that is the subject of this submission is a separate process to the GBP/CHF/JPY LIBOR Transition, however, market participants agree with CME that the Conversion is a necessary and preliminary process that must be undertaken by CME prior to the GBP/CHF/JPY LIBOR Transition in December 2021.

<sup>3</sup> Note that position holders will continue to have exposure in GBP or JPY LIBOR referencing IRS following the Conversion. CME proposes to transition GBP and JPY LIBOR exposures to the relevant RFR in December 2021 as part of the GBP/CHF/JPY Transition, subject to regulatory review.

<sup>4</sup> A Clearing Advisory notice advising market participants of the proposed withdrawal of clearing support for the Contracts will be published by CME prior to the Conversion Date. The Clearing Advisory will advise that CME will delist the Contracts from September 24, 2021, subject to the necessary regulatory filings.

<sup>5</sup> On July 18, 2012, CME Inc. was designated as a systemically important financial market utility under Title VIII of the Dodd-Frank Act.

Following extensive industry consultation, on March 5, 2021, the Financial Conduct Authority (“FCA”) announced that certain settings of GBP and JPY LIBOR (among other currencies) will cease to be provided by IBA and will be permanently discontinued immediately after publication on December 31, 2021 and, further, that any remaining GBP and JPY LIBOR settings that are published from that date would cease to be representative of the underlying market from the same date.<sup>6</sup> Under the CME Rulebook, following incorporation of contractual “fallback” provisions in January 2021 based on the 2020 ISDA IBOR Fallbacks Supplement, on the point of permanent discontinuation or non-representativeness, as applicable, an “Index Cessation Event” will be deemed to have occurred in relation to each relevant CME cleared GBP and JPY IRS.<sup>7</sup> However, as noted above, following extensive market participant consultation and feedback, CME intends to transition GBP and JPY LIBOR referencing IRS before the relevant “Index Cessation Event” as part of a proposed GBP/CHF/JPY LIBOR Transition.<sup>8</sup>

### Rationale for the Conversion of Basis Swaps to Fixed-Float IRS Ahead of GBP/CHF/JPY LIBOR Transition

Following engagement with market participants, CME has determined that it is necessary and beneficial to convert or “split” each GBP and JPY LIBOR Basis Swap into corresponding pairs of fixed-float IRS referencing the relevant LIBOR rate as a preliminary process ahead of the proposed GBP/CHF/JPY LIBOR Transition scheduled for December 2021. In the absence of this preliminary process, GBP and JPY Basis Swaps would be converted, as part of the proposed GBP/CHF/JPY LIBOR Transition, into replacement RFR-RFR Basis Swaps. This resultant product would be operationally and technically difficult for the marketplace to support and would not be directly fungible with standard overnight index swaps in the relevant RFR, making them relatively illiquid which, in turn, would create challenges for market participants in managing those positions and for CCPs in managing a default of an account holding those positions. As a result, CME proposes to undertake the Basis Swap Conversion ahead of the GBP/CHF/JPY LIBOR Transition. CME understands that other major EU and UK central clearing counterparties (“CCPs”) clearing GBP and JPY basis swaps will undergo a similar exercise with their market participants to split relevant basis swaps into corresponding pairs of fixed-float IRS and market participants have encouraged CME to align the timing of its Conversion process with that of other CCPs to minimize any potential operational or market disruption.

### Summary of Proposed CME Conversion of Basis Swaps

At close of business on the Conversion Date, with the exception of Basis Swaps that mature on the Conversion Date, CME will convert each CME cleared Basis Swap that is open at close of business on the Conversion Date by splitting each Basis Swap into corresponding pairs of CME cleared fixed-float interest rate swaps, as follows:

- In respect of each Basis Swap (a “Pre-Conversion Basis Swap”), CME will close out the Pre-Conversion Basis Swap and establish in the account of the position holder of such Pre-Conversion

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<sup>6</sup> See FCA Announcement, March 5, 2021, available at <https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf>. The FCA is consulting with market participants regarding proposed use of its powers to require IBA to continue the publication of any GBP or JPY LIBOR settings on a “non-representative” basis after end December 2021, however, contractual fallback triggers in CME cleared (and most uncleared) derivative markets will take effect on or before publication of all GBP and JPY LIBOR settings on December 31, 2021, notwithstanding any continued publication of certain settings on a “non-representative” basis from that date. See <https://www.fca.org.uk/news/statements/fca-consults-proposed-decision-require-synthetic-libor-6-sterling-and-japanese-yen-settings>

<sup>7</sup> See footnote 2 above.

<sup>8</sup> See footnote 2 above. For further details, see <https://www.cmegroup.com/trading/interest-rates/files/cme-ibor-conversion-for-chf-jpy-and-gbp-cleared-swaps.pdf>. CME will publicize and submit for Commission review necessary changes to the CME Rulebook to effect the GBP/CHF/JPY LIBOR Transition in due course ahead of implementation in December 2021.

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Basis Swap the following replacement CME cleared IRS trades (corresponding to the relevant Floating Rate Index of the Pre-Conversion Basis Swap) as per the direction of the Pre-Conversion Basis Swap:

- a fixed-float interest rate swap, with Direction Pay Fixed, with a Floating Index Tenor corresponding to the Floating Rate Index 1 of the Pre-Conversion Basis Swap; and
- a fixed-float interest rate swap, with Direction Receive Fixed, with a Floating Index Tenor corresponding to the Floating Rate Index 2 of the Pre-Conversion Basis Swap

(each, a “Replacement Swap” and together, a “Replacement Swap Pair”).

- The Currency, Notional, Effective Date, Maturity Date, Day Count, Date Roll, Payment Calendar and Floating Leg Spread of each Replacement Swap (as applicable) will be the same as that of the relevant Pre-Conversion Basis Swap.
- The Fixed Rate for each Replacement Swap in a Replacement Swap Pair will be determined by CME and shall be equal to the “break-even” rate of the “larger” index tenor for the Pre-Conversion Basis Swap, e.g. 6 months for a 3 month vs. 6 month Basis Swap. The Fixed Rate determined by CME for each Replacement Swap will ensure that payments under each Replacement Swap will fully offset the payments of the other Replacement Swap in that Replacement Swap Pair.
- Each Replacement Swap Pair will retain the key economic terms of the corresponding Pre-Conversion Basis Swap. The combined Net Present Value (“NPV”) of each Replacement Swap Pair will be equal to that of the corresponding Pre-Conversion Basis Swap prior to amendment. As a result, the Conversion will not result in any change in risk exposure for a position holder of a Pre-Conversion Basis Swap and, therefore, no risk or cash compensation is required for position holders.
- Each Replacement Swap will be cleared by CME as an interest rate swap subject to the terms of the CME Rules.
- CME will report the close-out of each Pre-Conversion Basis Swap and the establishment of each Replacement Swap in the account of the relevant position holder to the CME Swap Data Repository (“SDR”) under Part 45 of the CFTC’s Regulations. The “Prior USI” field for each Replacement Swap report will reference the Unique Swap Identifier (“USI”) of the relevant corresponding Pre-Conversion Basis Swap, reflecting the nature of the Conversion process.

The Conversion is a mandatory process and will apply to all cleared trades in GBP and JPY Basis Swaps on the Conversion Date except those Basis Swaps that mature on the Conversion Date.

From close of business on the Conversion Date, CME will cease to accept GBP and JPY Basis Swaps for clearing.

Further details on the Conversion process are provided below.

### **Overview of Engagement with Market Participants and Industry Groups**

The Conversion of cleared GBP and JPY Basis Swaps by the “splitting” of such cleared trades into corresponding pairs of fixed-float IRS by CCPs is seen by market participants as an important preliminary step in the overall process of ensuring an orderly and efficient transition from LIBOR to RFRs in derivatives markets. Market participants have expressed a clear preference for CME to effect the Conversion of Basis Swaps ahead of the proposed GBP/CHF/JPY LIBOR Transition in December 2021.

Furthermore, in CME's engagement with market participants, these stakeholders have expressed a clear preference that CME's approach to the "splitting" of GBP and JPY Basis Swaps should be aligned as closely as possible with the wider industry approach adopted by other major CCPs.

CME has consulted with a diverse cross-section of market participants to obtain feedback on the operational processes for the Conversion. A summary of CME's Conversion plan was provided to market participants and made publicly available in June 2021 followed by operational testing and additional support prior to the proposed date of implementation, including a New Release Dress Rehearsal on August 27, 2021.<sup>9</sup>

The modifications to the CME Rulebook will be implemented via Advisory Notice published by the Clearing House setting out the terms of the Conversion, in the form set out in Exhibit 1 (the "Advisory Notice"). The Advisory Notice will be binding on all position holders and Clearing Members and shall be effective on the Conversion Date.

Further details on the Conversion process are set out below:

### **Operational Overview of Conversion Process**

In legal and contractual terms, the Conversion process will amend the terms of cleared trades in CME cleared GBP and JPY Basis Swaps, resulting in the establishment of replacement cleared trades in the form of the Replacement Swaps. This is reflected in operational terms by the reporting of each Replacement Swap by CME to CME SDR with reference to the "Prior USI" of the relevant corresponding Pre-Conversion Basis Swap. From an operational perspective within the CME clearing system, the Conversion will be processed by CME as a termination of each relevant Pre-Conversion Basis Swap and the establishment of a new corresponding pair of cleared trades within the clearing system in the form of the relevant Replacement Swaps.

To reflect the operational processes within the clearing system, CME will send:

- a termination message to relevant CME clearing firms in respect of the termination of each relevant Pre-Conversion Basis Swap; and
- a clearing confirmation message to relevant CME clearing firms in respect of the establishment of each new relevant Replacement Swap.

As part of the Conversion process, all relevant Trade IDs on the Pre-Conversion Basis Swap will be carried over to the relevant Replacement Swaps. In order to identify the link between each Pre-Conversion Basis Swap and the relevant Replacement Swaps, CME will add a replacement Trade ID and Original Trade ID respectively in the History section of the clearing confirmation messages.

### **Reporting to SDR**

CME will report the result of the Conversion to CME SDR in accordance with the requirements of the CFTC's Part 45 Regulations, to reflect the splitting of each Pre-Conversion Basis Swap into each Replacement Swap Pair. With regard to reporting data submitted to SDR in respect of each Replacement Swap, CME will populate the "Prior USI" field with the USI of the relevant Pre-Conversion Basis Swap to reflect the nature of the Conversion process. For SDR reporting purposes, reporting rows will be generated

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<sup>9</sup> The public overview is available on the CME Group website at: <https://www.cmegroup.com/trading/interest-rates/files/cme-ibor-conversion-for-chf-jpy-and-gbp-cleared-swaps.pdf>. CME operated an operational "Dress Rehearsal" for the Conversion process on August 27, 2021, to simulate the processes for the Conversion Date. All open Basis Swaps in the "New Release" Environment (not Production) were converted on that date to enable market participants to take part in a "test" portfolio Conversion simulation.

and submitted to CME SDR terminating the USI of each Pre-Conversion Basis Swap and CME will ensure that each Replacement Swap will be reported as a “New Trade.”

### **Withdrawal of Clearing Support for GBP and JPY Basis Swaps Following Conversion**

From close of business on the Conversion Date, CME Clearing will cease to accept for clearing trades in GBP and JPY Basis Swaps.

### **Fees for Conversion Process**

There are no Exchange fees payable in respect of the Conversion.

### **Implementation of Conversion**

No amendments to the Rulebook are necessary to implement the Conversion. The Conversion will be implemented via Advisory Notice published by the Clearing House setting out the terms of the Conversion, in the form set out in Exhibit 1. The Advisory Notice will be made available to Clearing Members, market participants and the general public via the CME Group website. The Advisory Notice will be binding on position holders in all GBP and JPY Basis Swaps on and after the Conversion Date of September 24, 2021.

From close of business on the Conversion Date, CME will cease to accept transactions in GBP and JPY Basis Swaps for clearing. The list of basis swap contracts accepted for clearing by CME will be updated on the CME Group website to reflect the delisting of the Basis Swap contracts.

The Conversion is a mandatory process and market participants will be notified in the Advisory Notice that the Conversion will apply to all positions in the relevant Basis Swaps on the Conversion Date. Market participants will be reminded that they should consider the terms and impact of the Conversion as set out in the Advisory Notice and take appropriate action prior to the Conversion Date. Position holders that do not wish to participate in the Conversion must close out any cleared trades in the Basis Swaps prior to the Conversion Date.

In addition to the information provided in the Advisory Notice, the Clearing House will provide to Clearing Members the following information applicable to positions in the Basis Swaps on the Conversion Date, or as otherwise specified below:

- Clearing confirmation messages in respect of the operational termination of each Pre-Conversion Basis Swap and the establishment of corresponding Replacement Swaps; and
- End of Day Trade Register report made available by the Clearing House only to IRS clearing members and clients via an sFTP site.

### **Governance, Industry Consultation, Comments/Opposing Views:**

CME recognizes that the Conversion will have an impact on market participants holding open positions in GBP and JPY Basis Swaps. As noted above, CME has engaged in discussions with Clearing Members and market participants with respect to the Conversion, both specifically in relation to treatment of Basis Swaps and as part of wider discussions around transition away from IBORs to alternative risk-free reference rates. A summary of the Conversion was provided to market participants and made publicly available in June 2021, followed by operational testing and additional support prior to the proposed date of implementation.<sup>10</sup>

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<sup>10</sup> The public overview is available on the CME Group website at: <https://www.cmegroup.com/trading/interest-rates/files/cme-ibor-conversion-for-chf-jpy-and-gbp-cleared-swaps.pdf>. CME operated an operational “Dress Rehearsal” for the Conversion process on 300 Vesey Street New York, NY 10282 t 212 299 2200 f 212 301 4645 christopher.bowen@cmegroup.com cmegroup.com

The Conversion and the text of the Advisory Notice is a product of the feedback provided by market participants during these consultation processes.

As part of the preparations for the Conversion, CME has provided market participants with information, reporting tools and rehearsals for operational readiness to ensure that CME clearing members and their customers understand the operational processes of the Conversion and are operationally ready for the Conversion Date. In addition, CME operated an operational “Dress Rehearsal” for the Conversion process on August 27, 2021, to simulate the processes for the Conversion Date. All open Basis Swaps in the “New Release” Environment (not Production) were converted on that date to enable market participants to take part in a “test” portfolio Conversion simulation.

As noted above, market participants have expressed a clear preference for CME to effect a preliminary conversion of GBP and JPY Basis Swaps a short period ahead of the proposed GBP/CHF/JPY LIBOR Transition in December 2021. Market participants have also requested that CME should ensure that the timing for its Conversion process should be aligned with that of other major EU and UK CCPs in order to minimize market and operational disruption.

During the consultation process, there were no substantive opposing views raised by market participants with respect to the proposals for the Conversion as set out in the text of the Advisory Notice.

The Clearing House IRS Risk Committee reviewed the Conversion proposal in the July 2021 meeting of the IRS Risk Committee and no objections were raised to the Conversion proposals. The Clearing House Oversight Committee (“CHOC”) reviewed the Conversion proposal in the September 2021 meeting of the CHOC and no objections were raised to the Conversion proposals.<sup>11</sup>

CME is not aware of any other substantive opposing views with respect to the Conversion or the text of the Advisory Notice.

#### **Derivatives Clearing Organization Core Principles (“DCO Core Principles”) Analysis in Connection with the Conversion and Advisory Notice**

CME reviewed the DCO Core Principles as set forth in the CEA. During the review, CME identified the following DCO Core Principles as potentially being impacted:

**DCO Core Principle D – Risk Management:** Following extensive market consultation, the implementation of the Conversion via the Advisory Notice by CME has been designed to be straightforward from an operational processing perspective. The Conversion ensures that each Replacement Swap Pair will retain the key economic terms of the corresponding Pre-Conversion Basis Swap. The combined Net Present Value (“NPV”) of each Replacement Swap Pair will be equal to that of the corresponding Pre-Conversion Basis Swap prior to amendment. As a result, the Conversion will not result in any change in risk exposure for a position holder of a Pre-Conversion Basis Swap. Also as a result, no risk or cash compensation is required for position holders.

Based on extensive outreach to customers, CME understands that market participants support CME’s approach and the close alignment with the approach of other CCPs.

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August 27, 2021, to simulate the processes for the Conversion Date. All open Basis Swaps in the “New Release” Environment (not Production) will be converted on that date to enable market participants to take part in a “test” portfolio Conversion simulation.

<sup>11</sup> CME will effect the Rule amendments under the authority of CME under Chapter 2 (Government) of the CME Rulebook which provides (at Rule 230.(j)) that the CME Board of Directors shall “make and amend the Rules; provided the Board may also delegate authority to make and amend the rules as it deems appropriate.”

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DCO Core Principle L – Public Information: The implementation of the Conversion via the Advisory Notice and the operational elements of the Conversion will affect firms holding GBP and JPY Basis Swaps. A summary of the Conversion was provided to market participants and made publicly available in June 2021. CME has taken appropriate steps to provide market participants with sufficient information to enable those market participants to identify and evaluate effectively the risk associated with holding positions in GBP and JPY Basis Swaps at the time of Conversion and thereafter. The operational workflows and legal basis for the Conversion have been made publicly available. As noted above, as part of the preparations for the Conversion, CME has provided market participants with an operational “Dress Rehearsal” for the Conversion process on August 27, 2021, to simulate the processes for the Conversion Date.<sup>12</sup>

CME will report the operational processes relating to the Conversion in accordance with Part 45 of the CFTC’s Regulations, as described above.

DCO Core Principle N – Antitrust Considerations: The Conversion will not result in any unreasonable restraint of trade or impose any material anticompetitive burden. The Conversion reflects a preliminary step in an industry-wide initiative to transition interest rate swaps and other products away from LIBOR rates, in line with the objectives of market participants and industry working groups, which is widely supported by market participants as promoting the orderly transition away from GBP and JPY LIBOR. CME has engaged with market participants to obtain feedback on the processes for the Conversion and has not received any comments regarding antitrust/fair competition concerns.

The text of the CME Clearing Advisory Notice is attached hereto in Exhibit 1.

The Clearing Advisory Notice shall be effective on September 24, 2021.

Pursuant to Section 5c(c)(1) of the CEA and CFTC Regulation 40.6(a), CME certifies that rule modifications in the form of the Clearing Advisory Notice complies with the CEA and the regulations thereunder.

CME certifies that this submission has been concurrently posted on CME Group’s website at <http://www.cmegroup.com/market-regulation/rule-filings.html>.

Should you have any questions concerning the above, please contact the undersigned at (212) 299-2200 or via e-mail at [CMEGSubmissionInquiry@cmegroup.com](mailto:CMEGSubmissionInquiry@cmegroup.com).

Sincerely,

/s/ Christopher Bowen  
Managing Director & Chief Regulatory Counsel

Attachment: Exhibit 1 – CME Clearing Advisory Notice

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<sup>12</sup> See Clearing Advisory 21-285 available at: <https://www.cmegroup.com/content/dam/cmegroup/notices/clearing/2021/08/Chadv21-285.pdf>

## Exhibit 1 CME Clearing Advisory Notice



TO: Clearing Member Firms  
Back Office Managers

DATE: [ ], 2021

FROM: CME Clearing

NOTICE #: 21-[ ]

SUBJECT: **Modification and Withdrawal of Clearing Support for Cleared Over-the-Counter (“OTC”) British pound (“GBP”) and Japanese Yen (“JPY”) Denominated Interest Rate Basis Swaps Referencing the London Interbank Offered Rate (“LIBOR”)**

### **Background**

On March 5, 2021, the UK Financial Conduct Authority (“FCA”) announced that certain settings of GBP and JPY LIBOR (among other currencies) will cease to be provided by ICE Benchmark Administration Limited (“IBA”) and will be permanently discontinued immediately after publication on December 31, 2021 and, further, that any remaining GBP and JPY LIBOR settings that are published from that date would cease to be representative of the underlying market from the same date.<sup>1</sup> These circumstances would give rise to an “Index Cessation Event” within the meaning of contractual “fallback” provisions within the ISDA IBOR Fallbacks Supplement and the CME Rulebook, necessitating a transition to the relevant term and spread adjusted risk-free reference rate for affected cleared and uncleared contracts.<sup>2</sup>

However, following extensive engagement with cleared derivatives industry participants in 2021, market participants have indicated a preference for a CCP-led conversion from certain LIBOR rates before the “Index Cessation Event” and the implementation of the contractual fallback provisions in CCP rulebooks. As a result, subject to regulatory review, CME proposes: (i) on December 3, 2021, to convert all CME cleared CHF and JPY IRS to reference the respective successor “risk-free” reference rates (“RFR”) that are the nominated successor to CHF LIBOR and JPY LIBOR respectively; and (ii) on December 17, 2021, to convert all CME cleared GBP IRS currently referencing GBP LIBOR to reference SONIA, the nominated RFR successor to GBP LIBOR, in each case ahead of the scheduled permanent discontinuation of GBP, CHF and JPY LIBOR rates following final publication by IBA on December 31, 2021 (the “GBP/CHF/JPY LIBOR Transition”).<sup>3</sup>

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<sup>1</sup> See FCA Announcement, March 5, 2021, available at <https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf>.

<sup>2</sup> In January 2021, as part of regulatory and industry initiatives to transition away from certain key interbank offered rates (“IBORs”) and interest rate benchmarks, CME implemented certain changes to the CME Rulebook to incorporate “fallback” provisions into CME cleared IRS to provide for contractual fallback to a relevant alternative spread and term adjusted RFR on the permanent discontinuation or “non-representativeness” of certain key IBORs, including GBP and JPY LIBORs. See <https://www.cmegroup.com/content/dam/cmegroup/notices/clearing/2021/01/Chadv21-039.pdf>.

<sup>3</sup> For further details, see <https://www.cmegroup.com/trading/interest-rates/files/cme-ibor-conversion-for-chf-jpy-and-gbp-cleared-swaps.pdf>. CME will incorporate necessary changes to the CME Rulebook to effect the GBP/CHF/JPY LIBOR Transition in due course ahead of implementation in December 2021. For the avoidance of doubt, the Conversion process for Basis Swaps that is the subject of this submission is a separate process to the GBP/CHF/JPY LIBOR Transition, however, market participants agree with CME that

As a preliminary process prior to the proposed GBP/CHF/JPY LIBOR Transition, following discussions with market participants, CME has determined that it is necessary and beneficial for CME to:

- convert or “split” each CME cleared GBP and JPY LIBOR Basis Swaps (the “Basis Swaps”) into corresponding pairs of fixed-float IRS referencing the relevant LIBOR rate ahead of the anticipated “Index Cessation Event” in respect of each of GBP LIBOR and JPY LIBOR (the “Conversion”), to take effect at close of business on Friday, September 24, 2021 (the “Conversion Date”); and
- withdraw clearing support for the Basis Swaps from the Conversion Date.

The modification to the terms of the Basis Swaps to implement the Conversion is set out in this Clearing Advisory Notice, effective September 24, 2021. No amendments to the CME Rulebook are required to effect the Conversion.

With effect from close of business on the Conversion Date, CME will withdraw clearing support for the GBP and JPY Basis Swaps and will therefore cease to accept for clearing trades in GBP or JPY basis swaps from that time. No amendments to the CME Rulebook are required to effect the delisting of the Basis Swaps. The list of basis swap contracts accepted for clearing by CME will be updated on the CME Group website from the Conversion Date to reflect the delisting of the Basis Swaps.

### **Rationale for Conversion Process**

Following engagement with market participants, CME has determined that it is necessary and beneficial to convert or “split” each GBP and JPY LIBOR Basis Swap into corresponding pairs of fixed-float IRS referencing the relevant LIBOR rate as a preliminary process ahead of the proposed GBP/CHF/JPY LIBOR Transition scheduled for December 2021. In the absence of this preliminary process, GBP and JPY Basis Swaps would be converted, as part of the proposed GBP/CHF/JPY LIBOR Transition, into Replacement RFR-RFR Basis Swaps. This resultant product would be operationally and technically difficult for the marketplace to support and would not be directly fungible with standard overnight index swaps in the relevant RFR, making them relatively illiquid which, in turn, would create challenges for market participants in managing those positions and for CCPs in managing a default of an account holding those positions.

CME understands that other major EU and UK CCPs clearing GBP and JPY basis swaps will undergo a similar exercise with their market participants to split relevant basis swaps into corresponding pairs of fixed-float IRS and market participants have encouraged CME to align the timing of the Conversion with that of other CCPs to minimize any potential operational or market disruption.

The Conversion will not have any economic impact on position holders in the Basis Swaps or CME and will be neutral from a risk perspective. As a result, no cash compensation or adjustment mechanism is required.

Further details on the Conversion are set out below.

### **Summary of Conversion Process**

At close of business on the Conversion Date, with the exception of Basis Swaps that mature on the Conversion Date, CME will convert each CME cleared Basis Swap that is open at close of business on the Conversion Date by splitting each Basis Swap into corresponding pairs of CME cleared fixed-float interest rate swaps, as follows:

- CME will amend the terms of each Basis Swap (a “Pre-Conversion Basis Swap”).

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the Conversion is a necessary and preliminary process that must be undertaken by CME prior to the GBP/CHF/JPY LIBOR Transition in December 2021.

- In respect of each Pre-Conversion Basis Swap, within the Clearing System CME will close out each Pre-Conversion Swap and establish in the account of the position holder of such Pre-Conversion Basis Swap the following replacement CME cleared IRS trades (corresponding to the relevant Floating Rate Index of the Pre-Conversion Basis Swap) as per the direction of the Pre-Conversion Basis Swap:
  - a fixed-float interest rate swap, with Direction Pay Fixed, with a Floating Index Tenor corresponding to the Floating Rate Index 1 of the Pre-Conversion Basis Swap; and
  - a fixed-float interest rate swap, with Direction Receive Fixed, with a Floating Index Tenor corresponding to the Floating Rate Index 2 of the Pre-Conversion Basis Swap

(each, a “Replacement Swap” and together, a “Replacement Swap Pair”).

- The Currency, Notional, Effective Date, Maturity Date, Day Count, Date Roll, Payment Calendar and Floating Leg Spread of each Replacement Swap (as applicable) will be the same as that of the relevant Pre-Conversion Basis Swap.
- The Fixed Rate for each Replacement Swap in a Replacement Swap Pair will be determined by CME and shall be equal to the “break-even” rate of the “larger” index tenor for the Pre-Conversion Basis Swap, e.g. 6 months for a 3 month vs. 6 month Basis Swap. The Fixed Rate determined by CME for each Replacement Swap will ensure that payments under each Replacement Swap will fully offset the payments of the other Replacement Swap in that Replacement Swap Pair.
- Each Replacement Swap Pair will retain the key economic terms of the corresponding Pre-Conversion Basis Swap. The combined Net Present Value (“NPV”) of each Replacement Swap Pair will be equal to that of the corresponding Pre-Conversion Basis Swap prior to amendment. As a result, the Conversion will not result in any change in risk exposure for a position holder of a Pre-Conversion Basis Swap. As a result, no risk or cash compensation is required for position holders.
- Each Replacement Swap will be cleared by CME as an interest rate swap subject to the terms of the CME Rules.

The Conversion is a mandatory process and will apply to all cleared trades in GBP and JPY Basis Swaps on the Conversion Date except those Basis Swaps that mature on the Conversion Date.

From close of business on the Conversion Date, CME will no longer have any open interest in the Basis Swaps and will cease to accept GBP and JPY Basis Swaps for clearing.

In legal and contractual terms, the Conversion process will amend the terms of cleared trades in CME cleared GBP and JPY Basis Swaps, resulting in the operational establishment of replacement cleared trades in the form of the Replacement Swaps. This is reflected in operational terms by the reporting of each Replacement Swap by CME to CME SDR with reference to the “Prior USI” of the relevant corresponding Pre-Conversion Basis Swap. From an operational perspective within the CME clearing system, the Conversion will be processed by CME as a termination of each relevant Pre-Conversion Basis Swap and the establishment of a new corresponding pair of cleared trades within the clearing system in the form of the relevant Replacement Swaps.

CME has consulted with a diverse cross-section of market participants to obtain feedback on the operational processes for the Conversion. The Conversion is seen by market participants as an important preliminary step in the overall process of ensuring an orderly and efficient transition from LIBOR to RFRs in derivatives markets. Market participants have expressed a clear preference for CME to effect the Conversion of Basis Swaps ahead of the proposed GBP/CHF/JPY LIBOR Transition in December 2021. Furthermore, in CME’s engagement with market participants, these stakeholders have expressed a clear preference that CME’s approach to the “splitting” of GBP and JPY Basis Swaps should be aligned as closely as possible with the wider industry approach adopted by other major CCPs.

A summary of CME's Conversion plan was provided to market participants and made publicly available in June 2021 followed by operational testing and additional support prior to the proposed date of implementation, including a New Release Dress Rehearsal on August 27, 2021.<sup>4</sup>

This Advisory Notice sets out the binding rules and operational processes under which CME Clearing will implement the Conversion, including the modification and operational close-out of GBP and JPY Basis Swaps and the establishment of replacement GBP and JPY fixed-float interest rate swaps, which will be implemented by CME with respect to open cleared trades in affected CME cleared products at the Conversion Date.

Terms used but not defined in this Advisory Notice shall have the meaning set out in the CME Rules.

### **CME Cleared Contracts Subject to the Conversion and this Advisory Notice**

The Conversion will apply to all cleared trades in CME cleared GBP and JPY Basis Swaps that are open at close of business ("COB") on the Conversion Date and which do not mature on the Conversion Date (the "Affected Contracts").

### **Terms and Operation of Conversion Process**

1. At or shortly after COB on the Conversion Date, CME Clearing will amend each cleared trade in the Affected Contracts (a "Pre-Conversion Basis Swap").
2. In respect of each Pre-Conversion Basis Swap, CME Clearing will close out the Pre-Conversion Swap and establish in the account of the position holder of such Pre-Conversion Basis Swap the following replacement CME cleared IRS trades:
  - (a) a fixed-float interest rate swap, with Direction Pay Fixed, with a Floating Index Tenor corresponding to the Floating Rate Index 1 of the Pre-Conversion Basis Swap; and
  - (b) a fixed-float interest rate swap, with Direction Receive Fixed, with a Floating Index Tenor corresponding to the Floating Rate Index 2 of the Pre-Conversion Basis Swap,(each, a "Replacement Swap" and together, a "Replacement Swap Pair").
3. Each Replacement Swap will have the following terms:
  - (a) The Currency, Notional, Effective Date, Maturity Date, Day Count, Date Roll, Payment Calendar and Floating Leg Spread of each Replacement Swap (as applicable) will be the same as that of the relevant Pre-Conversion Basis Swap; and
  - (b) The Fixed Rate for each Replacement Swap in a Replacement Swap Pair will be determined by CME and shall be equal to the "break-even" rate of the "larger" index tenor for the Pre-Conversion Basis Swap, e.g. 6 months for a 3 month vs. 6 month Basis Swap. The Fixed Rate determined by CME for each Replacement Swap will ensure that payments under each Replacement Swap will fully offset the payments of the other Replacement Swap in that Replacement Swap Pair.

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<sup>4</sup> The public overview is available on the CME Group website at: <https://www.cmegroup.com/trading/interest-rates/files/cme-ibor-conversion-for-chf-jpy-and-gbp-cleared-swaps.pdf>. CME will operate an operational "Dress Rehearsal" for the Conversion process on August 27, 2021, to simulate the processes for the Conversion Date. All open Basis Swaps in the "New Release" Environment (not Production) will be converted on that date to enable market participants to take part in a "test" portfolio Conversion simulation.

4. Each Replacement Swap will be cleared by CME as an interest rate swap subject to the terms of the CME Rules.
  
5. The terms of this Advisory Notice and the Conversion process are binding on Clearing Members and position holders in all Affected Contracts, effective September 24, 2021. To the extent that there is any conflict between the Rules and the terms of this Advisory Notice with respect to the Conversion process, this Advisory Notice shall prevail. For the purposes of this Advisory Notice, Rule 90103.A. (“Contract Modifications; CME Rules”) shall not apply to the extent it purports to restrict modification to the terms of IRS Contracts that are the subject of this Advisory Notice.

The Conversion is a mandatory process. The Conversion will therefore apply to all positions in cleared trades in Affected Contracts on the Conversion Date with the exception of trades that mature on the Conversion Date. Market participants should consider the terms and impact of the Conversion as set out in this Advisory Notice and take appropriate action prior to the Conversion Date. Position holders that do not wish to participate in the Conversion must close out any positions in Affected Contracts prior to the Conversion Date.

#### **Fees for Conversion Process**

There are no Exchange fees payable in connection with the Conversion.

#### **Withdrawal of Clearing Support for GBP and JPY Basis Swaps Following Conversion**

From close of business on the Conversion Date, CME Clearing will cease to accept for clearing trades in GBP and JPY Basis Swaps. No amendments to the CME Rulebook are required to effect the delisting of the Basis Swaps. The list of basis swap contracts accepted for clearing by CME will be updated on the CME Group website to reflect the delisting of the Basis Swaps from close of business on the Conversion Date.

#### **Operational Information and Reporting**

CME Clearing will provide the following information in relation to Affected Contracts:

- End of Day Trade Register report made available by the Clearing House only to IRS clearing members and clients via an sFTP site;
- FpML Clearing Confirmations for operational termination of Pre-Conversion Swaps and establishment of Replacement Swaps

To reflect the operational processes within the clearing system, CME will send:

- a termination message to relevant CME clearing firms in respect of the termination of each relevant Pre-Conversion Basis Swap; and
- a clearing confirmation message to relevant CME clearing firms in respect of the establishment of each new relevant Replacement Swap.

As part of the Conversion process, all relevant Trade IDs on the Pre-Conversion Basis Swap will be carried over to the relevant Replacement Swaps. In order to identify the link between each Pre-Conversion Basis Swap and the relevant Replacement Swaps, CME will add a replacement Trade ID and Original Trade ID respectively in the History section of the clearing confirmation messages.

CME will report the result of Conversion to CME SDR in accordance with the requirements of the CFTC's Part 45 Regulations, to reflect the splitting of each Pre-Conversion Basis Swap into each Replacement Swap Pair. With regard to reporting data submitted to SDR in respect of each Replacement Swap, CME will populate the "Prior USI" field with the USI of the relevant Pre-Conversion Basis Swap to reflect the nature of the Conversion process. For SDR reporting purposes, reporting rows will be generated and submitted to CME SDR terminating the USI of each Pre-Conversion Basis Swap and CME will ensure that each Replacement Swap will be reported as a "New Trade."

Additional details regarding the Conversion may be viewed in ***CME Submission No. 21-412***.

Inquiries regarding the aforementioned may be directed to:

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