

MEMO# 32745

September 8, 2020

CFTC Staff Updates No-Action Relief Related to LIBOR and Benchmark Reform Transition

[32745]

September 8, 2020 TO: ICI Members
Investment Company Directors
ICI Global Members
Derivatives Markets Advisory Committee
Fixed-Income Advisory Committee
LIBOR Transition Working Group
Municipal Securities Advisory Committee SUBJECTS: Derivatives
Disclosure
Fixed Income Securities
Fund Accounting & Financial Reporting
International/Global
Investment Advisers
Municipal Securities
Operations
Trading and Markets RE: CFTC Staff Updates No-Action Relief Related to LIBOR and
Benchmark Reform Transition

The CFTC Divisions of Swap Dealer and Intermediary Oversight (DSIO), Market Oversight (DMO), and Clearing and Risk (DCR) recently revised and expanded previously-issued no-action letters that provide relief to swap dealers (SDs) and other market participants related to the transition to alternative reference rates.[\[1\]](#) The updated letters address requests from the Alternative Reference Rates Committee (ARRC) for additional relief and supersede the previous corresponding no-action letters referenced below.

CFTC No-Action Letter No. 20-23

DSIO issued No-Action Letter No. 20-23 to modify the relief provided previously in Letter No. 19-26 and to provide additional relief from certain SD requirements for “Qualifying Amendments” to Legacy Swaps[\[2\]](#) and Pre-Transition Swaps.[\[3\]](#) Letter No. 20-23 generally continues the relief from Letter No. 19-26 for an amendment to an uncleared swap that references an Impaired Reference Rate (IRR) solely to (i) include new fallback language to alternative reference rates triggered by permanent discontinuation of LIBOR or other IBORs or a determination that they are non-representative (“Fallback Amendment”); or (ii)

accommodate the replacement of IRRs in the swap (“Replacement Rate Amendment”) (re-designated together as a “Qualifying IRR Amendment”).[\[4\]](#) The revised letter also expands the types of amendments that constitute a “Qualifying Amendment” to include:

- the voluntary exchange of compensation for a swaption, or the amendment of a swaption’s terms, solely based on a central counterparty’s (CCP) changes to (i) the discount rate used to value cleared swaps and (ii) the rate applied to collateral or settlement amounts relating to certain cleared swaps (“Qualifying Swaption Amendment”);[\[5\]](#)
- an amendment to a credit support annex (CSA) solely to (i) align the interest rate paid on posted collateral for uncleared swaps under a CSA with the CCP’s discount rate; or (ii) replace an IRR paid on posted collateral for uncleared swaps (“Qualifying CSA Amendment”);[\[6\]](#) or
- any combination of the above.[\[7\]](#)

According to DSIO, these additional amendments are warranted due to intended changes announced by certain central counterparties (CCPs) to the discount rate used to value cleared swaps and to the rate applied to collateral or settlement amounts relating to certain cleared swaps.[\[8\]](#)

The revised letter further amends the prior relief as follows:

- With respect to SD business conduct standards,[\[9\]](#) the revised letter provides relief from Commission Regulation 23.431(a)(3)(i), which requires an SD to provide the mid-market mark of a swap.[\[10\]](#)
- The revised letter clarifies that relief from SD swap confirmation requirements applies not only with respect to Qualifying Amendments enacted for multiple swaps pursuant to a multilateral protocol (e.g., an ISDA protocol), but also pursuant to bilateral agreements.
- With respect to swaps that qualify for a user-based exception or exemption from the CFTC’s swap margin rules,[\[11\]](#) the revised letter expands the relief from certain qualifying conditions to a broader group of “Eligible End-Users”[\[12\]](#) and corresponding interest rate swap transactions (“Covered IRS”), including related commercial arrangements, that become subject to a Qualifying Amendment.[\[13\]](#) The revised letter also expands the relief for end-users with respect to end-user documentation and eligible contract participant status requirements.

CFTC Letter No. 20-24

DMO issued No-Action Letter No. 20-24 to modify relief provided previously in Letter No. 19-27 and to provide additional relief from the swap trade execution requirement for swaps that are modified or created to transition to an alternative reference rate. Letter No. 20-24 continues the relief from Letter No. 19-27, but also expands the scope of qualifying amendments and conforms other aspects of its relief to align with the relief provided by DSIO in Letter No. 20-23, described above, and DCR in Letter No. 20-25, described below. The relief is scheduled to expire on December 31, 2021.

CFTC Letter No. 20-25

DCR issued No-Action Letter No. 20-25 to modify relief provided previously in Letter No. 19-28 and to provide additional relief from the swap clearing requirement for uncleared legacy swaps that are amended to accommodate the transition to a new alternative reference rate. The revised letter continues the relief from Letter No. 19-28, which allowed an “Uncleared Legacy Swap”[\[14\]](#) that is amended to include fallback language to maintain

its legacy status. However, the revised letter now additionally provides relief for “Uncleared Legacy Swaptions,”^[15] as described below.

The revised letter amends the prior relief by:

- adopting a similar definition of “Qualifying Amendment” as DSIO in Letter No. 20-23 to expand relief for (i) amendments involving the replacement of IRRs in an Uncleared Legacy IRS or Uncleared Legacy Swaption (“Replacement Rate Amendment”);^[16] (ii) Qualifying Swaption Amendments; (iii) Qualifying CSA Amendments; and (iv) any combination of these amendments;^[17] and
- broadening the alternative reference rates that counterparties may select when adding fallback language to an Uncleared Legacy IRS. The counterparties may select a rate that they believe is appropriate after assessing its complexity, safety, and soundness, and taking into consideration appropriate risk management practices.^[18]

The revised letter also modifies its relief in certain other respects to align with the relief provided by DSIO in Letter No. 20-23. Further, the revised letter specifies that the relief will continue to not apply if (i) the original counterparties to the Uncleared Legacy IRS or Uncleared Legacy Swaption change; or (ii) if the swap was voluntarily submitted for clearing to a derivatives clearing organization (DCO). The relief is scheduled to expire on December 31, 2021.

With respect to swaps that qualify for a user-based exception or exemption from the clearing requirement,^[19] the revised letter expands the relief from certain qualifying conditions to a broader group of “Eligible End-Users” and Covered IRS, including related commercial arrangements, that become subject to a Qualifying Amendment. The letter also provides related no-action relief with respect to certain representation, reporting and ongoing monitoring requirements for Eligible End-Users.

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Notes

^[1] See <https://www.cftc.gov/PressRoom/PressReleases/8228-20>. The no-action letters are available at https://www.cftc.gov/LawRegulation/CFTCStaffLetters/letters.htm?field_csl_letter_types_target_id%5B%5D=636. We previously provided an overview of the original relief. See ICI Memorandum No. 32115, available at https://www.ici.org/my_ici/memorandum/memo32115.

^[2] Similar to Letter No. 19-26, Letter No. 20-23 defines a “Legacy Swap” as an uncleared swap that were entered into prior to the compliance date of a particular regulatory requirement, with the result that such requirement did not apply to those swaps.

^[3] Similar to Letter No. 19-26, Letter No. 20-23 defines a “Pre-Transition Swap” as an uncleared swap (including a Legacy Swap) that was entered into prior to the effective date of a Qualifying IRR Amendment, Qualifying Swaption Amendment, or Qualifying CSA Amendment, as described below.

[4] Letter No. 20-23 continues to define a “Fallback Amendment” as an amendment to a swap solely to include fallbacks triggered only by (i) permanent discontinuation of an IRR or (ii) a determination that an IRR is non-representative. Letter No. 20-23 also continues to define a “Replacement Rate Amendment” as a voluntary conversion by a market participant of IRR-linked uncleared swaps to alternative reference rates prior to the permanent cessation of the applicable IRR or a determination that it is non-representative.

[5] We previously provided an overview of the ARRC’s recommendations regarding a compensation methodology for swaptions that will be impacted by the upcoming discount rate transition by the CCPs. See ICI Memorandum No. 32459 (May 14, 2020), *available at* https://www.ici.org/libor/ici_resources/memos/memo32459.

[6] The ARRC explained that to mitigate potential basis risk between a cleared and uncleared swap, e.g., where an SD offsets the risk of an uncleared swap by executing a cleared swap with a third party, market participants may align the rate used in a CSA with the discount rate used by a CCP for cleared swaps.

[7] Letter No. 20-23 maintains that a Qualifying Amendment may include ancillary changes to existing trade terms to conform to different market conventions, but not any amendment that (i) extends the maximum maturity of a swap or a portfolio of swaps beyond what is necessary to accommodate the differences between market conventions for an IRR or CCP discount rate and its replacement; or (ii) increases the total effective notional amount of a swap or the aggregate total effective notional amount of a portfolio of swaps beyond what is necessary to accommodate the differences between market conventions for an IRR or CCP discount rate and its replacement.

[8] Specifically, CME and LCH have announced a plan to transition from using the daily effective federal funds rate (EFFR) to the Secured Overnight Financing Rate (SOFR) as of October 2020 with respect to USD discounted swaps. LCH and Eurex have transitioned from using the Euro OverNight Index Average (EONIA) to the Euro Short Term Rate (€STR) as of July 2020 with respect to EUR discounted swaps. Although these CCP-enacted changes directly apply to cleared swaps, the ARRC noted that they could also affect the value of many uncleared USD- and EUR-denominated swaptions that exercise into cleared swaps or cash settle by reference to the changed CCP discounting rates. Therefore, the ARRC and the Working Group on Euro Risk-Free Rates have recommended that counterparties amend applicable swaptions and simultaneously exchange compensation to account for the change in the CCP discount rate.

[9] Letter No. 20-23 continues to provide relief to SDs from the external business conduct requirements, to the extent such compliance would be required solely because of a Qualifying Amendment to an uncleared swap.

[10] Letter No. 20-23, however, continues to exclude relief from the other provisions of Commission Regulation 23.431(a), which require the SD to provide material information concerning the risks and characteristics of a swap to its counterparty at a reasonably sufficient time prior to entering into the swap.

[11] The exceptions to the CFTC swap margin rules are based on (i) the exception for commercial end-users and (ii) the exemption for cooperatives from the CFTC’s clearing requirements.

[12] The list of entities that qualify as an “Eligible End-User” and transactions that qualify

as “Covered IRS” correspond to the scope of relief provided by DCR in its revised no-action letter, as described further below.

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

[14] Letter No. 20-25 continues to define an “Uncleared Legacy IRS” as an interest rate swap that was executed prior to the relevant compliance date on which swap counterparties were required to comply with the CFTC’s clearing requirement, and thus, has not been cleared.

[15] Letter No. 20-25 defines an “Uncleared Legacy Swaption” as an uncleared swaption that, upon exercise, would result in an interest rate swap of a type subject to the 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 clearing requirement.

[16] Similar to DSIO’s relief in Letter No. 20-23, Letter No. 20-25 defines Replacement Rate Amendments, in addition to amendments to include new fallback language, *i.e.*, “Fallback Amendments,” as “Qualifying IRR Amendments.” Letter No. 19-28 had previously limited the relief to only amendments that incorporate fallback language.

[17] Similar to Letter No. 20-23, Letter No. 20-25 clarifies that a Qualifying Amendment may include certain ancillary amendments, but not amendments that inappropriately extend the maximum maturity or total notional amount of an Uncleared Legacy IRS or Uncleared Legacy Swaption. *See supra* note 7.

[18] In contrast, Letter No. 19-28 specified the permissible rates that counterparties would be able to select as a fallback rate to replace certain existing IBOR rates.

[19] These exceptions to the clearing requirement are based on (i) the exception for commercial end-users and (ii) the exemption for cooperatives from the CFTC’s clearing requirements.