

MEMO# 34145

May 16, 2022

CFTC Issues Proposal on Swap Clearing Requirements and LIBOR Transition

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TO: Derivatives Markets Advisory Committee
LIBOR Transition Working Group RE: CFTC Issues Proposal on Swap Clearing Requirements and LIBOR Transition

On May 9, the Commodity Futures Trading Commission (CFTC) proposed amendments to its swap clearing requirements reflecting the cessation of LIBOR (and other IBORs) and transition to alternative reference rates.[\[1\]](#) The CFTC proposes removing certain swaps referencing LIBOR from the clearing requirements while requiring swaps referencing alternative rates to be cleared. The proposal follows a 2021 request for information on swap clearing and LIBOR transition.[\[2\]](#)

The proposal is summarized below. Responses are due to the CFTC thirty days after publication in the Federal Register.

ICI, along with outside counsel Karen Stretch and Philip Hinkle of Dechert, will hold a member call on Tuesday, May 24 at 2:00 p.m. ET to discuss potential comments on the proposal. We will send you an Outlook calendar invitation with information on how to participate in the call.

Background on LIBOR Transition

Until recently, many swaps have referenced LIBOR or other IBORs, including certain fixed-to-floating swaps, basis swaps, and forward rate agreements. Over the past year, however, global regulators have caused certain LIBOR rates and other IBORs to cease publication or become unrepresentative, including EUR LIBOR, CHF LIBOR, JPY LIBOR,[\[3\]](#) and GBP (Sterling) LIBOR.[\[4\]](#)

USD LIBOR in its 1-week and 2-month tenors ceased publication on December 31, 2021, but other USD LIBOR rates will continue to be published until June 30, 2023 and will cease or be deemed to be unrepresentative after that date.

Regulators and market participants globally have been actively preparing to transition away from LIBOR and other IBORs and have identified alternative reference rates to replace ceased or non-representative LIBOR and other IBORs, such as SOFR for USD LIBOR. These

rates are referred to as risk-free rates (RFRs).

Background on Clearing Requirements

The Commodity Exchange Act (CEA) requires that a swap be cleared through a derivatives clearing organization (DCO) if the CFTC determines that the swap, or group, category, type, or class of swap, is required to be cleared, unless an exception to the clearing requirement applies. In making a clearing requirement determination, the CFTC must consider the following statutory factors:

- The existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data;
- The availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is traded;
- The effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCOs available to clear the contract;
- The effect on competition, including appropriate fees and charges applied to clearing; and
- The existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.

Previously, the CFTC has applied these factors in issuing two clearing requirement determinations, first for covered certain credit default swap indexes, and interest rate swaps in four currencies and in four classes,[\[5\]](#) and second for covered interest rate swaps in nine additional currencies.[\[6\]](#)

These determinations have resulted in clearing requirements for certain swaps that reference LIBOR and other IBORs, including fixed-to-floating swaps, basis swaps, and FRA classes that refer to LIBOR.[\[7\]](#)

The CFTC also has an obligation under Dodd-Frank to coordinate with non-US regulators to establish consistent international standards for swaps. The Proposing Release notes that Australia, Japan, the UK, and EU have proposed or finalized amendments to their clearing requirements to account for the global transition from LIBORs to RFRs.

CFTC Proposal on Clearing Requirements

The CFTC proposes updates to the swap clearing requirements to account for the transition from LIBOR and other IBORs to alternative reference rates that generally would:

- Remove all current swap clearing requirements for all classes of swaps that reference LIBOR and EUR EONIA (fixed to floating, basis swaps, FRAs, and for EUR EONIA, OISs); and[\[8\]](#)
- Require clearing for corresponding swaps referencing RFRs, specifically all RFR overnight index swaps (OISs). The CFTC notes that it is not proposing to add any new requirement to clear RFR-linked basis swaps because it believes that those are used primarily to move out of IBOR swap positions and into RFR swap positions.

Specifically, the CFTC proposes to amend regulation 50.4(a) thirty days after the adoption of any final amendments to:

- Remove swaps denominated in GBP, CHF, and JPY that reference LIBOR as a floating rate index from each of the fixed-to-floating swap, basis swap, and FRA classes, as applicable.
- Remove swaps denominated in EUR that reference EONIA as a floating rate index from the OIS class.
- Add to the OIS class:
 - Swaps denominated in USD that reference SOFR as a floating rate index with a stated termination date range of 7 days to 50 years,
 - Swaps denominated in EUR that reference €STR as a floating rate index with a stated termination date range of 7 days to 3 years,
 - Swaps denominated in CHF that reference SARON as a floating rate index with a stated termination date range of 7 days to 30 years,
 - Swaps denominated in JPY that reference TONA as a floating rate index with a stated termination date range of 7 days to 30 years, and
 - Swaps denominated in SGD that reference SORA as a floating rate index with a stated termination date range of 7 days to 10 years.
- Change the maximum stated termination date range for swaps denominated in GBP that reference SONIA as a floating rate index in the OIS class to 50 years, for a new stated termination date range of 7 days to 50 years.

Further, effective July 1, 2023, the proposed amendments would remove swaps denominated in USD that reference LIBOR as a floating rate index from each of the fixed-to-floating swap, basis swap, and FRA classes and remove swaps denominated in SGD that reference SOR-VWAP as a floating rate index from the fixed-to-floating swap class.

In issuing these proposed amendments, the CFTC states that it believes the RFR swap markets and DCOs are prepared to comply with the proposed requirements. The CFTC also analyzes the proposal through the five statutory determination factors as they relate to the proposed clearing of RFR OISs^[9] and preliminarily determines that the proposal meets each of those factors, including that:

- Data indicate sufficient outstanding notional exposures and regular trading activity in RFR OISs for purposes of demonstrating the liquidity necessary for DCOs to risk manage these products and to support a proposed clearing requirement.^[10] Further, there is adequate pricing data to support required clearing of RFR OISs.
- The DCOs have developed risk management practices that should ensure that the RFR OISs subject to the proposed clearing requirements can be cleared safely, even during times of market stress.
- DCOs would be able to manage the risk posed by clearing the new RFR OISs that would be required to be cleared and central clearing of those swaps would mitigate counterparty credit risk (potentially reducing systemic risk).
- The proposed clearing would not likely have a negative competitive impact.
- There is reasonable legal certainty about the treatment of customer and swap counterparty positions, funds, and property in connection with cleared swaps, including the RFR OISs subject to the proposal, in the event of a DCO or member insolvency.

Compliance Dates

The CFTC proposes that these amendments, if adopted, should become effective thirty days after the final amendments are published in the Federal Register.^[11] The CFTC notes its belief that the DCOs have largely completed IBOR swap conversions and that adopting a

single compliance date for all market participants is appropriate.

Sarah A. Bessin
Associate General Counsel

Bridget Farrell
Assistant General Counsel

endnotes

[1] 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 (May 9, 2022) ("Proposing Release"), available at <https://www.cftc.gov/media/7226/federalregister050922/download> .

[2] See Swap Clearing Requirement Amendments to Account for the Transition from LIBOR and Other IBORs to Alternative Reference Rates, Release 6351-01-P (Nov. 17, 2021), available at <https://www.cftc.gov/media/6741/federalregister111721/download>; see also ICI Comment Letter, available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=65918&SearchText=>.

[3] JPY LIBOR has ceased in the in the spot next, 1-week, 2-month, and 12-month tenors. The UK Financial Conduct Authority (FCA) determined that JPY LIBOR in 1-month, 3-month, and 6- month tenors are unrepresentative but is requiring those tenors to continue to be published using a synthetic methodology through 2022. See ICI Memorandum No. 33797 (October 1, 2021), available at <https://www.ici.org/memo33797>.

[4] GBP LIBOR has ceased publication in the in the overnight, 1-week, 2-month, and 12-month tenors. The FCA determined that GBP LIBOR in 1-month, 3-month, and 6- month tenors are unrepresentative but is requiring those tenors to continue to be published using a synthetic methodology through 2022.

[5] Specifically, fixed-to floating swaps; basis swaps; forward rate agreements (FRAs); and overnight index swaps (OIS). See Clearing Requirement Determination Under Section 2(h) of the CEA; Final Rule, 77 FR 74284 (December 13, 2012) (the "First Determination"), available at <https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/ClearingRequirement/index.htm>. See also regulation 50.4.

[6] See Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps; Final Rule, 81 FR 71202 (October 14, 2016) (the "Second Determination"), available at <https://www.cftc.gov/LawRegulation/DoddFrankAct/Rulemakings/ClearingRequirement/CDFCclearingReq.html>. See also regulation 50.26.

[7] Specifically, the First Determination covered certain interest rate swaps in each of these

classes referencing LIBOR in three currencies: U.S. dollars (USD), British pounds (GBP), and Japanese yen (JPY). The Second Determination covered certain fixed-to-floating interest rate swaps referencing LIBOR in Swiss francs (CHF)

[\[8\]](#) The CFTC proposes to remove these swaps from mandatory regulation 50.4 at the same time as it removes those swaps from 50.26.

[\[9\]](#) Specifically, USD SOFR, GBP SONIA, EUR ESTR, CHF SARON, JPY TONA, and SGD SORA OISs.

[\[10\]](#) The CFTC notes that significant amounts of notional RFR OIS already are being cleared voluntarily. The CFTC also provides data regarding clearing activity in swaps with longer-dated maturities (e.g., 15-30 years). See Proposing Release at 47-52.

[\[11\]](#) Except that amendments relating to SGD SOR-VWAP and those USD LIBOR rates that do not cease or become unrepresentative until June 30, 2023 would become effective after that date.