

CFTC Provides Additional No-Action Relief to Smooth IBOR Transition

The relief removes regulatory obstacles and provides additional flexibility for market participants.

On August 31, 2020, three divisions of the US Commodity Futures Trading Commission (CFTC) issued revised no-action letters providing additional relief to swap dealers (SDs), end users, and other market participants from registration requirements; business conduct standards; uncleared swap margin requirements; mandatory clearing; and trade execution requirements as a result of the looming discontinuation of the London Interbank Offered Rate (LIBOR) and other interbank offered rates (IBORs) and the transition to risk-free rates (RFRs). The relief came at the request of the Alternative Reference Rates Committee (ARRC), the group of private-market participants convened by the Federal Reserve Board and the Federal Reserve Bank of New York and that has been leading the transition away from USD LIBOR to the recommended US RFR, the Secured Overnight Financing Rate (SOFR). The revised no-action relief is set forth in:

- CFTC No-Action Letter [No. 20-23](#), issued by the Division of Swap Dealer and Intermediary Oversight (DSIO) (the DSIO No-Action Relief)
- CFTC No-Action Letter [No. 20-24](#), issued by the Division of Market Oversight (DMO) (the DMO No-Action Relief)
- CFTC No-Action Letter [No. 20-25](#), issued by the Division of Clearing and Risk (DCR) (the DCR No-Action Relief)

As explained by CFTC Chairman Heath P. Tarbert, the revised no-action relief is intended to “remove regulatory obstacles to the adoption of potential protocols updating robust fallback procedures” and to “help market participants continue managing their swap portfolios as clearinghouses implement their planned transition of discount rates towards new reference rates.”¹

The CFTC previously granted no-action relief in December 2019, as discussed in this [Client Alert](#). While the revised no-action relief is similar to the prior relief in many respects, it contains a number of incremental benefits and supersedes the prior relief in its entirety.

Conditions and Terminology

Reliance on the revised no-action letters is subject to a range of conditions and definitions.

The term “Impaired Reference Rate” (IRR) is defined by the DSIO and DCR (but not the DMO) to refer to (i) IBORs; (ii) any other interest rate that the parties to a swap reasonably expect to be discontinued or reasonably determine has lost its relevance as a reliable benchmark due to a significant impairment; or (iii) any other reference rate that succeeds any of the foregoing. This definition of IRR is intended to provide market participants with greater flexibility, permitting more than one amendment to the same swap or portfolio of swaps before settling on an alternative benchmark that adequately meets the counterparties’ commercial needs. This flexibility will allow counterparties to make further amendments if an initially identified replacement benchmark itself becomes an IRR or simply does not meet the counterparties’ commercial needs, so long as the original reference rate for the swap was an IBOR or meets the other criteria above.

The term “Qualifying Amendment” as employed by the DSIO and the DCR refers to:

- **Qualifying IRR Amendments.** This refers to (i) fallback amendments, whether effected by protocol adherence or bilateral negotiation, that take effect once an IRR is permanently discontinued or determined to be non-representative; and (ii) replacement rate amendments to replace an IRR with an alternative reference rate prior to any such discontinuation or determination.
- **Qualifying Swaption Amendments.** This refers to circumstances in which the counterparties to a swaption either (i) voluntarily exchange compensation for a swaption; or (ii) amend a swaption’s terms solely to reflect an agreement regarding the discount rate used by a central counterparty (CCP), solely as a result of a public announcement by a DCO of an impending change to the discount rate used for purposes of valuing cleared swaps and the rate applied to collateral or settlement amounts relating to certain cleared swaps.
- **Qualifying CSA Amendments.** This refers to an amendment to a credit support annex (CSA) solely to (i) align the interest rate paid on posted collateral for uncleared swaps under the CSA with the discount rate used by a CCP; or (ii) replace an IRR that is an interest rate paid on posted collateral for uncleared swaps.
- Any combination of the foregoing.

While a Qualifying Amendment may include ancillary changes to existing trade terms to conform to different market conventions, in general such an amendment may not:

- Change the counterparties to the swap
- Extend the maximum maturity of a swap or portfolio of such swaps beyond what is necessary to accommodate the differences between market conventions for an IRR or a discount rate used by a CCP and its replacement
- Increase the total effective notional amount of a swap or the aggregate total effective notional amount of a portfolio of such swaps beyond what is necessary to accommodate the differences between market conventions for an IRR or a discount rate used by a CCP and its replacement

Overall, the revised no-action relief addresses an expanded range of Qualifying Amendments compared with the prior relief, which did not address actions taken by DCOs to change discount rates used for valuing cleared swaps and the rates applied to collateral accounts. Additionally, the prior relief did not address CSA amendments intended to align the interest rates paid on posted collateral for uncleared swaps with the discount rate changes implemented by DCOs.

DSIO No-Action Relief

The DSIO No-Action Relief addresses a range of requirements under the Commodity Exchange Act (CEA) and CFTC regulations, including SD registration thresholds, uncleared swap margin requirements, SD business conduct standards, SD documentation and swap processing requirements, and certain requirements applicable to end users.

Unlike the DCR No-Action Relief and the DMO No-Action Relief, the DSIO No-Action Relief is not expressly time limited.

***De Minimis* Threshold**

Pursuant to the DSIO No-Action Relief, the DSIO will not recommend enforcement action against any person for failure to include a swap in its calculations under the *de minimis* threshold for SD designation and registration under Section 1a(49)(D) of the CEA to the extent such swap would be required to be counted as a consequence of a Qualifying Amendment. Such relief is intended to address concerns that entities that are actively monitoring and managing their swap dealing activities to stay below the *de minimis* threshold may be reluctant to amend their legacy swaps to transition away from IRRs for fear of such swaps being included in their *de minimis* calculations going forward.

Uncleared Swap Margin Requirements

SDs that are not prudentially regulated are subject to the uncleared swap margin requirements promulgated by the CFTC pursuant to Section 4s(e) of the CEA. While these requirements do not apply to uncleared swaps entered into by a SD before an applicable compliance date, in general amendments made after the applicable compliance date will bring such legacy swaps in scope and subject to the regulatory variation and/or initial margin requirements (as applicable). Pursuant to the DSIO No-Action Relief, however, the DSIO clarified that it does not expect compliance with the CFTC's uncleared swap margin requirements solely as a consequence of a Qualifying Amendment to a legacy swap.

In addition, and solely in relation to the CFTC's uncleared swap margin requirements, the DSIO No-Action Relief permits a SD to enter into basis swaps rather than amend their legacy swaps, provided that any such basis swap:

- References only one or more relevant legacy swaps
- Is entered into solely to achieve substantially the same effect as would be obtained by amending the relevant legacy swap(s) to replace an IRR
- Does not extend the maximum maturity or increase the total notional amount of the referenced legacy swap(s) beyond what is necessary to accommodate the differences between market conventions for an IRR and its replacement

Business Conduct Standards

The CFTC's business conduct standards ordinarily require a SD to provide or obtain specific information from their counterparties, to obtain specific representations in writing, and to perform certain due diligence inquiries prior to entering into or offering to enter into a swap with such counterparties. The CFTC previously indicated that material amendments to legacy swaps executed before the effective date of these requirements will generally subject such swaps to the business conduct standards as if they are new swaps.

Pursuant to the DSIO No-Action Relief, the DSIO indicated that it will not recommend enforcement action against a SD for failure to comply with the business conduct standards solely to the extent such compliance would be required as a consequence of a Qualifying Amendment to an uncleared swap. However, this relief does not extend to CFTC Regulation 23.431(a), which requires a 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, except for the requirement to provide the mid-market mark of the swap in CFTC Regulation 23.431(a)(3)(i). The exception extending the relief to the provision of mid-market marks reflects a minor departure from the approach in the prior relief.

Documentation and Swap Processing Requirements

Pursuant to the DSIO No-Action Relief, the DSIO provided relief in relation to the swap confirmation requirements in CFTC Regulation 23.501 solely to the extent such compliance would be required as a consequence of a Qualifying Amendment to an uncleared swap. However, this relief is limited to amendments accomplished by adherence to a multilateral protocol or a bilateral agreement that amends multiple swaps.

In addition, the DSIO provided relief from the requirements in CFTC Regulation 23.504 that regulatory compliant "swap trading relationship documentation" be entered into prior to a SD entering into any swap transaction. Under the DSIO No-Action Relief, SDs are not required to enter into such documentation solely as result of a Qualifying Amendment to a legacy swap that was originally entered into prior to the compliance date for the swap trading relationship documentation requirements.

Similarly, the DSIO indicated that it will not recommend enforcement action for a SD's failure to comply with the discrepancy resolution obligations under the portfolio reconciliation requirements in CFTC Regulation 23.502 solely to the extent such compliance would be required as a consequence of a Qualifying Amendment to an uncleared swap.

Certain End User Requirements

As discussed further below in relation to the DCR No-Action Relief, CFTC regulations provide certain commercial end users, small financial institutions, and cooperatives with exceptions and exemptions from the interest rate swap clearing requirement if certain conditions are met, including that the relevant swap is being used to "hedge or mitigate commercial risk." The CFTC's uncleared swap margin requirements pick up these clearing exceptions and exemptions to disapply the regulatory margin requirements for swaps being used by such commercial end users, small financial institutions, and cooperatives to hedge or mitigate commercial risk. Observers have expressed concerns that previously un-margined end user swaps may no longer qualify as being used to "hedge or mitigate commercial risk" as a result of temporary mismatches between the interest rates referenced in underlying commercial arrangements and the relevant interest rate swaps during the market transition to IBOR alternatives.

Assuaging such concerns, the DSIO indicated in the DSIO No-Action Relief that a non-prudentially regulated SD need not comply with the CFTC's uncleared swap margin requirements for swaps entered into with eligible end users if such compliance would be required solely as a consequence of a Qualifying Amendment to the relevant swap or solely as a consequence of an amendment to a commercial arrangement solely for the purpose of (i) including new fallbacks to alternative reference rates triggered only by permanent discontinuation of an IRR or a determination that an IRR is non-representative; or (ii) accommodating the replacement of an IRR.

The DSIO No-Action Relief extends to a greater range of eligible end users than the CFTC's prior relief, adding small financial institutions with less than US\$10 billion in assets and certain entities addressed in a recent proposed CFTC rulemaking, namely certain community development corporations as well as bank holding companies and savings and loan holding companies with less than US\$10 billion in assets. In addition, the DSIO indicated that it would not recommend enforcement action against a SD for failure to obtain the associated documentation required by CFTC Regulation 23.505(a)(4) from an end user for which it has previously obtained such documentation solely to the extent it would be required to do so as a result of a Qualifying Amendment.

The DSIO also clarified that a person who has previously qualified as an "eligible contract participant" pursuant to Section 1a(18)(xi) of the CEA on the basis that they enter into swaps in order to manage the risk associated with an asset or liability of such person will not be viewed as having lost eligible contract participant status solely as a consequence of a Qualifying Amendment to an uncleared swap.

DCR No-Action Relief in Relation to Clearing Requirements

Section 2(h)(1)(A) of the CEA and Part 50 of the CFTC's regulations require, subject to certain exceptions, that certain classes of interest rate swaps be cleared by CFTC-registered derivatives clearing organizations (DCOs). Pursuant to the DCR No-Action Relief, the DCR granted relief in relation to (i) the application of the interest rate swap clearing requirement to certain legacy uncleared swaps; and (ii) the requirements for relying on certain end user exceptions and exemptions from the clearing requirement, including to address an expanded scope of end users compared with the prior relief. The DCR No-Action Relief does not apply to swaps that have been submitted for clearing voluntarily.

The DCR No-Action Relief is time limited and extends until December 31, 2021.

Qualifying Amendments to Legacy Uncleared Interest Swaps

The DCR No-Action Relief addresses (i) swaps that were executed prior to the relevant compliance date on which swap counterparties were required to comply with the CFTC's interest rate swap clearing requirement (Uncleared Legacy IRS); and (ii) uncleared swaptions that, upon exercise, would result in an interest rate swap of a type subject to the CFTC's interest rate swap 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 applicable to such interest rate swaps (Uncleared Legacy Swaptions).

Under the DCR No-Action Relief, the DCR will not recommend enforcement action against any person for failure to comply with the interest rate swap clearing requirement if such person makes a Qualifying Amendment to an Uncleared Legacy IRS or Uncleared Legacy Swaption, provided that such amendment is made solely for the purpose of transitioning from an IRR to an RFR.

Relief for End Users Hedging or Mitigating Commercial Risk

CFTC Regulation 50.50 provides an exception from the mandatory clearing requirement for commercial end users using swaps to “hedge or mitigate commercial risk.” This exception is also available to certain small financial institutions with total assets less than US\$10 billion, again provided such institutions are using swaps to hedge or mitigate commercial risk. Similarly, CFTC Regulation 50.51 provides an exemption from the clearing requirement for certain exempt cooperatives that use swaps to hedge or mitigate commercial risk in relation to the provision of loans to their members. Observers have expressed concern that entities relying on these exceptions and exemptions may not be able to meet the “hedge or mitigate commercial risk” requirement and make representations to that effect due to a temporary mismatch between the rates referenced in their commercial arrangements and the rates referenced in the documentation of the interest rate swaps being used to hedge or mitigate the risk associated with such arrangements.

Under the DCR No-Action Relief, the DCR will not recommend enforcement action against an eligible end user seeking to remain in compliance with the “hedge or mitigate commercial risk” requirement if such end user enters into a Qualifying Amendment, provided such amendment is entered into solely for the purpose of transitioning from an IRR to an alternative reference rate. Similarly, the DCR will not recommend enforcement action against an end user seeking to remain in compliance with the “hedge or mitigate commercial risk” requirement if such end user amends an underlying commercial agreement, provided such amendment is entered into solely for the purpose of (i) including new fallbacks to alternative reference rates triggered only by permanent discontinuation of an IRR or determination that an IRR is non-representative; or (ii) accommodating the replacement of an IRR.

Like the DSIO No-Action Relief, the DCR No-Action Relief extends to a greater range of eligible end users than the CFTC’s prior relief, adding small financial institutions with less than US\$10 billion in assets and certain entities addressed in a recent proposed CFTC rulemaking, namely certain community development corporations as well as bank holding companies and savings and loan holding companies with less than US\$10 billion in assets that have previously been excepted from the clearing requirement only under DCR guidance and no-action letters.

The DCR No-Action Relief also provides relief to eligible end users for certain related ongoing compliance monitoring requirements and allows continued reliance on prior representations made to their swap counterparties at the time such end users originally elected an exception or exemption from the clearing requirement, provided any Qualifying Amendment is made for the sole purpose of transitioning from an IRR to an alternative reference rate. Neither of these issues were addressed in the prior relief.

DMO No-Action Relief in Relation to Trade Execution Requirements

Section 2(h)(8) of the CEA requires swaps that are subject to a clearing requirement to be executed on a CFTC registered designated contract market (DCM) or swaps execution facility (SEF) or an exempt SEF unless no DCM or SEF “makes the swap available to trade” or the swap is subject to an applicable clearing exemption.

Pursuant to the DMO No-Action Relief, the DMO will not recommend enforcement action against any person for failure to comply with this mandatory trade execution requirement with respect to an IBOR-linked swap that is amended or created by an “IBOR Transition Mechanism” for the sole purpose of accommodating the replacement of the applicable IBOR with an RFR. The DMO No-Action Relief defines an IBOR Transition Mechanism to include:

- **Fallback Amendments.** This refers to amendments of IBOR-linked swaps to incorporate fallbacks to new RFRs that are triggered when the applicable IBOR is unavailable, permanently discontinued, or determined to be non-representative by the benchmark administrator or the relevant authority in a jurisdiction. This includes amendments achieved by protocol adherence.
- **Replacement Rate Amendments.** This refers to bilateral action by swap counterparties to amend IBOR-linked swaps in order to reference RFRs prior to the cessation of the relevant IBOR. A Replacement Rate Amendment includes a Qualifying Swaption Amendment or Qualifying CSA Amendment as those terms are used above.
- **New RFR Swaps.** This refers to the trading of new swaps that reference RFRs in order to transition swaps or swap portfolios away from an IBOR to a new RFR, such as when executing new swaps is more efficient than amending existing IBOR-linked swaps.

The DMO No-Action Relief is time limited and extends until December 31, 2021.

Conclusion

The revised no-action relief provides ongoing certainty for market participants in relation to the IBOR transition and incremental benefits beyond the CFTC's prior no-action positions, including to address follow-on amendments; recent actions by DCOs and CCPs; CSA amendments; the requirement to provide mid-market marks; an expanded range of end users using swaps only to hedge or mitigate commercial risk; and the reporting and monitoring obligations associated with the end user exceptions and exemptions.

Uncertainty remains as to the interplay between the CFTC's no-action positions regarding the end user clearing exceptions and exemptions and how those exceptions and exemptions are picked up by and incorporated in the uncleared swap margin requirements of the US prudential regulators. Effective August 31, 2020, the US prudential regulators adopted a final rule allowing legacy swaps to retain their legacy status under the uncleared swap margin requirements applicable to prudentially regulated SDs ([85 Fed. Reg. 39754](#)). In doing so, the US prudential regulators indicated that they would treat commercial and cooperative end user swaps as remaining exempt from the uncleared swap margin requirements if amended in line with the CFTC's prior relief. However, the US prudential regulators made clear in a footnote that this position was specific to the prior relief and that they were "not applying CFTC no-action letters to modify the terms of the [prudential regulators' uncleared swap margin requirements] in any other regard." As the revised no-action relief supersedes the prior relief in its entirety, it is again uncertain whether swaps amended in accordance with the CFTC's no-action positions will qualify for the end user exemption from the US prudential regulators' uncleared swap margin rules.

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Endnotes

¹ Press Release No. 8228-20, “CFTC Provides Additional Relief to Market Participants Transitioning from LIBOR” (Aug. 31, 2020), available at <https://www.cftc.gov/PressRoom/PressReleases/8228-20>.