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January 24, 2022

Mr. Christopher Kirkpatrick  
Secretary  
Commodity Futures Trading Commission  
Three Lafayette Centre  
1155 21st Street NW  
Washington, DC 20581

Re: *Swap Clearing Requirement to Account for the Transition From LIBOR and Other IBORs to Alternative Reference Rates (RIN 3038–AF18)*

Dear Mr. Kirkpatrick:

The Investment Company Institute<sup>1</sup> is submitting this letter in response to the request of the Commodity Futures Trading Commission (“Commission” or CFTC) for feedback on how the Commission could amend its swap clearing requirement<sup>2</sup> to address the cessation of certain interbank offered rates (IBORs) (*e.g.*, LIBOR) used as benchmark reference rates and the market adoption of alternative reference rates (*i.e.*, overnight, nearly risk-free reference rates (RFRs)). The Commission also seeks input on aspects of the Clearing Requirement that could be affected by the ongoing and anticipated transition from certain IBORs to those RFRs.<sup>3</sup>

Investment companies that are regulated under the Investment Company Act of 1940, including mutual funds, ETFs, and closed-end funds (collectively, “funds”) use swaps and other derivatives in a variety of ways. Derivatives, and in particular certain interest rate swaps subject to the Clearing Requirement, are useful portfolio management tools that offer funds flexibility in structuring investment portfolios. Uses of swaps and other derivatives include, for example, hedging positions, equitizing cash that a fund cannot immediately invest in direct equity holdings, managing a fund’s cash positions more generally, adjusting the duration of a

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<sup>1</sup> The Investment Company Institute (ICI) is the leading association representing regulated funds globally, including mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and similar funds offered to investors in jurisdictions worldwide. ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. ICI’s members manage total assets of \$32.3 trillion in the United States, serving more than 100 million US shareholders, and \$9.6 trillion in assets in other jurisdictions. ICI carries out its international work through ICI Global, with offices in Washington, DC, London, Brussels, and Hong Kong.

<sup>2</sup> See Commission Regulation 50.4, 17 C.F.R. 50.4 (“Clearing Requirement”).

<sup>3</sup> See Swap Clearing Requirement to Account for the Transition From LIBOR and Other IBORs to Alternative Reference Rates, 86 Fed. Reg. 66476 (Nov. 23, 2021), available at <https://www.cftc.gov/sites/default/files/2021/11/2021-25450a.pdf> (“Request for Comment”).

fund's portfolio, or managing a fund's portfolio in accordance with the investment objectives stated in a fund's prospectus.

We support the Commission's initiation of a dialogue on the transition from LIBOR and other IBORs to RFRs, including a review of the classes of interest rate swaps currently subject to a Clearing Requirement. We appreciate the Commission's assurances that it is monitoring the market's transition to RFRs on an ongoing basis, including the effect on trading liquidity, clearing availability, and other factors with respect to the relevant swaps that are currently subject to the Clearing Requirement.<sup>4</sup>

We support voluntary clearing of swaps that reference certain RFRs and urge the Commission to allow the market for the relevant cleared swaps to continue to develop organically and autonomously, without prematurely being driven by a Clearing Requirement, reflecting the increasing adoption of RFRs across the financial markets. Swaps referencing RFRs should only be subject to the Clearing Requirement once the market for such swaps is sufficiently developed, both from a liquidity and operational perspective.

In particular, we believe that it is premature for the Commission to extend the Clearing Requirement to new swaps referencing RFRs unless and until:

- more data is available to demonstrate significant notional volume and trading liquidity in new swaps referencing RFRs;
- market participants, including futures commission merchants (FCMs), funds, and their managers, have an opportunity to develop the operational and technological infrastructure to support clearing of new swaps referencing RFRs; and
- there is a sufficient level of voluntary clearing of new swaps referencing RFRs to support a Clearing Requirement.

If the Commission does apply the Clearing Requirement to swaps referencing RFRs, we request that the Commission provide sufficient time for industry review of any proposed Clearing Requirement, as well as a sufficiently long implementation period for any Clearing Requirement the Commission adopts to avoid market disruptions.

Furthermore, to the extent the Commission issues updated Clearing Requirements for new swaps referencing RFRs, it is critical that the Commission respect the separate and distinct nature of the mandatory clearing and trade execution requirements. A "made available to trade" (MAT) determination should not automatically follow a Clearing Requirement for a new swap referencing an RFR, and the two requirements should not be conflated to the detriment of market participants.

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<sup>4</sup> See Request for Comment at 66478.

**I. It is Premature to Apply the Clearing Requirement to Swaps Referencing RFRs**

ICI and its members generally support the regulatory objectives of the Clearing Requirement, which include reducing systemic risk, protecting taxpayers through the reduction of counterparty credit risk, and providing an organized mechanism for collateralizing the risk exposures posed by swaps.<sup>5</sup> However, we believe that it is premature for the Commission to impose the Clearing Requirement on any new swaps referencing RFRs unless and until:

***1. More data is available to demonstrate significant notional volume and trading liquidity in new swaps referencing RFRs.*** The Request for Comment cites limited data regarding (1) derivatives clearing organizations' (DCOs') clearing of certain swaps referencing RFRs, and (2) shifts in trading liquidity and outstanding notional derivatives positions from cleared swaps that reference LIBOR to those that reference RFRs.<sup>6</sup> This limited data reflects that DCOs have only recently begun to transition their product offerings and suggests that markets are still developing for trading in cleared swaps referencing RFRs.<sup>7</sup> Although trading volumes of these swaps are increasing, the Commission notes that additional data is needed from DCOs.<sup>8</sup>

In the absence of additional data and Commission analysis to determine whether there is sufficient outstanding notional exposure and trading liquidity in new swaps referencing RFRs to support a Clearing Requirement, it is premature for the Commission to take action with respect to the Clearing Requirement.<sup>9</sup> We expect that more data will be available in the coming months

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<sup>5</sup> See, e.g., Clearing Requirement Determination under Section 2(h) of the CEA, Final Rule, 77 Fed. Reg. 74284 (Dec. 13, 2012) ("Initial Clearing Determination"), at 74285.

<sup>6</sup> See Request for Comment at 66484 and 66485. The Commission also notes limited growth in the SOFR-based derivatives markets and observes that the share of outstanding SOFR derivatives remained small compared with USD LIBOR derivatives. See *id.* at 66480 (citing Financial Stability Board, Progress report to the G20 on LIBOR Transition Issues, July 6, 2021, at 8-10); Request for Comment at 66485-6.

<sup>7</sup> See *id.* at 66484. In contrast, at the time that the Commission proposed the initial clearing requirement in 2012 for certain classes of interest rate swaps, LCH and CME had been clearing interest rate swaps since 1999 and 2010, respectively. See Clearing Requirement Determination under Section 2(h) of the CEA, Proposed Rule, 77 Fed. Reg. 47170 (Aug. 7, 2012), at 47187.

<sup>8</sup> See Request for Comment at 66487 (requesting for "swaps that reference one of the alternative reference rates including, GBP SONIA, JPY TONA, CHF SARON, ESTR, and USD SOFR in each of the fixed-to-floating swap, basis swap, [forward rate agreement (FRA)], and [overnight index swap (OIS)] classes, data from the quarter ending September 30, 2021 concerning: (A) The amount of notional cleared, including as a percentage of total notional cleared of all swaps; (B) total notional outstanding, including as a percentage of total notional outstanding; and (C) total number of clearing members clearing such swaps, including as a percentage of the total population of clearing members.").

<sup>9</sup> We also agree with the UK regulators that because most USD LIBOR tenors will not cease until June 2023, it is premature to make changes now with respect to mandatory clearing of swaps referencing USD LIBOR. The Bank of England has indicated that it expects to consult on such changes in 2022 and in its September 29, 2021 Policy Statement referenced coordinating with the Commission on changes to the UK and US clearing obligations. See Derivatives clearing obligation – modifications to reflect the interest rate benchmark reform: Amendments to BTS 2015/2205 (Sept. 29, 2021), available at <https://www.bankofengland.co.uk/paper/2021/derivatives-clearing-obligation-modifications-to-reflect-interest-rate-benchmark-reform>. We support the Commission's coordination with global regulators, including with respect to the transition to RFRs, but appreciate that the Commission must

following the cessation of various LIBORs at the end of 2021, the CFTC’s Market Risk Advisory Committee’s “SOFR First” initiative, and ongoing transition to RFRs.

**2. Market participants, including FCMs, funds, and their managers, have the necessary opportunity to develop the operational and technological infrastructure to support clearing of new swaps referencing RFRs.** In determining whether to impose a Clearing Requirement, we urge the Commission to consider the operational readiness of market participants, in addition to DCOs and their clearing members, to clear any new swaps referencing RFRs.

Applying the Clearing Requirement to such new swaps will raise a number of operational issues that industry participants, in addition to DCOs and FCMs, will need to consider and address. Before funds, their managers, and other market participants are prepared to trade in new swaps referencing RFRs subject to a Clearing Requirement, they may need to address the following issues, among others:

- put in place appropriate affirmation and matching systems and other middle office infrastructure relating to any new categories of swaps subject to the Clearing Requirement;
- consider any unique tax and accounting issues swaps that reference RFRs may raise, including potential enhancements to booking and valuation systems; and
- make any necessary changes to systems to confirm margin and payment obligations with respect to these new swaps. Funds also may need to analyze whether such swaps create different economic exposures than the swaps they are intended to replace (*e.g.*, presenting different portfolio duration risk or discounting risk).

**3. There is a sufficient level of voluntary clearing of new swaps referencing RFRs to support a Clearing Requirement.** We believe that it is unnecessary at this time to impose a Clearing Requirement on new swaps that reference RFRs, given the growing levels of voluntary clearing of such swaps. We note, for example, that the “SOFR First” initiative has already led to improved liquidity and trading conditions for impacted SOFR-based US dollar interest rate derivatives, and may cause market participants to move voluntarily to trading in such products.<sup>10</sup> The Request for Comment also provides support for this view, noting that:

As regulators and market participants in different jurisdictions work to identify alternative reference rates, the Commission anticipates that the interest rate swaps markets will evolve to incorporate those rates, with the goal of shifting all activity to the alternative reference rates before the relevant IBOR is discontinued. The Commission believes this process can occur organically, driven by market demand and DCO offerings.<sup>11</sup>

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make an independent data-driven determination regarding application of the Clearing Requirement to new swaps that reference RFRs.

<sup>10</sup> See CFTC, MRAC Subcommittee on Interest Rate Benchmark Reform, “SOFR First” User Guide for Exchange-Traded Derivatives Transactions at 2, available at <https://www.cftc.gov/media/6816/SOFRFIRSTUSERGUIDE/download>.

<sup>11</sup> See Request for Comment at 66480.

Allowing voluntary clearing volumes to grow further would be beneficial in several important respects. First, DCOs would have an opportunity to refine or increase their product offerings and market participants would be able work through the related operational issues identified above. Second, the Commission could obtain additional data to assess whether significant notional volume and trading liquidity in these swaps exist to support a Clearing Requirement in the future. Third, the Commission would have an opportunity to identify any other issues arising from the transition process, including potential barriers to clearing access, and address them as needed prior to adopting a Clearing Requirement.

## **II. Provide Sufficient Time for Public Comment and Industry Implementation of Any Clearing Requirement**

It is critical that the Commission incorporate into any proposed Clearing Requirement sufficient time for public review and comment and provide a sufficiently long implementation period for any Clearing Requirement the Commission adopts.

The Commission should provide a comment period for public feedback on a proposed Clearing Requirement for new swaps referencing RFRs that is longer than the minimum 30-day period required under Sections 2(h)(2)(A) and (B) and Regulation 39.5. We recommend that the Commission provide a comment period of no less than 90 days. This time period is necessary to provide market participants with the time necessary to gather the market data that is necessary to inform a proposed Clearing Requirement by the Commission.<sup>12</sup>

If the Commission adopts a Clearing Requirement for new swaps that reference RFRs, it must provide adequate time for market participants to address the operational, documentation, and compliance considerations that may be raised by the Clearing Requirement.

## **III. Adoption of a Clearing Requirement Does Not Mean a MAT Determination is Appropriate**

If the Commission determines that certain categories of swaps referencing RFRs should be subject to a Clearing Requirement, it is critical that the Commission not assume those swaps should therefore also be “made available to trade” and subject to the trade execution requirement. As we have emphasized previously,<sup>13</sup> different considerations underlie the mandatory clearing and trading determinations, especially regarding trading liquidity. A swap should not automatically be subject to a MAT determination simply because it has become subject to mandatory clearing. A MAT determination for any swap subject to the Clearing Requirement has significant implications for market participants because the relevant swap can

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<sup>12</sup> In determining whether to adopt a Clearing Requirement, the Commission is required to consider factors including trading liquidity, pricing data, capacity, operational expertise and resources, the effect on the mitigation of systemic risk, and other information that may be relevant to the Commission’s determination with respect to a specific swap. *See* CEA Section 2(h)(2)(D)(ii).

<sup>13</sup> *See* Letter to Mr. Christopher Kirkpatrick, Secretary, CFTC, from David W. Blass, General Counsel, ICI, dated Aug. 17, 2015, available at <https://www.ici.org/pdf/29262.pdf>; Letter to Mr. David A. Stawick, Secretary, CFTC, from Karrie McMillan, General Counsel, ICI, dated Feb. 13, 2012, available at <https://www.ici.org/pdf/25910.pdf>.

only be traded on a designated contract market (DCM) or swap execution facility (SEF) via prescribed execution methods.

Given the important distinction between the Clearing Requirement and the MAT determination processes, it is critical that the Commission carefully review any future MAT filings for swaps that reference RFRs that are submitted subsequent to the adoption of a Clearing Requirement. Reflecting the differences between the Clearing Requirement and the trading execution requirement, the factors with respect to the currently applicable MAT determination process under Commission Regulations 37.10(b) and 38.12(b) focus almost exclusively on those elements that contribute to overall trading liquidity.<sup>14</sup> We support the Commission's ongoing consideration of how to improve the MAT process<sup>15</sup> and believe the MAT determination process should capture only that subset of cleared swaps that is the most liquid.

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ICI appreciates the opportunity to respond to the Request for Comment. If you have any questions or would like to discuss our recommendations, please feel free to contact Sarah Bessin at (202) 326-5835 or Bridget Farrell at (202) 672-4098.

Sincerely,

/s/ Sarah A. Bessin

Sarah A. Bessin  
Associate General Counsel

cc: The Honorable Rostin Behnam, Chair  
The Honorable Dawn DeBerry Stump, Commissioner

Sarah E. Josephson, Deputy Director, Division of Clearing and Risk  
Melissa D'Arcy, Special Counsel, Division of Clearing and Risk  
Daniel O'Connell, Special Counsel, Division of Clearing and Risk  
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<sup>14</sup> These rules provide that, to make a swap available to trade, for purposes of section 2(h)(8) of the Act, a SEF or DCM shall consider, as appropriate, the following factors with respect to such swap: (1) whether there are ready and willing buyers and sellers; (2) the frequency or size of transactions; (3) the trading volume; (4) the number and types of market participants; (5) the bid/ask spread; or (6) the usual number of resting firm or indicative bids and offers.

<sup>15</sup> See *CFTC Fall 2021 Regulatory Agenda, Amendment to the Made Available to Trade Process*, RIN 3038-AF13 (stating that the Commission will "[p]ropose amendments to the Made Available to Trade (MAT) process to determine swaps that have made available to trade and therefore subject to the trade execution requirement"). See also *Swap Execution Facilities and Trade Execution Requirement*, RIN 3038-AE25, Proposed rule; withdrawal (Dec. 8, 2020); and *Recommendations Regarding the "Made Available to Trade" (MAT) Process*, Report of the Market Structure Subcommittee, Market Risk Advisory Committee of the U.S. Commodity Futures Trading Commission (Feb. 23, 2021), available at <https://www.cftc.gov/About/AdvisoryCommittees/MRAC>.