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24 January 2022

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

RE: 17 CFR Part 50, RIN 3038-AF18, 86 Fed.Reg. 66476 (11/23/21)
Request for Information re Swap Clearing Requirements To Account for Transition From LIBOR and Other IBORs to Alternative Reference Rates

Dear Mr. Kirkpatrick,

The American Council of Life Insurers (ACLI) greatly appreciates the opportunity to share its views on the captioned request for information and comment (the "Request"). The ACLI is the leading trade association driving public policy and advocacy on behalf of the life insurance industry. 90 million American families rely on the life insurance industry for financial protection and retirement security. ACLI's member companies are dedicated to protecting consumers' financial wellbeing through life insurance, annuities, retirement plans, long-term care insurance, disability income insurance, reinsurance, and dental, vision and other supplemental benefits. ACLI's 280 member companies represent 94 percent of industry assets in the United States.

The ACLI contributes frequently to regulatory proposals and requests for information relating to life insurer use of swaps and derivatives. Life insurers are significant end-users of derivatives that enable the prudent management of asset and liability risks, as permitted under state insurance codes and regulations.[1] The long-term nature of the industry's life and retirement products requires insurers to match long-term obligations with assets of a longer duration than most other financial institutions, leading to directional portfolios of long-dated interest rate swaps.

We share the Commission's commitment to safe, robust derivatives markets and to a smooth transition from certain interbank offered rates (IBORs) to alternative rates. For the reasons laid out more fully below, we believe that the best course of action to preserve both is to:

1. remove IBOR-referencing derivative trades from the clearing requirement, based on declining liquidity in those products and in concert with the actions of global regulators;
2. delay adding new products to the clearing requirement until sufficient liquidity has been achieved through voluntary clearing of those products;

[1] The National Association of Insurance Commissioners' (NAIC) *Derivatives Instruments Model Regulation*:

- Limits derivative transactions to hedging (with limited exceptions) and for prudent uses;
- Requires effectiveness testing to monitor uses over time;
- Requires internal control procedures;
- Establishes counterparty exposure limits and credit quality standards;
- Establishes documentation and trading requirements;
- Achieves transparency through statutory reporting (Schedule DB).

3. if and when clearing requirements are considered, focus on the most liquid and common trade conventions (such as the Secured Overnight Financing Rate – Overnight Index Rate (SOFR OIS), also known as compound-in-arrears SOFR);
4. provide an opportunity to comment on any specific clearing requirement proposals that the Commission may present in the future, and provide amble implementation time prior to an effective date; and
5. consider the systemic risk management benefits of initial margin rules on uncleared swaps, including the phase 5 implementation on September 1, 2021, and upcoming phase 6 implementation on September 1, 2022.

We urge the Commission to consider any expansion of the clearing requirement in the broader context of a marketplace in which large participants are already subject to uncleared swap margin rules that have transformed the systemic risk profile of the bilateral derivatives market, and which provide ample incentives to clear standardized products outside of any clearing requirement.

Swaps Subject to the Clearing Requirement

Declining Liquidity in IBOR Swaps

The Commission's clearing requirement was enacted in 2012 and expanded in 2016, after significant investigation into the five statutory factors for clearing requirement determinations (77 FR 74284, 74294). In both rulemakings, the Commission engaged in a data-driven process, carefully considering such factors as trading liquidity, operational expertise and credit support infrastructure for the product, and the effect on mitigating systemic risk. Chief among those factors is trading liquidity. We urge the Commission to consider removing interest rate swaps based on IBORs from the clearing requirement as the liquidity in those product categories wanes.

The Request notes that global regulators are making significant efforts to ease the market transition away from certain IBORs and toward rates calculated under a more robust methodology. Notably, prudential regulators including the Board of Governors of the Federal Reserve System have issued Supervisory Guidance[2] exhorting their regulated entities to cease issuing instruments that reference USD-LIBOR after December 31, 2021. The Supervisory Guidance lists a narrow range of exceptions. With this guidance firmly in place, we expect liquidity in IBOR-referencing swaps to decrease rapidly to a level that no longer justifies their inclusion in the clearing requirement. With declining liquidity inevitable, the Commission should move swiftly to remove interest rate swaps referencing IBORs from its clearing requirement.

[2] Joint Statement on Managing the LIBOR Transition, October 20, 2021 (https://www.fdic.gov/news/financial-institution-letters/2021/fil21070.html).

Global Regulators Removing IBOR Swaps From Clearing Requirements

Global regulators have begun adjusting their clearing requirements in the wake of declining liquidity in several interest rate swap categories. As noted in the Request, the Bank of England and the European Securities and Markets Authority (ESMA) engaged in public consultations on amending their respective clearing requirements to remove the requirement to clear swaps referencing certain IBORs. Since the Request was announced, ESMA has issued its Final Report on Draft RTS on the Clearing and Derivative Trading Obligations in View of the Benchmark Transition to Risk Free Rates, which includes a recommendation to remove classes of swaps referencing EONIA (EUR) and LIBOR (GBP, JPY and USD) from its clearing obligation. We encourage the Commission similarly to remove classes of swaps referencing IBORs – including USD-LIBOR - from the clearing requirement. Changes to the clearing requirement should also be reflected in the trade execution requirement.

Swaps Not Currently Subject to the Clearing Requirement

The Commission should take a cautious and measured approach as it considers adding new products to its clearing requirement, particularly with respect to reference rates replacing USD-LIBOR. Alternatives to USD-LIBOR, including the secured overnight financing rate (SOFR) are relatively new to the marketplace and market participants require time to reach a consensus on which rates they view as most attractive substitutes for LIBOR and to develop standardized conventions around trades referencing those rates.

Emerging Liquidity

While uptake of interest rate derivatives referencing IBOR alternatives is rising, the increase varies significantly across currencies. For example, GBP-LIBOR alternatives and JPY-LIBOR alternatives have climbed significantly as a percentage of the Dollar Value of a Basis Point (DV01) per currency traded as an alternative reference rate, while alternatives to USD-LIBOR have continued to make up a far smaller percentage.[3] This pattern is evident in the data presented in the Request (on page 66486): *i.e.,* across each of the weekly data points presented in the tables, both (i) the notional value of swaps traded and (ii) the trade count of swaps reported show a higher number for alternative rates compared with IBORs denominated in GBP, CHF, and JPY. At the same time, for USD swaps reported, SOFR-based swaps significantly lag swaps referencing USD-LIBOR in both notional value and trade count. We expect that more recent data will show a significant increase in both market volume and trade count for the most liquid SOFR-based swap products. We suggest that any clearing requirement for SOFR-based swaps should be delayed until liquidity builds to at least 70% or greater of U.S. market volumes.

We also do not believe that SOFR-LIBOR basis swaps should be added to the clearing requirement due to low liquidity and limitations on electronic execution. We expect SOFR-LIBOR basis swaps to require bilateral OTC treatment for their limited and dwindling use cases.

[3] *See* ISDA-Clarus RFR Adoption Indicator: Charts and Data at (https://rfr.clarusft.com/)

Growing Consensus on Rates and Conventions

At least as important as the necessity of increased trading volume, the market in USD-denominated interest rate derivatives has not reached a stable consensus on either rate options or standard conventions for instruments referencing USD-LIBOR alternatives. The rate most-commonly suggested as an alternative to USD-LIBOR is the secured overnight financing rate (SOFR). SOFR is a fairly new rate and is only beginning to be used for many classes of investment in the cash markets. Those markets have yet to coalesce around a single SOFR-based rate, with compounded in-arrears rates (Daily Simple SOFR and Term SOFR) all in use. Likewise, conventions for calculating interest rate swaps based on those rates are also still forming. This contrasts with the development of interest rate swaps referencing SONIA – the alternative reference rate that is largely replacing GBP-LIBOR; SONIA is a long-established benchmark with more established trading conventions. At this point, we believe OIS SOFR-based swaps have the most standardized conventions and the most developed market liquidity, but even that class of swaps has lower liquidity for longer tenors. For instance, ESMA's clearing requirement has focused only on SOFR OIS swaps up to 3 years, to start. For these reasons, we encourage the Commission to allow ample time for the market to coalesce around standard rates and conventions before considering the addition of interest rate swaps based on SOFR to the clearing requirement.

Additions to the Clearing Requirement Should Follow a Significant Increase in Voluntary Clearing

The lack of a clearing mandate does not mean that products based on alternative rates will not be eligible to clear; rather there are reasons to believe market participants will seek out cleared swaps in the most liquid and standardized instruments while market liquidity and standardized conventions solidify. Allowing voluntary clearing volumes to increase outside of an expanded clearing requirement will provide an important opportunity for market participants to work through operational challenges surrounding use of non-IBOR rates. These may include technical issues around trading infrastructure or margining and payment systems but may also include tax and accounting issues arising from the use of novel rates. Allowing for a significant period of voluntary clearing will allow the Commission to gather additional data around best practices to allow for a smoother transition if the Commission ultimately decides to expand the clearing requirement.

Non-SOFR Rates

Each of the concerns we raise with respect to the liquidity and standardization of interest rate swaps based on SOFR are amplified when considering non-SOFR based alternatives to USD-LIBOR, such as Ameribor and the Bloomberg Short-Term Bank Yield Index (BSBY).

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Timing

Finally, if the Commission determines that the clearing requirement should be expanded, the Commission should provide an opportunity for comment on the particular parameters of the additional classes of products to be included. To ensure a smooth implementation of any expanded clearing requirement, a minimum of six months should be provided between the adoption of an expanded clearing requirement and the effective date of the requirement, to give market participants time to ready systems and processes.

The Clearing Requirement in the Context of Uncleared Swap Margin

The Commission's original clearing requirement was enacted before the prudential regulators' and the Commission's uncleared margin rules were finalized. The Commission explicitly stated that its clearing requirement was considered "in light of existing market practice" at that time (81 FR 71202 at 71219). In its 2016 expansion of the clearing requirement, the Commission noted that "[g]oing forward, the requirement to margin uncleared swaps in certain circumstances will mitigate the accumulation of risk between counterparties in a manner similar to that of central clearing." *(Id.)*

The uncleared swaps market has undergone monumental change since the Commission last considered its clearing requirement. Market participants with notional swap exposures exceeding the Material Swap Exposure threshold for Phase 5 of the uncleared swap margin rules are currently required to post and collect initial margin on their uncleared swaps. Entities in scope for Phase 6 of the uncleared margin rules will almost certainly face the same requirement before any new clearing requirements take effect. The uncleared swap trades of many ACLI member companies are already subject to these margin rules and many others will be in scope for initial margin on uncleared swaps by September 1, 2022.

We encourage the Commission to consider whether the marginal risk mitigation benefits of an expanded clearing requirement outweigh the costs of compliance in light of this substantial increase in uncleared swap margin.[4] We also note that – even without a clearing requirement in place – the uncleared swap margin rules provide a powerful incentive for market participants to clear trades in the most liquid and standardized products: a market participant subject to the uncleared swap margin rules must post initial margin sufficient to cover a 99% risk horizon calculated over a 10-day period, while the same entity would post initial margin sufficient to cover a 5-day risk period for a cleared transaction. In addition, cleared swaps do not count toward a financial entity's average aggregate notional amount, which means that a market participant near the material swap exposure threshold for the uncleared margin rules could use cleared swaps instead of uncleared swaps to avoid being in scope for uncleared swap margin requirements altogether. In this environment, the necessity of a clearing requirement for liquid swaps is

[4] As the ACLI has noted in previous commentary on the clearing requirement, the need to post cash collateral to clearinghouses forces life insurers to liquidate higher yielding securities for cash, resulting in higher hedging costs for products that may ultimately be borne by consumers. In addition, the directional nature of life insurer portfolios do not afford them the netting benefits experienced by dealers and other financial end-users. *See* ACLI Input in Response to CFTC Project KISS-Clearing Issues (September 26, 2017).

significantly lessened. If the Commission determines that an expanded clearing requirement is warranted despite the risk mitigating effects of the uncleared swap margin rules, the operation of those rules should dampen the urgency for adding new products to the clearing requirement while the market coalesces around conventions for interest rate swaps referencing alternative reference rates and while liquidity in those reference rates builds.

Thank you for your consideration.

Sincerely,

THE AMERICAN COUNCIL OF LIFE INSURERS

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