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CFTC DIVISIONS RELEASE NO-ACTION RELIEF RELATED TO LIBOR TRANSITION: SUMMARY AND ANALYSIS

To Our Clients and Friends:

On December 18, 2019, the staffs of the Division of Swap Dealer and Intermediary Oversight ("**DSIO**"),[1] the Division of Market Oversight ("**DMO**")[2], and the Division of Clearing and Risk ("**DCR**")[3] of the Commodity Futures Trading Commission ("**CFTC**") each released no-action letters (collectively, the "**CFTC Letters**") that provide relief to market participants in connection with the industry-wide initiative to transition swaps that reference the London Interbank Offered Rate ("**LIBOR**") and other interbank offered rates ("**IBORs**") to swaps that reference alternative risk-free reference rates.[4]

The CFTC Letters respond to a request by the Alternative Reference Rates Committee ("**ARRC**")[5] on behalf of its members subject to certain CFTC regulations to address issues that will result from amendments made by market participants to their swap documentation to either (i) include fallback language to address what will happen when LIBOR or another IBOR ceases to exist (or is deemed to be non-representative by the benchmark administrator or relevant authority in a jurisdiction) ("**Fallback Amendment**") or (ii) convert LIBOR and other IBOR-linked uncleared swaps to an alternative reference rate, like SOFR, prior to the cessation of such IBORs ("**Replacement Rate Amendment**").[6] The amendments to swap documentation would likely be viewed as material amendments that would trigger the same requirements as "new" swaps, meaning that each swap may trigger uncleared margin, clearing, business conduct and other requirements and should be analyzed accordingly. The ARRC sought clarification and relief from such requirements so that market participants could make such amendments without facing costly and onerous requirements applied to their existing swaps.

The CFTC Letters provide helpful relief to swap market participants with respect to the LIBOR transition in connection with several areas, including the swap dealer de minimis exception, uncleared swap margin, swap dealer business conduct standards, swap trading relationship documentation, portfolio reconciliation, confirmations, eligible contract participants ("**ECPs**"), the end-user clearing exception, clearing and trade execution requirements; however, the relief in the CFTC Letters does not cover certain requirements (e.g., there is no relief for reporting requirements),[7] and there are some areas of uncertainty that remain and are likely to impact certain swap market participants.

In this alert we discuss, for the relief granted in each of the CFTC Letters, the issue, no-action relief position, as well as the impacts and remaining areas of concern and uncertainty that may require further consideration and analysis.

I. DSIO Letter

A. Scope of Relief

The DSIO Letter applies to the amendment of uncleared swaps that reference USD LIBOR, another IBOR or other reference rates that are phased-out or become impaired[8] (collectively, "**Impaired Reference Rates**" or "**IRRs**"). DSIO notes that defining IRRs in this manner will permit a market participant to make 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."[9] The amendments may be achieved by (i) adherence to a protocol issued by the International Swaps and Derivatives Association ("**ISDA**"), (ii) contractual amendment between counterparties or (iii) execution of new contracts in replacement of and immediately upon termination of existing contract(s) (*i.e.*, "contract tear-ups").

DSIO limits the scope of relief to amendments of legacy uncleared swaps that reference an IRR solely to "(i) include new fallbacks to alternative reference rates triggered only by permanent discontinuation of an IRR or determination that an IRR is non-representative by the benchmark administrator or the relevant authority in a jurisdiction; or (ii) accommodate the replacement of an IRR" (each, a "**Qualifying Amendment**"); however, a Qualifying Amendment does not include any amendment that (i) extends the maximum maturity of a swap or portfolio of swaps, or (ii) increases the total effective notional amount of a swap or the aggregate total effective notional amount of a portfolio of swaps.[10] DSIO recognizes that Qualifying Amendments may require a number of ancillary changes to existing trade terms to conform to different market conventions used for the alternative reference rate (e.g., reset dates, fixed/floating leg payment dates, day count fractions, etc.).

B. No-Action Positions, Potential Concerns and Other Considerations

1) *Swap Dealer De Minimis Calculation*

Issue: Entities that actively manage their swap dealing activities to stay below the swap dealer de minimis threshold of $8 billion may be reluctant to transition away from IRRs voluntarily and early if amendments and modifications made to accommodate either a Fallback Amendment or a Reference Rate Amendment will need to be included in the calculation.

No-action position: DSIO provides no-action relief to any person that excludes a swap from the swap dealer de minimis calculation that references an IRR solely to the extent that such swap would be included as a consequence of a Qualifying Amendment.[11]

Potential concerns and other considerations: Non-swap dealers that engage in swap dealing activities will need to (i) rely on the no-action relief provided in the DSIO Letter in order to preclude such swaps from being counted and (ii) modify their swap dealer de minimis calculation methodology accordingly to account for this subset of swaps that will not be counted.

2) *CFTC Uncleared Swap Margin Requirements*

Issue: Uncleared swaps entered into prior to the relevant compliance date of the CFTC Margin Rule (set forth in CFTC regulation 23.161) ("**CFTC Margin Rule Legacy Swaps**") are not subject to the provisions of the CFTC Margin Rule. However, if a CFTC Margin Rule Legacy Swap is amended after the compliance date applicable to a swap dealer and its counterparty, it would cause such CFTC Margin Rule Legacy Swaps to be brought into compliance with the CFTC Margin Rule which would likely have a materially adverse effect to the parties of the swap.

No-action position: DSIO provides no-action relief to swap dealers for a failure to comply with the CFTC Margin Rule[12] solely to the extent such compliance would be required as a consequence of a Qualifying Amendment CFTC Margin Rule Legacy Swaps. Additionally, DSIO provided no-action relief for those swap dealers that use basis swaps to accomplish the necessary transition rather than amending individual swaps.[13]

Potential concerns and other considerations: As discussed above, this no-action position regarding uncleared swaps is necessary because amendments to CFTC Margin Rule Legacy Swaps after the relevant compliance date would cause such swaps to be brought into scope for purposes of compliance with the CFTC Margin Rule. Further, it aims to be consistent with the Prudential Regulators' Proposed LIBOR Amendments.

3) *Swap Dealer Business Conduct Requirements*

Issue: Swap dealers are subject to numerous business conduct standards when dealing with their counterparties ("**Counterparty BCS**").[14] To the extent that a swap dealer's existing swap is amended as a result of a Fallback Amendment or a Reference Rate Amendment, it would be treated as if it were a new swap and therefore the swap dealer would need to comply with all Counterparty BCS for that swap.[15]

No-action position: DSIO provides no-action relief to swap dealers for a failure to comply with the Counterparty BCS (other than requirements to disclose material information concerning risks and characteristics of a swap pursuant to CFTC regulation 23.431(a)) solely to the extent such compliance would be required as a consequence of a Qualifying Amendment to an uncleared swap.

Potential concerns and other considerations:

Risk Disclosures and Provision of Material Information: DSIO makes clear that there is no relief provided with respect to CFTC Regulation 23.431(a) and that swap dealers must provide material information concerning risks and characteristics of a swap to their counterparties "at a reasonably sufficient time prior to entering into the swap."[16] In this regard, DSIO notes that pursuant to the IRR transition, counterparties to swap dealers will be moving from familiar reference rates to newly created alternative reference rates. Accordingly, DSIO explains that swap dealers "should be required to provide material information about such new rates in order for counterparties to better understand what they are stepping into."[17]

As a result, questions arise relating to what swap dealers should include in such disclosures to their counterparties and the timing of such disclosures (e.g., the determination of "reasonably sufficient time"). With respect to the timing, any such disclosures would likely need to occur in advance of the swap dealer agreeing to a Fallback Amendment or Reference Rate Amendment with a counterparty, including adhering to a multilateral protocol (e.g., an ISDA protocol).

ECP Status: The DSIO Letter provides relief from a swap dealer's obligation under CFTC regulation 23.430 to verify a counterparty's ECP status. However, pursuant to Commodity Exchange Act ("**CEA**") Section 2(e) it is unlawful for "any person … to enter into a swap" (other than a swap entered into on a designated contract market) that is not an ECP. None of the CFTC Letters provide any relief from this requirement under CEA Section 2(e) and, as a result, there would be a potential violation of CEA Section 2(e) for the counterparty and increased contractual risk in the event that a counterparty that was an ECP when a swap was originally entered into, is no longer an ECP when a Fallback Amendment or Replacement Rate Amendment occurs.[18]

4) *Swap Confirmation Requirements*

Issue: Swap dealers are required to confirm amendments to swaps within certain timeframes; however, it is expected that most market participants will adhere to a multilateral protocol (e.g., an ISDA protocol) which enables multiple swaps to be legally amended and confirmed simultaneously. However, there is uncertainty under CFTC regulation as to whether a swap dealer would need to issue new confirmations that are amended via such multilateral protocol.

No-action position: DSIO provides no-action relief to swap dealers for a failure to comply with the CFTC's confirmation requirements under CFTC regulation 23.501 provided that the Qualifying Amendment is accomplished pursuant to a multilateral protocol (i.e., not a bilateral amendment between counterparties) and solely to the extent that such compliance would be required as a result of a Qualifying Amendment to an uncleared swap.

Potential concerns and other considerations:

Limited to amendment by multilateral protocol: DSIO makes clear that relief from the confirmation requirements is only available to a swap dealer's uncleared swaps that are amended pursuant to a multilateral protocol. Accordingly, swap dealers will need to ensure that any bilateral amendment for a Fallback Amendment or a Reference Rate Amendment with a counterparty satisfies the requirements of CFTC regulation 23.501.

5) *Swap Trading Relationship Documentation ("STRD")*

Issue: CFTC regulation 23.504(a)(2) requires that swap dealers enter into STRD prior to entering into any "swap transaction" which includes amendments to uncleared swaps entered into prior to the date a swap dealer was required to be in compliance with the STRD rule ("**STRD Legacy Swaps**"). Accordingly, a Fallback Amendment or a Reference Rate Amendment would cause an STRD Legacy Swap to lose its status as such and would require a swap dealer to enter into documentation to comply with the STRD requirements.

No-action position: DSIO provides no-action relief to swap dealers for a failure to comply with the STRD requirements under CFTC regulation 23.504 solely to the extent such compliance would be required as a consequence of a Qualifying Amendment to STRD Legacy Swaps.

6) *Reconciliation*

Issue: The CFTC's portfolio reconciliation rules require swap dealers to resolve discrepancies of material terms of their swaps with other swap dealers "immediately"[19] and with non-swap dealer counterparties "in a timely fashion."[20] Since swap dealers and their counterparties may book Fallback Amendments and Reference Rate Amendments at different times and these timeframes may not be met during the transition, notwithstanding that the counterparties are engaging in reconciliation in good faith.

No-action position: DSIO provides no-action relief to swap dealers for a failure to comply with the discrepancy resolution timing requirements under CFTC regulations 23.502(a)(4) and (b)(4) solely to the extent such compliance would be required as a consequence of a Qualifying Amendment to an uncleared swap.

7) *End-User Exceptions and Exemptions from the CFTC Margin Rule*

Issue: Some end-user counterparties may question whether a swap still qualifies as an instrument "used to hedge or mitigate commercial risk as prescribed in [CFTC] regulations 50.50(c) and 50.51(b)(2)" in the event that the reference rate on the swap for which the exception or exemption is elected is different from the rate on the underlying loan, debt instrument or other agreement or commercial arrangement.[21] Because a Fallback Amendment or a Reference Rate Amendment would trigger "new" swap requirements, the swap would need to be analyzed for its qualification for the end-user exception at the time of such amendment. If a swap was determined not to be used for "hedging or mitigating commercial risk" in light of the rate mismatch with the underlying commercial arrangement, then it would not qualify for the end-user exception from clearing (in CFTC regulation 50.50) or for the exemption for cooperatives (in CFTC Regulation 50.51).

End-users that qualify for an exception from clearing will qualify for an exclusion from the CFTC Margin Rule pursuant to CFTC regulation 23.150(b). If an end-user no longer qualifies for an exception from clearing, then it would not be permitted to rely on this exclusion.[22]

The language defining "hedging or mitigating commercial risk" in the context of the end-user exception is broad and a swap that references a commercial arrangement with a different reference rate may still qualify under that definition; however, there may be situations where such qualification is uncertain.

No-action position: DSIO explains that to "alleviate any question" regarding whether one or more swaps will still qualify as instruments used to "hedge or mitigate commercial risk as prescribed in CFTC regulations 50.50(c) and 50.51(b)(2),"[23] it is providing relief for swap dealers for a failure to comply with the CFTC Margin Rule with respect to a swap entered into with an entity electing an exception or exemption pursuant to the requirements of CFTC regulations 50.50(c) or 50.51(b)(2), if the following three conditions are met:

(i) the swap is an uncleared swap referencing an IRR that qualified as a swap used to hedge or mitigate commercial risk pursuant to CFTC regulation 50.50(c) or 50.51(b)(2) at the time of execution;

(ii) compliance with the CFTC Margin Rule would be required solely as a consequence of a Qualifying Amendment to such swap, or, with respect to the commercial arrangement for which the swap qualified as a swap used to hedge or mitigate commercial risk, solely as a consequence of an amendment to such commercial arrangement solely for the purpose of: (a) including new fallbacks to alternative reference rates triggered only by permanent discontinuation of an IRR or determination that an IRR is non-representative by the benchmark administrator or the relevant authority in a jurisdiction; or (b) accommodating the replacement of an IRR; and

(iii) such swap or the commercial arrangement for which the swap qualified as a swap used to hedge or mitigate commercial risk is amended prior to December 31, 2021, such that the swap again qualifies as a swap used to hedge or mitigate commercial risk pursuant to CFTC regulation 50.50(c) or 50.51(b)(2).[24]

Potential concerns and other considerations:

Relief is Time-Limited: This end-user related relief is only available until December 31, 2021, however, given the uncertainty around the transition and fallback terms of underlying commercial arrangements (e.g., an end-user may have a commercial arrangement with fallback language that uses the last published rate), it is possible that relief may be needed after December 31, 2021.

Similar relief not provided by the Prudential Regulators: While DSIO is providing no-action relief to swap dealers with respect to compliance with the CFTC Margin Rule, the Prudential Regulators have not included such a provision in the Prudential Regulators' Proposed LIBOR Amendments or otherwise. Accordingly, there is question as to how the Prudential Regulators will view the available exclusion from the uncleared swap margin rules for swaps with end-users that qualify for the end-user exception from clearing and that are relying on no-action relief provided under the DSIO Letter and DCR Letter to continue to qualify for the end-user exception during the transition.

Financial entity status: While the relief addresses the impact of mismatches between an uncleared swap and an underlying commercial arrangement that may cause a swap to not be considered to "hedge or mitigate commercial risk," there is no relief granted in the event that a counterparty's financial entity status changes from a non-financial entity at the time the swap was originally entered into to a financial entity at the time of the Fallback Amendment or Reference Rate Amendment.[25] Without such relief, such legacy swaps may need to be cleared and may be subject to the CFTC Margin Rule when trading with swap dealers.

Captive finance and small bank exemptions: No relief is provided in a situation where a captive finance company no longer meets the 90/90 test under CEA Section 2(h)(7)(C)(iii) or where a small bank exceeds the $10 million threshold under CFTC regulation 50.50(d). Without such relief, the legacy swaps of such entities whose status changes may need to be cleared and be subject to the CFTC Margin Rule when trading with swap dealers.

8) *ECP Status*

Issue: Some individuals identify themselves as ECPs because the purposes of their swaps are "to manage the risk associated with an asset or liability owned or incurred or reasonably likely to be owned or incurred" by the individual in the conduct of the individual's business. In the event that a Fallback Amendment or a Reference Rate Amendment leads to a temporary mismatch, such individuals may question whether they continue to qualify as an ECP.

No-Action Position: DSIO explains that to "alleviate any question" it is providing no-action relief to any individual for failure to qualify as an ECP pursuant to CEA Section 1a(18)(A)(xi) which provides that an individual can qualify as an ECP based on a swap's purpose "to manage the risk associated with an asset or liability owned or incurred" by the individual in the conduct/operation of the individual's business, solely to the extent such status is relevant as a consequence of a Qualifying Amendment to an uncleared swap.[26]

Potential concerns and other considerations:

No relief for dollar thresholds of ECP provisions: There is no relief provided by DSIO or the other Divisions in the event that the individual cannot satisfy the dollar thresholds to qualify as an ECP at the time of a Qualifying Amendment. Accordingly, an individual whose amounts invested on a discretionary basis fall below the dollar thresholds in CEA Section 1a(18)(A)(xi) at the time of a Qualifying Amendment may not qualify as an ECP and may therefore be viewed to violate CEA Section 2(e).

No relief for entities: While DSIO provides relief for individuals from mismatches that may occur between the rates referenced in an "asset or liability owned or incurred" and the swaps used to hedge that the risk of such asset or liability, neither DSIO nor the other Divisions provide parallel relief for entities from CEA Section 1a(18)(A)(v)(III)(bb). Additionally, DSIO does not provide relief for entities that may fall below the dollar thresholds for entities in the ECP provisions. Accordingly, there may be some question for entities that had been relying on this section to qualify as an ECP at the time of a Qualifying Amendment.

9) *End-User Documentation*

Issue: Swap dealers must obtain documentation from an entity claiming the end-user exception or exemption so that the swap dealer has a reasonable basis to believe the counterparty is hedging or mitigating commercial risk. As a result of a Fallback Amendment or Reference Rate Amendment, a swap dealer may be required to obtain such documentation under CFTC regulation 23.505(a)(4).

No-action position: DSIO provides no-action relief to swap dealers for a failure to obtain documentation that an entity is "hedging or mitigating a commercial risk" (as required under CFTC regulation 23.505(a)(4)) from an entity for which it has previously obtained such documentation, solely to the extend such would be required as a consequence of a Qualifying Amendment to an uncleared swap.

Potential concerns and other considerations:

Other end-user exception documentation requirements: To the extent that a swap dealer has not obtained representations from its counterparty regarding its end-user status either through an annual filing, protocol or other representation, a Fallback Amendment or Reference Rate Amendment could trigger a requirement to once again obtain such information. For example, if there were legacy swaps entered into before clearing requirements became effective, a swap dealer would likely be required to obtain such information from a counterparty prior to entering into a Fallback Amendment or Reference Rate Amendment.

End-user exception election: Many swap dealers have received standing end-user exception elections from their end-user counterparties that indicate that for each swap for which the end-user exception is elected. However, for those swaps where there is not a standing end-user exception election in place and a counterparty would need to rely on the end-user exception, pursuant to CFTC regulation 23.505(a)(2), a swap dealer may need to ensure that the counterparty elects not to clear the amended swap prior to the occurrence of a Fallback Amendment or Reference Rate Amendment.

II. DCR Letter

A. Scope

The DCR Letter applies to uncleared swaps that would have been subject to the interest rate swap ("**IRS**") clearing requirement under CEA Section 2(h)(1)(A) and CFTC regulation 50.4(a) but for the fact that such swaps were entered prior to the date on which the counterparties were required to begin complying with the relevant IRS clearing requirement ("**Uncleared Legacy IRS**"),[27] that are amended as a result of an amendment of fallback provisions (or addition of contractual terms)[28] "to modify the process for selecting the new floating rate term of an IRS that is not available because the rate is unavailable, permanently discontinued, or determined to be non-representative by the benchmark administrator or the relevant authority in a particular jurisdiction" (a "**IRS Fallback Amendment**").[29] The relief in the DCR letter would not be available if the IRS Fallback Amendment (i) extends the maximum maturity of an Uncleared Legacy IRS; or (ii) increases the total effective notional amount of an Uncleared Legacy IRS. The relief granted under the DCR Letter would permit such IRS Fallback Amendments to be achieved through a multilateral protocol or through bilateral amendment.

The DCR Letter is limited with respect to Uncleared Legacy IRSs to which it is applicable by specifying the LIBOR rates and risk-free fallback rates to which it applies. In particular, the DCR Letter would permit the following rates and fallback rates that may serve as replacement for the floating LIBOR rates or rates using LIBOR for input:

Currency and IBOR Floating Rate	**Permissible Risk-Free Reference Fallback Rate**
GBP LIBOR	SONIA
CHF LIBOR	SARON

JPY LIBOR	TONA
USD LIBOR	SOFR
SGD SOR - VWAP	SORA

The DCR Letter does not apply to swaps that have been voluntarily submitted for clearing and does not apply if the original counterparties to the Uncleared Legacy IRS change. The relief under the DCR Letter is also time-limited and will expire on December 31, 2021.

B. No-Action Positions, Potential Concerns and Other Considerations

(1) *Uncleared Legacy Swaps*

Issue: The execution of an IRS Fallback Amendment to an Uncleared Legacy IRS would cause the counterparties to treat such amendment as a "new" swap and would trigger an analysis to determine whether the swap is required to be cleared or subject to an exception.

No-action position: Until December 31, 2021, DCR provides no-action relief for any person that fails to comply with the swap clearing requirements of CEA Section 2(h)(1)(A) and CFTC regulation 50.2 with respect to an Uncleared Legacy IRS that references: USD LIBOR, JPY LIBOR, GBP LIBOR, CHF LIBOR or SGD SOR and is amended by adding a Fallback Amendment for the sole purpose of changing the existing floating rate to: SOFR, TONA, SONIA, SARON or SORA, respectively, in the event that the existing floating rate is unavailable, permanently discontinued or has been determined to be non-representative by the benchmark administrator or relevant authority in a jurisdiction.

Further, persons wishing to take advantage of this relief must satisfy the all of the following conditions:

i. The swap meets the definition of the term "Uncleared Legacy Swaps"[30] as described in the DCR Letter and is not required to be cleared under CEA Section 2(h)(1)(A) and Part 50 of the CFTC's regulations because it was entered into before an applicable compliance date and has not been voluntarily submitted for clearing to a derivatives clearing organization; and

ii. Each amended "Uncleared Legacy Swap" must:

   a. Have the same counterparties as the original swap that is amended;

   b. Have the same maximum maturity as the original swap that is amended; and

   c. Be amended for the sole purpose of changing the floating rate fallback provisions.[31]

Potential concerns and other considerations:

Scope of risk-free reference fallback rates is limited: The DCR Letter only contemplates the fallback to explicit permissible risk-free reference rates (e.g., for USD LIBOR only SOFR is contemplated). Additional relief will need to be sought from DCR in the event that counterparties wish to switch to another risk-free rate.

Relief is Time-Limited: This relief is only available until December 31, 2021, however, given the uncertainty around the transition and fallback terms, relief may be needed after that date.

(2) *Relief regarding the end-user exception and exemptions*

Issue: This relief coincides with the relief provided for end-users under the DSIO Letter and described in detail in Section I(B)(7) above. Some end-users may question whether a temporary mismatch between the floating rates referenced in commercial arrangements and the rates referenced in their swaps could cause the swaps to not qualify as hedging or mitigating commercial risk and therefore potentially cause the swaps to not qualify for the end-user exception or exemption from clearing.

No-action position: Until December 31, 2021, DCR provides no-action relief for an entity that qualifies for an exception or exemption under CFTC regulations 50.50(c) or 50.51(b)(2) for a failure to clear a swap pursuant to CFTC regulation 50.2 if:

(i) Such swap is an uncleared swap that references a floating rate that qualified as a swap to hedge or mitigate commercial risk as defined in CFTC regulation 50.50(c);

(ii) One or more of the following occurs: (a) such swap or relevant commercial agreement is amended by execution of a Fallback Amendment (or similar contractual provision in a commercial agreement); or (b) an existing fallback provision in a commercial agreement is activated because the floating rate is unavailable, permanently discontinued, or has been determined to be non-representative by the benchmark administrator or the relevant authority in a jurisdiction; or (c) a commercial agreement is amended for the sole purpose of changing the existing floating rate to an applicable risk-free rate; and

(iii) Prior to December 31, 2021, the commercial arrangement documentation and/or the uncleared swap documentation is amended such that the uncleared swap again qualifies as a swap used to hedge or mitigate the commercial risk of such entity pursuant to CFTC regulation 50.50(c) or 50.51(b)(2).[32]

Potential concerns and other considerations:

Please see the discussion in Section I(B)(7) above as those issues and concerns are relevant in the context of the relief provided under the DCR Letter.

In addition, the DCR Letter explains that "[w]ith regard to the last condition, DCR notes that because both commercial end-users and cooperatives are subject to an ongoing obligations [sic] under CFTC regulations to maintain eligibility to elect an exception or exemption from the clearing requirement, such entities should plan to amend the reference rate provisions in both swap documentation and commercial

documentation so that the rates referenced are aligned again as soon as practical, but no later than December 31, 2021."[33] This intent of this statement is unclear given that (i) end-users do not have an ongoing obligation with respect to a swap since eligibility for an exception or exemption from clearing is determined at execution and (ii) DCR is specifically referencing the "last condition" which only discusses the "hedge or mitigate commercial risk" requirement under CFTC regulation 50.50(c) and 50.51(b)(2).

III. DMO Letter

A. Scope

The DMO Letter applies to all swaps that are amended by a Fallback Amendment or a Replacement Rate Amendment or that are created to transition swaps or swap portfolios from IBOR to a new risk-free rate ("**New RFR Swaps**"). However, there are some limitations on the risk-free rates that can be included in the amended or new swaps (described below). Notably, the DMO Letter does not place a restrictions on the use of a Fallback Amendment or Replacement Rate Amendment relating to changes to the maturity or notional amount in the same manner as the DSIO Letter and the DCR Letter. The relief under the DMO Letter is also time-limited and will expire on December 31, 2021

B. No-Action Positions, Potential Concerns and Other Considerations

Issue: Swaps that are (i) subject to the mandatory clearing requirement and (ii) made available to trade on a swap execution facility ("**SEF**"), exempt SEF or designated contract market ("**DCM**"), must be executed on a SEF, exempt SEF or DCM and must be executed pursuant to the CFTC's regulations regarding SEFs or DCMs.

No-action position: Until December 31, 2021, DMO provides no-action relief to any person for failure to comply with the trade execution requirement under CEA Section 2(h)(8) (i.e., the trade execution requirement), with respect to an IBOR-linked swap that is a New RFR Swap or is amended by a Fallback Amendment or Replacement Rate Amendment, for the sole purpose of accommodating the replacement (including ancillary changes) of the applicable IBOR with a risk-free rate that has been identified by a national level committee or working group in response to the Financial Stability Board's Official Sector Steering Group's report and recommendation that central banks and supervisory authorities should work together with market participants to identify and implement risk-free rates.[34]

Potential concerns and other considerations:

Relief is Time-Limited: This relief is only available until December 31, 2021, however, given the uncertainty around the transition and fallback terms, relief may be needed after that date. This relief will work in tandem with the relief in the DCR Letter.

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[1] CFTC Letter No. 19-26, DSIO, "No-Action Positions to Facilitate an Orderly Transition of Swaps from Inter-Bank Offered Rates to Alternative Benchmarks" (Dec. 17, 2019) ("**DSIO Letter**").

[2] CFTC Letter No. 19-27, DMO, "Staff No-Action Relief from the Trade Execution Requirement to Facilitate an Orderly Transition from Inter-Bank Offered Rates to Alternative Risk-Free Rate" (Dec. 17, 2019) ("**DMO Letter**").

[3] CFTC Letter No. 19-28, DCR, "Staff No-Action Relief from the Swap Clearing Requirement for Amendments to Legacy Uncleared Swaps to Facilitate Orderly Transition from Inter-Bank Offered Rates to Alternative Risk-Free Rates" (Dec. 17, 2019) ("**DCR Letter**").

[4] In July 2017, the U.K. Financial Conduct Authority ("**FCA**"), which regulates the ICE Benchmark Administration Limited, the administrator of ICE LIBOR, announced that it would only seek commitments from banks to continue to contribute to LIBOR through the end of 2021, but that the FCA would not compel or persuade contributions beyond such date. *See* The Future of LIBOR, Speech by Andrew Bailey, Chief Executive of the UK FCA (July 27, 2017), available at https://www.fca.org.uk/news/speeches/the-future-of-libor.

[5] The ARRC is a group of diverse private market participants convened and run by the Board of Governors of the Federal Reserve System and the Federal Reserve Bank of New York to help ensure successful transition from U.S. dollar ("**USD**") LIBOR to the recommended alternative Secured Overnight Financing Rate ("**SOFR**"). More information about the ARRC is available here: https://www.newyorkfed.org/arrc.

[6] The CFTC staff's no-action relief follows proposed regulations and guidance issued by the U.S. Department of Treasury ("**Treasury**") regarding tax consequences. Gibson Dunn's Client Alert regarding Treasury's proposal is available here: https://www.gibsondunn.com/treasury-releases-guidance-on-transition-from-libor-to-other-reference-rates/. Additionally, the prudential regulators have proposed rules to provide relief from uncleared swap margin rules related to LIBOR cessation. *See* Margin and Capital Requirements for Covered Swap Entities, 84 Fed. Reg. 59,970 (Nov. 7, 2019) ("**Prudential Regulators' Proposed LIBOR Amendments**"). The DSIO Letter aims to harmonize with the relief with respect to uncleared swap margin requirements provided in the Prudential Regulators' Proposed LIBOR Amendments.

[7] The CFTC Letters do not provide relief from reporting requirements under Parts 43 or 45 of the CFTC's regulations.

[8] The relief in the DSIO Letter also applies to other IRRs in addition to IBORs which include "conversions away from (i) any other interest rate that the parties to a swap reasonably expect to be discontinued or reasonably determines has lost its relevance as a reliable benchmark due to a significant impairment; or (ii) any other reference rate that succeeds any of the foregoing (the IBORs and any other rate meeting either of the foregoing criterion …." DSIO Letter at 3-4.

[9] DSIO Letter at 4.

[10] DSIO Letter at 8. These limitations are aimed at harmonizing with the Prudential Regulators' Proposed LIBOR Amendments.

[11] DSIO Letter at 9-10.

[12] *See* Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 Fed. Reg. 636 (Jan. 6, 2016) (the "**CFTC Margin Rule**"). The CFTC Margin Rule is codified in CFTC regulations 23.151-159 and 23.161. See 17 CFR §§ 23.150-159, 161.

[13] With respect to basis swaps, DSIO will not recommend the CFTC take an enforcement action against a swap dealer for failure to comply with the CFTC Margin Rule with respect to a basis swap that: (1) references only one or more CFTC Margin Rule Legacy Swaps; (2) is entered into solely to achieve substantially the same effect as would be obtained by an amendment to the referenced CFTC Margin Rule Legacy Swap(s) to accommodate the replacement of an IRR; and (3) does not have the effect of extending the maximum maturity or increasing the aggregate total effective notional amount of the CFTC Margin Rule Legacy Swaps that are referenced. DSIO Letter at 12.

[14] *See* 17 CFR §§ 23.400 through 23.451, § 23.701. *See also*, Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 Fed. Reg. 9734 (Feb. 17, 2012).

[15] These existing swaps may be swaps that were entered into by a swap dealer before the Counterparty BCS rules were effective or after they were effective.

[16] DSIO Letter at 14.

[17] DSIO Letter at 14.

[18] Swap dealers should also consider if there may be any regulatory risk for "aiding and abetting" a counterparty that is no longer an ECP, particularly in the event that the swap dealer knew or should have known that such counterparty was no longer an ECP.

[19] CFTC regulation 23.502(a)(4).

[20] CFTC regulation 23.502(b)(4).

[21] DSIO Letter at 17.

[22] We note that many end-users that are eligible for an exception or exemption from clearing would likely not be considered "financial end users" as defined in CFTC regulation 23.151 and therefore would not be subject to the CFTC Margin Rules in any event.

[23] DSIO Letter at 17-18. The use of the phrase "[t]o alleviate any question in this regard" by DSIO (and also by DCR in the DCR Letter) suggests that end-users may determine that the swap still qualifies as hedging or mitigating commercial risk under CFTC regulation 50.50(c) in which case they would not need to rely on this no-action relief.

[24] DSIO Letter at 17-18. While this relief in the DSIO Letter is only available for swap dealers from the requirements under CFTC regulation 23.151, comparable relief is provided for end-users with respect to the requirements of CFTC regulations 50.50(c) and 50.5(b)(2) in the DCR Letter.

[25] For example, financial entity status could change because an entity's registration status changes or because they become predominantly involved in activities that are financial in nature pursuant to CEA Section 2(h)(7)(C)(i)(VIII).

[26] DSIO Letter at 19.

[27] *See* 2012 IRS Clearing Requirement, 77 Fed. Reg. 74284 (Dec. 13, 2012). Swap dealers, major swap participants and active funds were required to comply beginning on March 11, 2013, while all other financial entities were required to clear beginning on June 10, 2013, except for accounts managed by third-party investment managers, as well as ERISA pension plans, which required to begin clearing on September 9, 2013.

[28] The amendment to contractual terms is limited solely to situations where the underlying swap documentation is not based on the 2006 ISDA Definitions, which contains fallback provisions.

[29] DCR Letter at 4-5.

[30] The DCR Letter states that "Uncleared Legacy Swaps" "refer to uncleared swaps that would have been subject to the IRS clearing requirement under CFTC regulation 50.4(a), but for the fact that such swaps were entered into before the application of the 2012 clearing requirement as set forth under CFTC regulation 50.5[] and relevant implementation phasing dates." DCR Letter at 8. However DCR does not specifically define the term "Uncleared Legacy Swaps," yet it does define the term "Uncleared Legacy IRS" as "swaps that were executed prior to the compliance date on which swap counterparties were required to begin centrally clearing interest rate swaps (IRS) pursuant to the CFTC's swap clearing requirement and thus were not required to be cleared and have not been cleared." DCR Letter at 1.

[31] DCR Letter at 11-12.

[32] DCR Letter at 13.

[33] *Id.*

[34] DMO Letter at 6.

The following Gibson Dunn lawyers assisted in preparing this client update: Jeffrey Steiner and Erica Cushing.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please contact the Gibson Dunn lawyer with whom you usually work in the firm's Financial Institutions and Derivatives practice groups, or any of the following:

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