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June 30, 2022

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

Re: *Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps to account for the Transition from LIBOR and Other IBORs to Alternative Reference Rates (RIN 3038–AF18)*

Dear Mr. Kirkpatrick:

The Investment Company Institute<sup>1</sup> appreciates the opportunity to comment on the proposed amendments (“Proposal”) by the Commodity Futures Trading Commission (“Commission” or CFTC) to its swap clearing requirement<sup>2</sup> to reflect the cessation of LIBOR and certain other IBORs and the transition to alternative reference rates (*i.e.*, overnight, nearly risk-free reference rates (RFRs)).<sup>3</sup>

We generally support the Proposal, which would amend the Clearing Requirement to remove all swaps referencing LIBOR and EONIA and add certain corresponding swaps referencing RFRs to the overnight interest rate swap (OIS) class. However, we urge the Commission in mandating clearing for these swaps to continue to respect the separate and distinct nature of its Clearing Requirement and its mandatory trade execution requirement, which could apply, by virtue of a “made available to trade” (MAT) determination, to those swaps mandated to be cleared.

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<sup>1</sup> The [Investment Company Institute](https://www.ici.org) (ICI) is the leading association representing regulated investment funds. ICI’s mission is to strengthen the foundation of the asset management industry for the ultimate benefit of the long-term individual investor. Its members include mutual funds, exchange-traded funds (ETFs), closed-end funds, and unit investment trusts (UITs) in the United States, and UCITS and similar funds offered to investors in Europe, Asia and other jurisdictions. Its members manage total assets of \$29.7 trillion in the United States, serving more than 100 million investors, and an additional \$9.3 trillion in assets outside the United States. ICI has offices in Washington, DC, Brussels, London, and Hong Kong and carries out its international work through [ICI Global](https://www.ici.org/global).

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

<sup>3</sup> *Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps to Account for the Transition from LIBOR and Other IBORs to Alternative Reference Rates*, 87 Fed. Reg. 32898 (May 31, 2022), available at <https://www.cftc.gov/sites/default/files/2022/05/2022-10490a.pdf> (“Proposing Release”).

Specifically, if the Commission adopts a Clearing Requirement for certain categories of swaps referencing RFRs, the Commission should not approve or allow certification of a subsequent MAT determination following a Clearing Requirement for a new swap referencing an RFR solely on the basis of the swap being subject to the Clearing Requirement. Making a MAT determination on that basis would inappropriately conflate the Clearing Requirement and the trade execution requirement to the detriment of market participants. It is critically important that the Commission make an independent assessment of whether it is appropriate for a cleared swap to be subject to the trade execution requirement. Ensuring a separate and independent MAT process is especially important with respect to the longer-dated swaps proposed to be cleared under the Proposal (*i.e.*, those with tenors up to 30-50 years), which are characterized by lower levels of liquidity.

We support the Commission's ongoing consideration of how to improve the MAT process<sup>4</sup> and believe that any MAT determination process with respect to swaps referencing RFRs should capture only that subset of cleared swaps that is the most liquid.

## **I. Introduction and Background**

The Proposal would amend Commission Regulation 50.4(a) to account for the transition from LIBOR and other IBORs to RFRs as follows:

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

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<sup>4</sup> See *CFTC Spring 2022 Regulatory Agenda, Amendment to the Made Available to Trade Process*, RIN 3038-AF13 (stating that the Commission, by September 2022, 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>.

- Change the maximum stated termination date range for swaps denominated in GBP that reference SONIA as a floating rate index in the OIS class to 50 years, for a new stated termination date range of 7 days to 50 years.
- **Effective July 1, 2023:**
  - Remove swaps denominated in USD that reference LIBOR as a floating rate index from each of the fixed-to-floating swap, basis swap, and FRA classes.
  - Remove swaps denominated in SGD that reference SOR-VWAP as a floating rate index from the fixed-to-floating swap class.

The Proposal follows the Commission’s 2021 request for information (RFI) on swap clearing and LIBOR transition.<sup>5</sup> ICI’s response to the RFI supported voluntary clearing of swaps that reference certain RFRs and urged the Commission to allow the market for the relevant cleared swaps to continue to develop organically and autonomously before imposing a clearing mandate.<sup>6</sup> Since its issuance of the RFI, however, the Commission has identified market data showing a significant increase in voluntary clearing of notional amounts transacted in the RFR OIS swaps subject to the Proposal.<sup>7</sup> Accordingly, we are not commenting on the proposed modifications to the Clearing Requirement under the Proposal.

## **II. A MAT Determination Should Not Automatically Follow the Adoption of a Clearing Requirement**

If the Commission adopts a Clearing Requirement for certain categories of swaps referencing RFRs, the Commission should not approve or allow certification of a subsequent MAT determination following a Clearing Requirement for a new swap referencing an RFR solely on the basis of the swap being subject to the Clearing Requirement. It is critically important that the Commission make an independent assessment of whether it is appropriate for a cleared

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<sup>5</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>.

<sup>6</sup> See Letter to Mr. Christopher Kirkpatrick, Secretary, Commodity Futures Trading Commission, from Sarah A. Bessin, Associate General Counsel, Investment Company Institute, dated Jan. 24, 2022, available at <https://comments.cftc.gov/PublicComments/ViewComment.aspx?id=65918&SearchText=> (“ICI Letter on RFI”). In that letter, ICI recommended that the Commission not extend the Clearing Requirement to new swaps referencing RFRs unless and until: (i) more data is available to demonstrate significant notional volume and trading liquidity in new swaps referencing RFRs; (ii) 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 (iii) there is a sufficient level of voluntary clearing of new swaps referencing RFRs to support a Clearing Requirement.

We recommended 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 disruption. We also urged the Commission to not allow a MAT determination to automatically follow a Clearing Requirement for a new swap referencing an RFR, given the distinct purposes and considerations applicable to each mandate. We reiterate and expand upon these comments in this letter.

<sup>7</sup> See Proposing Release at Table 6. For OIS referencing each of USD SOFR, GBP SONIA, EUR €STR, CHF SARON, JPY TONA, and SGD SORA, the proportion of notional transacted each month from November 2021 through January 2022 that was cleared consistently approached 100%.

swap to be subject to the trade execution requirement. Ensuring a separate and independent MAT process is especially important with respect to the longer-dated swaps proposed to be cleared under the Proposal (*i.e.*, those with tenors up to 30-50 years), which are characterized by lower levels of liquidity.

### **A. Different Considerations and Purposes Underlie the Clearing Requirement and the Trade Execution Requirement**

As we have emphasized previously,<sup>8</sup> different considerations underlie the Clearing Requirement and the trade execution requirement, especially the importance of trading liquidity. Moreover, the requirements serve different purposes, as the Clearing Requirement is intended to reduce counterparty and systemic risk and the trade execution requirement is intended to increase pre-trade price transparency.<sup>9</sup> The Clearing Requirement's purpose is reflected in its broad scope of relevant factors, including liquidity.<sup>10</sup> In contrast to the Clearing Requirement, the applicable factors with respect to the 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>11</sup> Given that the Clearing Requirement requires consideration of more factors and weighs those factors differently than the factors relevant to a MAT determination, a conclusion that there is liquidity sufficient to support a Clearing Requirement does not necessarily mean that there is liquidity sufficient to support the trade execution requirement. Accordingly, making a MAT determination based solely on the adoption of a Clearing Requirement would inappropriately conflate the Clearing Requirement and the trade execution requirement. To allow

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<sup>8</sup> See ICI Letter on RFI; 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> ("ICI 2015 MAT Letter"); 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>.

<sup>9</sup> See S. REP. No. 111-176 (Apr. 30, 2010), at 33 ("With appropriate collateral and margin requirements, a central clearing organization can substantially reduce counterparty risk and provide an organized mechanism for clearing transactions. . . . While large losses are to be expected in derivatives trading, if those positions are fully margined there will be no loss to counterparties and the overall financial system . . ."); Section 5h(e) of the Commodity Exchange Act (CEA) ("The goal of [the swap trade execution requirement] is to promote pre-trade price transparency in the swaps market.").

<sup>10</sup> Section 2(h)(2)(D)(ii) of the CEA requires the Commission to consider five factors when making a clearing requirement determination: (1) the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data; (2) the availability of rule framework, capacity, operational expertise and resources, and credit support infrastructure to clear the contract on terms that are consistent with the material terms and trading conventions on which the contract is traded; (3) the effect on the mitigation of systemic risk, taking into account the size of the market for such contract and the resources of the DCOs available to clear the contract; (4) the effect on competition, including appropriate fees and charges applied to clearing; and (5) the existence of reasonable legal certainty in the event of the insolvency of the relevant DCO or one or more of its clearing members with regard to the treatment of customer and swap counterparty positions, funds, and property.

<sup>11</sup> Under Regulations 37.10(b) and 38.12(b), to make a swap available to trade, for purposes of section 2(h)(8) of the CEA, 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.

these requirements to properly serve their respective purposes, the Commission must keep the MAT process separate and independent from a related Clearing Requirement determination.

### **B. Conflating the Clearing Requirement and the Trade Execution Requirement Would Be Detrimental to Market Participants**

A MAT determination that is approved or deemed certified for a swap subject to the Clearing Requirement has significant implications for market participants because it would prohibit bilateral trading: the relevant swap must then be traded only on a designated contract market (DCM) or swap execution facility (SEF) via prescribed execution methods. The data cited by the Commission in the Proposal suggests that the liquidity transition for swaps referencing RFRs may be incomplete. For example, from November 2021 through January 2022, the notional amount transacted in USD SOFR OIS swaps averaged only 40% of the notional transacted in USD LIBOR fixed-to-floating swaps.<sup>12</sup> By forcing trading on a DCM or SEF, a MAT determination could result in inappropriate costs being incurred by market participants. Moreover, a premature MAT determination may drive market participants to other, potentially less efficient, swaps not subject to a mandatory trade execution requirement, and thereby decrease liquidity in those swaps subject to the MAT determination and potentially lower investor returns.

### **C. Longer-Tenor RFR OIS Currently Could Be Prematurely Subject to the Trade Execution Requirement**

The importance of maintaining a distinction between the Clearing Requirement and the MAT determination process is especially important with respect to certain of the longer-tenor swaps that would be subject to the Clearing Requirement under the Proposal. As described below, these swaps may not have sufficient liquidity to support the application of the trade execution requirement, but nonetheless could be prematurely subjected to a MAT determination as a consequence of the current MAT process.

#### **i. Lack of Liquidity for Certain Longer-Tenor RFR OIS**

The Proposal would add to the Clearing Requirement the following RFR OIS with tenors longer than 15 years:

- USD SOFR OIS up to 50 years;
- CHF SARON OIS up to 30 years;
- JPY TONA OIS up to 30 years; and
- GBP SONIA OIS to 50 years.

Based on the Commission's data set forth in the Proposal, trading in these longer-tenor swaps appears to be far less liquid than the corresponding shorter-tenor swaps, and is characterized by

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<sup>12</sup> See Proposing Release at Table 4. In the three-month period from November 2021 through January 2022, the estimated notional transacted (in USD billions) was \$8,313 in USD SOFR OIS and \$20,681 in USD LIBOR Fixed-to-Floating Swaps.

dramatically lower notional cleared volume and trade count.<sup>13</sup> By way of example, the following table derived from the Commission’s data illustrates the small fraction of cleared notional transacted in the tenors longer than 15 years relative to the total notional transacted in all tenors for the relevant swaps:

<b>Estimated Notional Transacted in January 2022</b>				
<b>Product</b>	<b>Maximum Tenor Under Proposal</b>	<b>Notional Cleared with &gt; 15-year Tenor<sup>14</sup></b>	<b>Total Notional Transacted (in billions)<sup>15</sup></b>	<b>Percentage Cleared with &gt; 15-year Tenor vs. Total Transacted</b>
USD SOFR OIS	50 years	234B	3,918B	5.97%
CHF SARON OIS	30 years	2B	130B	1.54%
JPY TONA OIS	30 years	36B	377B	9.55%
GBP SONIA OIS	50 years	124B	4,149B	2.99%

#### **ii. These Swaps May Be Vulnerable to Premature MAT Determinations**

We are particularly concerned that these longer-tenor swaps may be prematurely subject to the trade execution requirement because of the limitations inherent in the Commission’s current MAT process, which does not provide adequate protection against a premature MAT determination.<sup>16</sup>

This is not a hypothetical risk: the CFTC’s practical inability to modify or reject overly broad MAT determinations was highlighted by the original MAT determination. In October 2013, Javelin SEF, LLC (“Javelin”) became the first SEF to submit a proposed MAT determination to the Commission.<sup>17</sup> Instead of limiting the determination to the most standard and liquid benchmark tenors for interest rate swaps (such as 1 year, 5 years, 10 years), the original Javelin

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<sup>13</sup> See Proposing Release at Tables 7-9. For most of these swaps, the Commission provides data in the aggregate for tenors over 15 years. The Commission does provide more granular data for USD SOFR fixed-to-floating swaps. It would be helpful for this purpose, however, to understand the differences in liquidity for swaps within the 15-30/15-50 year tenor range for each class proposed to be subject to the Clearing Requirement.

<sup>14</sup> *Id.* at Table 7.

<sup>15</sup> *Id.* at Table 4.

<sup>16</sup> As we have observed previously, the Commission’s current MAT process is fundamentally flawed and in critical need of reform. It provides the Commission no meaningful role in determining which swaps will be subject to mandatory trading and turns over this process to SEFs and DCMs. The MAT process also does not adequately establish criteria to ensure that there is sufficient liquidity of the swap to trade on the SEF or DCM, or sufficient operational readiness of market participants to support mandatory trading in the swap. This process fails to protect adequately against the financial incentives of DCMs and SEFs to subject a swap to mandatory trading, even when there is insufficient liquidity to support mandatory trading in that swap. Furthermore, the process does not provide an adequate opportunity for public input. See ICI 2015 MAT Letter. For these reasons, we urge the Commission to promptly reform the MAT process.

<sup>17</sup> See Javelin Determination of Made Available to Trade of certain Interest Rate Swaps made Pursuant to Parts 37 of the Rules of the Commodity Futures Trading Commission, Submission No. 13-06 (Oct. 18, 2013), available at [http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/javelin\\_sef101813.pdf](http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/javelin_sef101813.pdf).

determination extended to interest rate swaps with tenors from one month to 51 years.<sup>18</sup> Javelin's proposed determination was widely viewed as overly broad.<sup>19</sup> If the Javelin determination had been adopted as initially submitted, it is possible that trading in a number of important swap instruments would have become subject to significantly impaired liquidity or would have otherwise ceased trading in the US swap market. Although Javelin ultimately narrowed its proposed MAT determination in response to extensive public criticism, the process highlighted the potential that an unworkable MAT determination easily could have been approved. We urge the Commission to not allow the same mistake to be made with respect to the longer-tenor swaps referenced above.

We support the Commission's ongoing efforts to improve the MAT process and believe that any MAT determination process with respect to swaps referencing RFRs should capture only that subset of cleared swaps that is the most liquid.

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<sup>18</sup> *Id.* at 4.

<sup>19</sup> Even Javelin itself recognized the excessive breadth of its proposed determination and amended its determination multiple times. Javelin conceded that the initial determination had raised significant operational and logistical readiness issues regarding the trading of certain swap products. See Press Release, *Javelin SEF Streamlines its Interest Rate Swap MAT Submission Citing Operational Readiness Concern* (Nov. 29, 2013), available at <https://www.prnewswire.com/news-releases/javelin-sef-streamlines-its-interest-rate-swap-mat-submission-citing-operational-readiness-concerns-233873811.html> (“[W]hat has become clear is that considerable operational hurdles remain as the market prepares for the swap trading mandate.”).

Mr. Christopher Kirkpatrick

June 30, 2022

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Thank you for the opportunity to comment on the Proposal. If you have any questions or would like to discuss our recommendations, please contact me at (202) 326-5835.

Sincerely,

/s/ Sarah A. Bessin

Sarah A. Bessin  
Associate General Counsel

cc: The Honorable Rostin Behnam, Chair  
The Honorable Kristin N. Johnson, Commissioner  
The Honorable Christy Goldsmith Romero, Commissioner  
The Honorable Summer K. Mersinger, Commissioner  
The Honorable Caroline D. Pham, Commissioner

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Commodity Futures Trading Commission