U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000

Market Participants
Division

Amanda L. Olear
Director

Re: Request for No-Action Position for Swap Dealers and Major Swap Participants Regarding the Obligation to Provide a Pre-Trade Mid-Market Mark for Certain Transactions Referencing the Secured Overnight Financing Rate

Ladies and Gentlemen:

This letter responds to a request ("**Request**") received by the Market Participants Division ("**MPD**") of the Commodity Futures Trading Commission ("**CFTC**" or "**Commission**") from the Alternative Reference Rates Committee's ("**ARRC**") regulatory working group subcommittee and its member firms ("**ARRC RWG**"), in which ARRC RWG requested that MPD provide a no-action position similar to that in CFTC Staff Letter 12-58[1] ("**Letter 12-58**") for registered swap dealers and major swap participants ("**Swap Entities**") that enter into certain overnight index swaps ("**OIS**") referencing the Secured Overnight Financing Rate ("**SOFR**") without disclosing a pre-trade mid-market mark ("**PTMMM**") to the counterparty of the transaction as required under § 23.431(a)(3)(i),[2] as further described below.[3]

I. Background

A. Regulatory Background

Section 4s(h)(3)(B) of the Commodity Exchange Act ("**CEA**")[4] directs the Commission to adopt business conduct standards for Swap Entities that:

[1] *See* CFTC Staff Letter 12-58 (Dec. 18, 2012), Re: Request for Relief Regarding Obligation to Provide Pre-Trade Mid-Market Mark for Certain Credit Default Swaps and Interest Rate Swaps, *available at https://www.cftc.gov/LawRegulation/CFTCStaffLetters/letters.htm*. All other CFTC staff letters referenced in this letter are also available on the Commission's website.

[2] 17 CFR 23.431(a)(3)(i).

[3] MPD understands that the ARRC and ARRC RWG dissolved after making the Request, however, ARRC RWG's representatives have informed the Commission that the former members wish to continue with the request.

[4] 7 U.S.C. § 6s(h)(3)(B).

> require disclosure by the swap dealer or major swap participant to any counterparty to the transaction (other than a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant) of –
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> * * *
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> > (iii) (I) for cleared swaps, upon the request of the counterparty, receipt of the daily mark of the transaction from the appropriate derivatives clearing organization; and (II) for uncleared swaps, receipt of the daily mark of the transaction from the swap dealer or the major swap participant.[5]

On February 17, 2012, the Commission published final rules prescribing certain business conduct standards for Swap Entities,[6] which included § 23.431.[7] In relevant part, § 23.431 reads as follows:

> At a reasonably sufficient time prior to entering into a swap, a swap dealer or major swap participant shall disclose to any counterparty to the swap (other than a swap dealer, major swap participant, security-based swap dealer, or major security-based swap participant) material information concerning the swap in a manner reasonably designed to allow the counterparty to assess . . . [t]he material incentives and conflicts of interest that the swap dealer or major swap participant may have in connection with a particular swap, which shall include: (i) [w]ith respect to disclosure of the price of the swap, the price of the swap and the mid-market mark of the swap as set forth in paragraph (d)(2) of this section…[8]

In describing the purpose of requiring Swap Entities to disclose the PTMMM, the Commission stated that "the spread between the quote and mid-market mark is relevant to disclosures regarding material incentives and provides the counterparty with pricing information that facilitates negotiations and balances historical information asymmetry regarding swap pricing."[9,10]

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[5] *Id*.

[6] *See* Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties, 77 FR 9734 (Feb. 17, 2012) ("**Final Business Conduct Standards**").

[7] 17 CFR 23.431. In the proposed business conduct standards rules, the Commission proposed § 23.431 to "provide specificity with respect to certain material information that must be disclosed" by Swap Entities. *Business Conduct Standards for Swap Dealers and Major Swap Participants with Counterparties*, 75 FR 80638, 80643 (proposed Dec. 22, 2010) ("**Proposed Business Conduct Standards**").

[8] Final Business Conduct Standards at 77 FR 9824.

[9] *Id*. at 9766.

[10] In the preamble to the proposed rule, the Commission noted that the "mid-market [mark] is a transparent measure that would assist counterparties in calculating valuations for their own internal risk management purposes," Proposed Business Conduct Standards at 75 FR 80646.

B. Letter 12-58

On December 18, 2012, the Commission's Division of Swap Dealer and Intermediary Oversight ("**DSIO**" and now, MPD) published Letter 12-58 in response to a request from the International Swaps and Derivatives Association, Inc. ("**ISDA**"). ISDA requested, and DSIO granted, a no-action position relating to the requirement under § 23.431(a)(3)(i)[11] to provide a PTMMM to certain counterparties for certain swaps, including interest rate swaps:

> (A) in the "fixed-for-floating swap class" (as such term is used in § 50.4(a)[12]) denominated in USD or EUR,
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> (B) for which the remaining term to the scheduled termination date is no more than 30 years, and
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> (C) that have the specifications set out in the § 50.4[13] ("**Covered Rates Derivative Transactions**").[14]

In support of its request, ISDA argued that Covered Rates Derivative Transactions are highly-liquid, exhibit narrow bid-ask spreads, and are widely quoted by Swap Entities in the marketplace.[15] ISDA further noted that in light of these and other factors, compliance with the PTMMM requirement does not provide any significant informational value and would require adding further operational capabilities that may add significant costs for Swap Entities while delaying trade times for their counterparties.[16]

C. Market Transition from LIBOR to SOFR

In response to significant concerns regarding the reliability and robustness of LIBOR and other interbank offered rates (collectively, "**IBORs**"), the Financial Stability Board ("**FSB**") called for the identification of alternative benchmarks to the IBORs and transition plans to support

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[11] 17 CFR 23.431(a)(3)(i).

[12] 17 CFR 50.4(a).

[13] 17 CFR 50.4.

[14] *See* Letter 12-58 at 3–5. Covered Rates Derivative Transactions included certain swaps referencing the London Interbank Offered Rate ("**LIBOR**").

[15] *Id.* at 3.

[16] *Id.*

implementation.[17,18] The U.S. Financial Stability Oversight Council ("**FSOC**") made repeated calls for member agencies to work closely with market participants to identify and mitigate risks that may arise during an IBOR transition process.[19]

In 2014, the Federal Reserve Bank of New York convened ARRC in order to identify best practices for U.S. alternative reference rates, identify best practices for contract robustness, develop an adoption plan, and create an implementation plan with metrics of success and a timeline. In June 2017, ARRC identified a broad Treasuries repo financing rate, SOFR, as the preferred alternative benchmark to U.S. Dollar LIBOR ("**USD LIBOR**") for certain new U.S. Dollar derivatives and other financial contracts.[20] It also published an updated "Paced Transition Plan" outlining the steps that ARRC, central counterparties, and other market participants would take in order to help build the liquidity required to support the issuance of, and transition to, contracts referencing SOFR.[21] In accordance with ARRC's Paced Transition Plan,[22] trading of SOFR-based derivatives and other financial contracts linked to alternative benchmarks commenced in 2018 and has since expanded in scope.[23] While USD LIBOR's use as an interest

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[17] *See generally* FSB Statement, *Interest rate benchmark reform: Overnight risk-free rates and term rates* (July 12, 2018), *available at https://www.fsb.org/2018/07/interest-rate-benchmark-reform-overnight-risk-free-rates-and-term-rates/*; *see* FSB Statement, *Reforming Major Interest Rate Benchmarks* (July 22, 2014), *available at https://www.fsb.org/wp-content/uploads/r_140722.pdf*; *see* International Organization of Securities Commissions ("**IOSCO**") Final Report, *Principles for Financial Benchmarks* (July 2013), *available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD415.pdf*.

[18] *See* FSB Statement, *Interest rate benchmark reform: Overnight risk-free rates and term rates*, at 1–2 ("Because derivatives represent a particularly large exposure to certain IBORs, and because these prospective [risk-free rate] RFR-derived term rates can only be robustly created if derivatives markets on the overnight RFRs are actively and predominantly used, the FSB believes that transition of most derivatives to the more robust overnight RFRs is important to ensuring financial stability.").

[19] *See e.g.*, FSOC Statement, *2018 Annual Report*, 4–5, 8–9, 108–109 (Dec. 19, 2018), *available at https://home.treasury.gov/system/files/261/FSOC2018AnnualReport.*pdf. *See* FSOC Statement, *2013 Annual Report*, 6, 14–15, 137, 140–142 (June 2013), *available at https://www.treasury.gov/initiatives/fsoc/Documents/FSOC%202013%20Annual%20Report.pdf* ("The uncertainty surrounding LIBOR's sustainability may threaten individual financial institutions and the U.S. financial system more broadly. Specifically, without advance preparation, a sudden cessation of such a heavily used reference rate could cause considerable disruptions to, and uncertainties around, the large flows of LIBOR-related payments. It could also impair the functioning of a variety of markets, including business and consumer lending …. The Council recommends that member agencies work closely with market participants to identify and mitigate risks from potential dislocations during the transition process.").

[20] *See* ARRC, Press Release (June 22, 2017), *available at https://www.newyorkfed.org/medialibrary/microsites/arrc/files/2017/ARRC-press-release-Jun-22-2017.pdf*.

[21] *See* ARRC, *Second Report* at 17–24 (March 5, 2018), *available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2018/ARRC-Second-report*.

[22] *See* ARRC, *2019 Incremental Objectives*, *available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/ARRC_2019_Incremental_Objectives.pdf*.

[23] *See e.g.*, ARRC, *SOFR: A Year in Review* (Apr. 2019), *available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2019/SOFR_Anniversary.pdf*. *See also* ISDA, *Interest Rate Benchmarks Review: Full Year 2018 and the Fourth Quarter of 2018* (Jan. 2019), *available at https://www.isda.org/a/xogME/Benchmarks-Full-Year-2018.pdf*.

rate derivatives benchmark has declined substantially,[24] SOFR has become the prevailing interest rate derivatives benchmark.[25]

II. Request for No-Action Letter

ARRC RWG submits that the rationale underlying Letter No. 12-58 and the no-action position provided to Swap Entities entering into Covered Rates Derivative Transactions is equally applicable to certain OIS which reference SOFR ("**SOFR OIS**"), and that relief from the PTMMM requirement should therefore be extended to such SOFR OIS. Specifically, ARRC RWG represents that the rationale underlying Letter 12-58—that the benefits of a PTMMM are minimal for liquid swaps with publicly-available price information, and that providing a PTMMM is costly and may adversely affect counterparties—is now true of these SOFR OIS and will be increasingly true in the wake of the transition to SOFR OIS. Therefore, ARRC RWG requests that a Swap Entity not be required to disclose a PTMMM in connection with interest rate swaps: (1) in the "overnight index swap class" (as such term is used in § 50.4(a)[26]) denominated in USD; (2) referencing the SOFR floating rate index; (3) for which the remaining term to the scheduled termination date is no more than 50 years; and (4) that have the specifications set out in § 50.4[27] ("**Covered SOFR OIS**").

In support of its request, ARRC RWG notes that the SOFR OIS market continues to serve as the prevailing benchmark of the interest rate swaps market[28] and is widely quoted by dealers on- and off-facility, with real-time tradable bid and offer prices made available electronically via trading facilities, including via multiple swap execution facilities. In addition, ARRC RWG states that the implementation and familiarity of market participants with part 43[29] real-time reporting requirements provides an additional source for readily available pricing data to market participants.[30] ARRC RWG also observes that the Commission itself has affirmed that SOFR OIS

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[24] In March 2021, the U.K. Financial Conduct Authority ("**FCA**") confirmed that certain IBOR settings would either cease to be provided by any administrator or would no longer be representative for the one-week and two-month USD LIBOR settings, immediately after December 31, 2021, and for all other USD LIBOR settings, immediately after June 30, 2023. *See* FCA Statement, *Announcement on Future Cessation and Loss of Representativeness of the LIBOR Benchmarks* (March 5, 2021), *available at https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf*.

[25] *See* Request at 5 and Appendix A for additional information evidencing the growth of SOFR's usage in swaps markets.

[26] 17 CFR 50.4(a).

[27] 17 CFR 50.4.

[28] *See* ARRC, *March 9 Meeting Readout* (March 9, 2023), *available at https://www.newyorkfed.org/medialibrary/Microsites/arrc/files/2023/ARRC-Readout-March-2023-Meeting.pdf* (finding that SOFR-linked interest rate swaps have consistently accounted for more than 85% of daily average risk traded in the interest rate swaps market since June 2022.).

[29] 17 CFR part 43.

[30] *See* 17 CFR 43.3(a)(2) and (3) (requiring that executed trades and pricing information, including the interest rate benchmark, *i.e.* the "spread" data element, be publicly available "as soon as technologically practicable" after

is highly traded, liquid, and produces or makes available accessible pricing data. Specifically, ARRC RWG notes that when the Commission extended swap clearing requirements to cover SOFR OIS,[31] the Commission considered and affirmed that SOFR OIS presents, in relevant part, "the existence of significant outstanding notional exposures, trading liquidity, and adequate pricing data."[32]

ARRC RWG notes that the Commission has supported the transition to SOFR in other actions. In particular, ARRC RWG notes that the Commission has implemented a series of no-action letters that eased the transition from LIBOR-referencing interest rate swaps to SOFR-referencing interest rate swaps.[33] These no-action letters have generally provided no-action positions for SOFR-referencing swaps related to uncleared margin and external business conduct standards,[34] trade execution,[35] clearing,[36] and trade reporting requirements.[37] A separate no-action position related to futures commission merchants' investment of customer funds "in permitted investments that contain an adjustable rate of interest that is benchmarked to SOFR"[38] was also issued.

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execution. Real-time reporting creates a publicly accessible and historical record of pricing data for SOFR OIS promptly after trade execution.).

[31] *See* 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 FR 52182 (Aug. 24, 2022) (modifying the Commission's interest rate swap clearing requirement by removing the requirement to clear interest rate swaps referencing LIBOR and other IBORs and replacing them with clearing mandates for interest rate swaps referencing overnight RFRs, including OIS referencing SOFR.).

[32] *See* section 2(h)(2)(D)(ii) of the CEA, 7 U.S.C. 2(h)(2)(D)(ii).

[33] *See e.g.*, CFTC Staff Letters 21-26 (Dec. 20, 2021), Re: Revised No-Action Positions to Facilitate an Orderly Transition of Swaps from Inter-Bank Offered Rates to Alternative Benchmarks; 21-27 (Dec. 20, 2021), Re: Extension of Certain Staff No-Action Relief from the Trade Execution Requirement to Facilitate an Orderly Transition from Inter-Bank Offered Rates to Alternative Risk-Free Rates; 21-28 (Dec. 20, 2021), Re: Revised Staff No-Action Relief from the Swap Clearing Requirement for Amendments to Legacy Uncleared Swaps to Facilitate an Orderly Transition from Inter-Bank Offered Rates to Alternative Risk-Free Rates; 21-30 (Dec. 22, 2021), Re: No-Action Position With Respect to Certain Requirements of Parts 43 and 45 for Registered Entities and Swap Counterparties Reporting Swap Data for LIBOR Swaps That Will Transition to Risk-Free Rates; and 22-21 (Dec. 31, 2022), Re: CFTC Regulation 1.25 – Investment of Customer Funds in Securities with an Adjustable Rate of Interest Benchmarked to the Secured Overnight Financing Rate – Extension of Time-Limited No-Action Position Concerning Investments by Futures Commission Merchants and No-Action Position Concerning Investments by Derivatives Clearing Organizations.

[34] See CFTC Staff Letter 21-26.

[35] *See* CFTC Staff Letter 21-27.

[36] *See* CFTC Staff Letter 21-28.

[37] *See* CFTC Staff Letter 21-30.

[38] *See* CFTC Staff Letter 21-02 (Jan. 4, 2021), Re: CFTC Regulation 1.25 – Investment of Customer Funds – Time-Limited No-Action Position for Investments in Securities with an Adjustable Rate of Interest Benchmarked to the Secured Overnight Financing Rate, *as extended by* CFTC Staff Letter 22-21.

III. MPD No-Action Position

After carefully considering the request, MPD believes that a no-action position is warranted in relation to the PTMMM requirement for Covered SOFR OIS. Accordingly, MPD will not recommend that the Commission take an enforcement action against a Swap Entity for its failure to disclose the PTMMM, as required by § 23.431(a)(3), to a counterparty in a Covered SOFR OIS, provided that: (1) real-time tradeable bid and offer prices for the Covered SOFR OIS are available electronically, in the marketplace, to the counterparty; and (2) the counterparty to the Covered SOFR OIS agrees in advance, in writing, that the Swap Entity need not disclose a PTMMM for the Covered SOFR OIS.

MPD is providing this no-action position based on, among other things, ARRC RWG's representations that Covered SOFR OIS benefit from a combination of high liquidity, narrow bid and offer spreads, and the existence of a significant amount of publicly available information with respect thereto. MPD will continue to monitor market data with respect to the liquidity of, bid and offer spreads for, and publicly available information on Covered SOFR OIS, and if the circumstances change, MPD may limit, impose additional or different conditions on, or revoke this no-action position. MPD notes that this no-action position is applicable only with respect to Covered SOFR OIS and does not apply to any obligations of a Swap Entity to disclose PTMMMs for contracts other than the Covered SOFR OIS or to any other Commission regulation, including, without limitation, the requirement to provide a daily mark pursuant to § 23.431(d).[39] However, MPD may consider extending this no-action position to other transactions, if sufficient data and other relevant information are submitted to MPD establishing the appropriateness of an extension.[40]

This letter, and the position taken herein, represent the views of MPD only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. This letter and the no-action position taken herein are not binding on the Commission.[41] Further, this letter, and the positions taken herein, are based upon the facts and circumstances presented to MPD staff. Any different, changed or omitted material facts or circumstances might render the position taken in this letter void. Finally, as with all staff letters, MPD retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the position taken herein, in its discretion.

Should you have any questions, please do not hesitate to contact Frank Fisanich, Chief Counsel, at (202) 418-5949; or Jacob Chachkin, Associate Chief Counsel, at (202) 418-5496.

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[39] 17 CFR 23.451(d).

[40] Any requests to extend this relief to other transactions should be submitted, along with data and other relevant information, in accordance with § 140.99, 17 CFR 140.99.

[41] *See* § 140.99(a)(2), 17 CFR 140.99(a)(2) ("A no-action letter binds only the issuing Division . . . and not the Commission or other Commission staff.").

Sincerely,

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Amanda L. Olear
Director
Market Participants Division

cc: Regina Thoele, Compliance
National Futures Association, Chicago