

TO: Clearing Member Firms  
Back Office Managers

DATE: September 14, 2021

FROM: CME Clearing

NOTICE #: 21-325

SUBJECT: **Modification and Withdrawal of Clearing Support for Cleared Over-the-Counter (“OTC”) British pound (“GBP”) and Japanese Yen (“JPY”) Denominated Interest Rate Basis Swaps Referencing the London Interbank Offered Rate (“LIBOR”)**

### **Background**

On March 5, 2021, the UK Financial Conduct Authority (“FCA”) announced that certain settings of GBP and JPY LIBOR (among other currencies) will cease to be provided by ICE Benchmark Administration Limited (“IBA”) and will be permanently discontinued immediately after publication on December 31, 2021 and, further, that any remaining GBP and JPY LIBOR settings that are published from that date would cease to be representative of the underlying market from the same date.<sup>1</sup> These circumstances would give rise to an “Index Cessation Event” within the meaning of contractual “fallback” provisions within the ISDA IBOR Fallbacks Supplement and the CME Rulebook, necessitating a transition to the relevant term and spread adjusted risk-free reference rate for affected cleared and uncleared contracts.<sup>2</sup>

However, following extensive engagement with cleared derivatives industry participants in 2021, market participants have indicated a preference for a CCP-led conversion from certain LIBOR rates before the “Index Cessation Event” and the implementation of the contractual fallback provisions in CCP rulebooks. As a result, subject to regulatory review, CME proposes: (i) on December 3, 2021, to convert all CME cleared CHF and JPY IRS to reference the respective successor “risk-free” reference rates (“RFR”) that are the nominated successor to CHF LIBOR and JPY LIBOR respectively; and (ii) on December 17, 2021, to convert all CME cleared GBP IRS currently referencing GBP LIBOR to reference SONIA, the nominated RFR successor to GBP LIBOR, in each case ahead of the scheduled permanent discontinuation of GBP, CHF and JPY LIBOR rates following final publication by IBA on December 31, 2021 (the “GBP/CHF/JPY LIBOR Transition”).<sup>3</sup>

---

<sup>1</sup> See FCA Announcement, March 5, 2021, available at <https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf>.

<sup>2</sup> In January 2021, as part of regulatory and industry initiatives to transition away from certain key interbank offered rates (“IBORs”) and interest rate benchmarks, CME implemented certain changes to the CME Rulebook to incorporate “fallback” provisions into CME cleared IRS to provide for contractual fallback to a relevant alternative spread and term adjusted RFR on the permanent discontinuation or “non-representativeness” of certain key IBORs, including GBP and JPY LIBORs. See <https://www.cmegroup.com/content/dam/cmegroup/notices/clearing/2021/01/Chadv21-039.pdf>.

<sup>3</sup> For further details, see <https://www.cmegroup.com/trading/interest-rates/files/cme-ibor-conversion-for-chf-jpy-and-gbp-cleared-swaps.pdf>. CME will incorporate necessary changes to the CME Rulebook to effect the GBP/CHF/JPY LIBOR Transition in due course ahead of implementation in December 2021. For the avoidance of doubt, the Conversion process for Basis Swaps that is the subject of this submission is a separate process to the GBP/CHF/JPY LIBOR Transition, however, market participants agree with CME that the Conversion is a necessary and preliminary process that must be undertaken by CME prior to the GBP/CHF/JPY LIBOR Transition in December 2021.

As a preliminary process prior to the proposed GBP/CHF/JPY LIBOR Transition, following discussions with market participants, CME has determined that it is necessary and beneficial for CME to:

- convert or “split” each CME cleared GBP and JPY LIBOR Basis Swaps (the “Basis Swaps”) into corresponding pairs of fixed-float IRS referencing the relevant LIBOR rate ahead of the anticipated “Index Cessation Event” in respect of each of GBP LIBOR and JPY LIBOR (the “Conversion”), to take effect at close of business on Friday, September 24, 2021 (the “Conversion Date”); and
- withdraw clearing support for the Basis Swaps from the Conversion Date.

The modification to the terms of the Basis Swaps to implement the Conversion is set out in this Clearing Advisory Notice, effective September 24, 2021. No amendments to the CME Rulebook are required to effect the Conversion.

With effect from close of business on the Conversion Date, CME will withdraw clearing support for the GBP and JPY Basis Swaps and will therefore cease to accept for clearing trades in GBP or JPY basis swaps from that time. No amendments to the CME Rulebook are required to effect the delisting of the Basis Swaps. The list of basis swap contracts accepted for clearing by CME will be updated on the CME Group website from the Conversion Date to reflect the delisting of the Basis Swaps.

### **Rationale for Conversion Process**

Following engagement with market participants, CME has determined that it is necessary and beneficial to convert or “split” each GBP and JPY LIBOR Basis Swap into corresponding pairs of fixed-float IRS referencing the relevant LIBOR rate as a preliminary process ahead of the proposed GBP/CHF/JPY LIBOR Transition scheduled for December 2021. In the absence of this preliminary process, GBP and JPY Basis Swaps would be converted, as part of the proposed GBP/CHF/JPY LIBOR Transition, into Replacement RFR-RFR Basis Swaps. This resultant product would be operationally and technically difficult for the marketplace to support and would not be directly fungible with standard overnight index swaps in the relevant RFR, making them relatively illiquid which, in turn, would create challenges for market participants in managing those positions and for CCPs in managing a default of an account holding those positions.

CME understands that other major EU and UK CCPs clearing GBP and JPY basis swaps will undergo a similar exercise with their market participants to split relevant basis swaps into corresponding pairs of fixed-float IRS and market participants have encouraged CME to align the timing of the Conversion with that of other CCPs to minimize any potential operational or market disruption.

The Conversion will not have any economic impact on position holders in the Basis Swaps or CME and will be neutral from a risk perspective. As a result, no cash compensation or adjustment mechanism is required.

Further details on the Conversion are set out below.

### **Summary of Conversion Process**

At close of business on the Conversion Date, with the exception of Basis Swaps that mature on the Conversion Date, CME will convert each CME cleared Basis Swap that is open at close of business on the Conversion Date by splitting each Basis Swap into corresponding pairs of CME cleared fixed-float interest rate swaps, as follows:

- CME will amend the terms of each Basis Swap (a “Pre-Conversion Basis Swap”).
- In respect of each Pre-Conversion Basis Swap, within the Clearing System CME will close out each Pre-Conversion Swap and establish in the account of the position holder of such Pre-Conversion Basis Swap the following replacement CME cleared IRS trades (corresponding to the relevant

Floating Rate Index of the Pre-Conversion Basis Swap) as per the direction of the Pre-Conversion Basis Swap:

- a fixed-float interest rate swap, with Direction Pay Fixed, with a Floating Index Tenor corresponding to the Floating Rate Index 1 of the Pre-Conversion Basis Swap; and
- a fixed-float interest rate swap, with Direction Receive Fixed, with a Floating Index Tenor corresponding to the Floating Rate Index 2 of the Pre-Conversion Basis Swap

(each, a “Replacement Swap” and together, a “Replacement Swap Pair”).

- The Currency, Notional, Effective Date, Maturity Date, Day Count, Date Roll, Payment Calendar and Floating Leg Spread of each Replacement Swap (as applicable) will be the same as that of the relevant Pre-Conversion Basis Swap.
- The Fixed Rate for each Replacement Swap in a Replacement Swap Pair will be determined by CME and shall be equal to the “break-even” rate of the “larger” index tenor for the Pre-Conversion Basis Swap, e.g. 6 months for a 3 month vs. 6 month Basis Swap. The Fixed Rate determined by CME for each Replacement Swap will ensure that payments under each Replacement Swap will fully offset the payments of the other Replacement Swap in that Replacement Swap Pair.
- Each Replacement Swap Pair will retain the key economic terms of the corresponding Pre-Conversion Basis Swap. The combined Net Present Value (“NPV”) of each Replacement Swap Pair will be equal to that of the corresponding Pre-Conversion Basis Swap prior to amendment. As a result, the Conversion will not result in any change in risk exposure for a position holder of a Pre-Conversion Basis Swap. As a result, no risk or cash compensation is required for position holders.
- Each Replacement Swap will be cleared by CME as an interest rate swap subject to the terms of the CME Rules.

The Conversion is a mandatory process and will apply to all cleared trades in GBP and JPY Basis Swaps on the Conversion Date except those Basis Swaps that mature on the Conversion Date.

From close of business on the Conversion Date, CME will no longer have any open interest in the Basis Swaps and will cease to accept GBP and JPY Basis Swaps for clearing.

In legal and contractual terms, the Conversion process will amend the terms of cleared trades in CME cleared GBP and JPY Basis Swaps, resulting in the operational establishment of replacement cleared trades in the form of the Replacement Swaps. This is reflected in operational terms by the reporting of each Replacement Swap by CME to the CME Swap Data Repository (“SDR”) with reference to the “Prior USI” of the relevant corresponding Pre-Conversion Basis Swap. From an operational perspective within the CME clearing system, the Conversion will be processed by CME as a termination of each relevant Pre-Conversion Basis Swap and the establishment of a new corresponding pair of cleared trades within the clearing system in the form of the relevant Replacement Swaps.

CME has consulted with a diverse cross-section of market participants to obtain feedback on the operational processes for the Conversion. The Conversion is seen by market participants as an important preliminary step in the overall process of ensuring an orderly and efficient transition from LIBOR to RFRs in derivatives markets. Market participants have expressed a clear preference for CME to effect the Conversion of Basis Swaps ahead of the proposed GBP/CHF/JPY LIBOR Transition in December 2021. Furthermore, in CME’s engagement with market participants, these stakeholders have expressed a clear preference that CME’s approach to the “splitting” of GBP and JPY Basis Swaps should be aligned as closely as possible with the wider industry approach adopted by other major CCPs.

A summary of CME's Conversion plan was provided to market participants and made publicly available in June 2021 followed by operational testing and additional support prior to the proposed date of implementation, including a New Release Dress Rehearsal on August 27, 2021.<sup>4</sup>

This Advisory Notice sets out the binding rules and operational processes under which CME Clearing will implement the Conversion, including the modification and operational close-out of GBP and JPY Basis Swaps and the establishment of replacement GBP and JPY fixed-float interest rate swaps, which will be implemented by CME with respect to open cleared trades in affected CME cleared products at the Conversion Date.

Terms used but not defined in this Advisory Notice shall have the meaning set out in the CME Rules.

### **CME Cleared Contracts Subject to the Conversion and this Advisory Notice**

The Conversion will apply to all cleared trades in CME cleared GBP and JPY Basis Swaps that are open at close of business ("COB") on the Conversion Date and which do not mature on the Conversion Date (the "Affected Contracts").

### **Terms and Operation of Conversion Process**

1. At or shortly after COB on the Conversion Date, CME Clearing will amend each cleared trade in the Affected Contracts (a "Pre-Conversion Basis Swap").
2. In respect of each Pre-Conversion Basis Swap, CME Clearing will close out the Pre-Conversion Swap and establish in the account of the position holder of such Pre-Conversion Basis Swap the following replacement CME cleared IRS trades:
  - (a) a fixed-float interest rate swap, with Direction Pay Fixed, with a Floating Index Tenor corresponding to the Floating Rate Index 1 of the Pre-Conversion Basis Swap; and
  - (b) a fixed-float interest rate swap, with Direction Receive Fixed, with a Floating Index Tenor corresponding to the Floating Rate Index 2 of the Pre-Conversion Basis Swap,(each, a "Replacement Swap" and together, a "Replacement Swap Pair").
3. Each Replacement Swap will have the following terms:
  - (a) The Currency, Notional, Effective Date, Maturity Date, Day Count, Date Roll, Payment Calendar and Floating Leg Spread of each Replacement Swap (as applicable) will be the same as that of the relevant Pre-Conversion Basis Swap; and
  - (b) The Fixed Rate for each Replacement Swap in a Replacement Swap Pair will be determined by CME and shall be equal to the "break-even" rate of the "larger" index tenor for the Pre-Conversion Basis Swap, e.g. 6 months for a 3 month vs. 6 month Basis Swap. The Fixed Rate determined by CME for each Replacement Swap will ensure that payments under each Replacement Swap will fully offset the payments of the other Replacement Swap in that Replacement Swap Pair.

---

<sup>4</sup> The public overview is available on the CME Group website at: <https://www.cmegroup.com/trading/interest-rates/files/cme-ibor-conversion-for-chf-jpy-and-gbp-cleared-swaps.pdf>. CME operated an operational "Dress Rehearsal" for the Conversion process on August 27, 2021, to simulate the processes for the Conversion Date – see <https://www.cmegroup.com/notices/clearing/2021/08/Chadv21-285.html>. All open Basis Swaps in the "New Release" Environment (not Production) were converted on that date to enable market participants to take part in a "test" portfolio Conversion simulation.

4. Each Replacement Swap will be cleared by CME as an interest rate swap subject to the terms of the CME Rules.
5. The terms of this Advisory Notice and the Conversion process are binding on Clearing Members and position holders in all Affected Contracts, effective September 24, 2021. To the extent that there is any conflict between the Rules and the terms of this Advisory Notice with respect to the Conversion process, this Advisory Notice shall prevail. For the purposes of this Advisory Notice, Rule 90103.A. ("Contract Modifications; CME Rules") shall not apply to the extent it purports to restrict modification to the terms of IRS Contracts that are the subject of this Advisory Notice.

The Conversion is a mandatory process. The Conversion will therefore apply to all positions in cleared trades in Affected Contracts on the Conversion Date with the exception of trades that mature on the Conversion Date. Market participants should consider the terms and impact of the Conversion as set out in this Advisory Notice and take appropriate action prior to the Conversion Date. Position holders that do not wish to participate in the Conversion must close out any positions in Affected Contracts prior to the Conversion Date.

#### **Fees for Conversion Process**

There are no Exchange fees payable in connection with the Conversion.

#### **Withdrawal of Clearing Support for GBP and JPY Basis Swaps Following Conversion**

From close of business on the Conversion Date, CME Clearing will cease to accept for clearing trades in GBP and JPY Basis Swaps. No amendments to the CME Rulebook are required to effect the delisting of the Basis Swaps. The list of basis swap contracts accepted for clearing by CME will be updated on the CME Group website to reflect the delisting of the Basis Swaps from close of business on the Conversion Date.

#### **Operational Information and Reporting**

CME Clearing will provide the following information in relation to Affected Contracts:

- End of Day Trade Register report made available by the Clearing House only to IRS clearing members and clients via an sFTP site;
- FpML Clearing Confirmations for operational termination of Pre-Conversion Swaps and establishment of Replacement Swaps

To reflect the operational processes within the clearing system, CME will send:

- a termination message to relevant CME clearing firms in respect of the termination of each relevant Pre-Conversion Basis Swap; and
- a clearing confirmation message to relevant CME clearing firms in respect of the establishment of each new relevant Replacement Swap.

As part of the Conversion process, all relevant Trade IDs on the Pre-Conversion Basis Swap will be carried over to the relevant Replacement Swaps. In order to identify the link between each Pre-Conversion Basis Swap and the relevant Replacement Swaps, CME will add a replacement Trade ID and Original Trade ID respectively in the History section of the clearing confirmation messages.

CME will report the result of Conversion to CME SDR in accordance with the requirements of the CFTC's Part 45 Regulations, to reflect the splitting of each Pre-Conversion Basis Swap into each Replacement Swap Pair. With regard to reporting data submitted to SDR in respect of each Replacement Swap, CME will populate the "Prior USI" field with the USI of the relevant Pre-Conversion Basis Swap to reflect the nature of the Conversion process. For SDR reporting purposes, reporting rows will be generated and submitted to CME SDR terminating the USI of each Pre-Conversion Basis Swap and CME will ensure that each Replacement Swap will be reported as a "New Trade."

Additional details regarding the Conversion may be viewed in [\*\*CME Submission No. 21-412.\*\*](#)

Inquiries regarding the aforementioned may be directed to:

Jim Roper - Clearing	<a href="mailto:jim.roper@cmegroup.com"><u>jim.roper@cmegroup.com</u></a>	312.338.7137
Steve Dayon - OTC Products	<a href="mailto:steven.dayon@cmegroup.com"><u>steven.dayon@cmegroup.com</u></a>	312.466.4447