

TO: Clearing Member Firms  
Back Office Managers

DATE: March 20, 2023

FROM: CME Clearing

NOTICE #: 23-096

SUBJECT: **Modification and Withdrawal of Clearing Support for Certain Cleared Over-the-Counter (“OTC”) U.S. Dollar (“USD”) 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 all remaining settings of USD ICE LIBOR<sup>1</sup> would cease to be representative of the underlying market from June 30, 2023 (the “Scheduled Final Representative USD LIBOR Publication Date”).<sup>2</sup> These circumstances constitute an “Index Cessation Event” within the meaning of contractual “fallback” provisions within the ISDA IBOR Fallbacks Supplement and the CME Rulebook.<sup>3</sup> As a result, as with bilateral uncleared derivative contracts incorporating the relevant ISDA contractual fallbacks, the existing contractual fallbacks in CME cleared OTC derivative contracts currently provide that USD LIBOR referencing swaps shall transition to the Secured Overnight Financing Rate (“SOFR”) as the reference rate for affected contracts following the relevant “Index Cessation Effective Date”, which shall be the next publication date after the Scheduled Final Representative USD LIBOR Publication Date.

However, following the successful CME Clearing-led conversion of Non-USD LIBOR derivative contracts into corresponding standardised successor risk-free rate overnight index swaps (“OIS”) in December 2021 ahead of the relevant Index Cessation Effective Dates (the “Non-USD LIBOR Conversion”),<sup>4</sup> market

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<sup>1</sup> The family of interest rate benchmarks known as “LIBOR” are also known as “ICE LIBOR” (LIBOR® and ICE LIBOR®) and are administered and published by ICE Benchmark Administration Limited, a U.K. authorised and regulated benchmark administrator. ICE LIBOR is a registered trademark of Intercontinental Exchange Holdings, Inc. and is used under license.

<sup>2</sup> See FCA Announcement, March 5, 2021, available at

<https://www.fca.org.uk/publication/documents/future-cessation-loss-representativeness-libor-benchmarks.pdf>. In November 2022, the FCA opened a consultation proposing to continue to publish certain USD LIBOR settings on a “synthetic”, non-representative basis after end-June 2023 but confirmed that such rates would be permitted for limited use only in certain legacy contracts and that such rates would not be representative of the underlying market and economic reality that USD LIBOR seeks to measure.

<sup>3</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 USD LIBOR.

See <https://www.cmegroup.com/content/dam/cmegroup/notices/clearing/2021/01/Chadv21-039.pdf>.

<sup>4</sup> In December 2021, CME effected a conversion of CME cleared British Pound (“GBP”), Japanese Yen (“JPY”) and Swiss Franc (“CHF”) OTC IRS contracts into standardized corresponding “risk-free rate” (“RFR”) overnight index swaps (“OIS”) ahead of the relevant “Index Cessation Effective Dates” for such contracts. This was driven by market participants’ clear preference for a CPP-led conversion process into standardized RFR OIS rather than reliance on the fallback provisions equivalent to those used in bilateral uncleared markets. Ahead of the Non-USD LIBOR Conversion, CME effected a conversion of GBP and JPY denominated interest rate basis swap products in September 2021, converting each CME cleared affected basis swap contract into corresponding CME

participants have expressed a preference for a similar CCP-led conversion of OTC USD LIBOR IRS into corresponding standardized SOFR OIS before the Scheduled Final Representative USD LIBOR Publication Date rather than to rely on implementation of the existing contractual fallback provisions in the CME Rulebook based on the relevant ISDA contractual fallbacks. As a result, CME has determined it will convert the majority of CME cleared USD LIBOR IRS to reference SOFR, the nominated successor to USD LIBOR, shortly before the Scheduled Final Representative USD LIBOR Publication Date (the “USD LIBOR Conversion”).<sup>5</sup>

As a preliminary process prior to the proposed USD LIBOR Conversion, following discussions with market participants, CME has determined that it is necessary and beneficial for CME to:

- implement modifications to the terms of certain CME cleared OTC basis swaps referencing USD LIBOR (except USD LIBOR vs Fed Funds basis swaps<sup>6</sup>) (the “Basis Swaps”) to convert each such cleared Basis Swap into corresponding CME cleared fixed-floating interest rate swaps (the “Basis Swap Conversion”), to take effect following close of business on Friday, March 24, 2023 (the “Basis Swap Conversion Date”); and
- withdraw clearing support for the Basis Swaps following the Basis Swap Conversion.

The Basis Swap Conversion is necessary as a preliminary step ahead of the USD LIBOR Conversion scheduled for April 2023. The Basis Swap Conversion will not have an economic impact on position holders and CME will remain neutral from a risk perspective.<sup>7</sup>

The modification to the terms of the Basis Swaps to implement the Basis Swap Conversion is set out in this Clearing Advisory Notice, effective March 24, 2023. No amendments to the CME Rulebook are required to effect the Basis Swap Conversion.

With effect from close of business on the Basis Swap Conversion Date, CME will withdraw clearing support for the Basis Swaps and will therefore cease to accept for clearing trades in the 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 Basis Swap Conversion Date to reflect the delisting of the Basis Swaps.

### **Rationale for Basis Swap Conversion Process**

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cleared fixed-floating interest rate swaps- see <https://www.cmegroup.com/content/dam/cmegroup/market-regulation/rule-filings/2021/9/21-412.pdf>. See also CME Submission 21-515, accessible at <https://www.cftc.gov/sites/default/files/filings/orgrules/21/11/rule111821cmeco001.pdf>.

<sup>5</sup> A secondary conversion event will take place shortly after the Scheduled Final Representative USD LIBOR Publication Date to convert any remaining USD LIBOR IRS not converted on the primary USD LIBOR Conversion date. For further details, see <https://www.cmegroup.com/content/dam/cmegroup/trading/interest-rates/files/cme-conversion-for-usd-libor-cleared-swaps.pdf>. CME will incorporate necessary changes to the CME Rulebook to effect the USD LIBOR Conversion in due course ahead of implementation in March / April 2023. For the avoidance of doubt, the Conversion process for Basis Swaps that is the subject of this submission is a separate operational process to the USD LIBOR Conversion, however, market participants agree with CME that the Conversion is a necessary and preliminary process that must be undertaken by CME prior to the USD LIBOR Conversion in April 2023.

<sup>6</sup> USD LIBOR vs. Fed Funds basis swaps are excluded from the Basis Swap Conversion. CME will retain these contracts as basis swaps and later convert them to SOFR vs Fed Funds Basis Swaps as a part of the USD LIBOR Conversion in April 2023.

<sup>7</sup> Note that position holders will continue to have exposure in USD LIBOR referencing IRS following the Basis Swap Conversion. CME proposes to convert USD LIBOR swaps to SOFR OIS and to convert USD LIBOR vs Fed Funds basis swap exposures into corresponding SOFR vs Fed Funds basis swaps as part of the conversion processes for the USD LIBOR Conversion.

CME has consulted with a diverse cross-section of market participants to obtain feedback on the proposals and operational processes for the Basis Swap Conversion, in the context of the broader USD LIBOR Transition proposals. The Basis Swap Conversion is seen by market participants as an important preliminary step in the overall process of ensuring an orderly and efficient transition from USD LIBOR to SOFR in derivatives markets. Market participants have expressed a clear preference for CME to effect the conversion of USD LIBOR Basis Swaps ahead of the proposed USD LIBOR Conversion scheduled for April 2023. Without this preliminary process, USD LIBOR vs SOFR and USD LIBOR vs USD LIBOR basis swaps would be converted, as part of the proposed USD LIBOR Conversion, into replacement SOFR-SOFR basis swaps. Such a product is operationally and technically difficult for the marketplace to support and would not be fungible with standard SOFR overnight index swaps, making them relatively illiquid which, in turn, would create challenges for market participants in managing those positions and for CCPs in managing them in the event of a default.

As a result, CME has determined that it is necessary and beneficial to convert or “split” each USD LIBOR vs SOFR and USD LIBOR vs USD LIBOR basis swaps into corresponding pairs of fixed-float IRS referencing USD LIBOR as a preliminary process ahead of the proposed USD LIBOR Conversion scheduled for April 2023. A summary of CME's Basis Swap Conversion plan was provided to market participants and made publicly available in August 2022.<sup>8</sup>

The Basis Swap 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 Basis Swap Conversion are set out below.

### **Summary of Basis Swap Conversion Process**

The Basis Swap Conversion is a mandatory process and will apply to all cleared trades in USD LIBOR basis swaps on the Basis Swap Conversion Date except:

- those basis swaps that mature on the Basis Swap Conversion Date; or
- USD LIBOR vs Fed Funds basis swaps.

At close of business on the Basis Swap Conversion Date, CME will convert each in-scope CME cleared Basis Swap that is open at close of business on the Basis Swap Conversion Date (each, a “Pre-Conversion Basis Swap”) by splitting each Pre-Conversion Basis Swap into corresponding pairs of CME cleared fixed-float interest rate swaps, as follows:

- 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

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<sup>8</sup> See <https://www.cmegroup.com/content/dam/cmegroup/trading/interest-rates/files/cme-conversion-for-usd-libor-cleared-swaps.pdf>

- 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. Therefore all USD LIBOR and SOFR floating legs will be carried over to the relevant Replacement Swap in each case.
- 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 close out. As a result, the Basis Swap 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.

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

In legal and contractual terms, the Basis Swap Conversion process will amend the terms of cleared trades in CME cleared USD LIBOR 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 CME 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 Basis Swap 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.

#### **Amendment to Basis Swap Conversion Date in Limited Circumstances**

CME reserves the right to amend the proposed Basis Swap Conversion Date in its sole and absolute discretion prior to the Basis Swap Conversion in limited circumstances, for example, where implementation of the conversion process on the previously communicated date could, in the opinion of the Clearing House, result in an unacceptable level of operational or market disruption or where financial stability issues could threaten the orderly transition. In such circumstances, CME will communicate the amended Basis Swap Conversion Date to market participants as soon as practicable upon making such determination.<sup>9</sup>

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<sup>9</sup> CME Clearing has identified a provisional contingency fallback date of April 14, 2023, in the event that the March 24, 2023, date for the Basis Swap Conversion is determined to be unsuitable.

## **Fees for Basis Swap Conversion Process**

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

## **Operational Information and Reporting**

CME has provided operational testing and additional support prior to the scheduled date of implementation, including a New Release Dress Rehearsal which took place on January 27, 2023.<sup>10</sup>

On the Basis Swap Conversion Date, to reflect the operational processes within the clearing system, CME will send:

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

As part of the Basis Swap 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 Basis Swap 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 Basis Swap 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."

## **Implementation of Basis Swap Conversion**

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

The Basis Swap Conversion is a mandatory process and will therefore apply to all positions in cleared trades in affected contracts on the Basis Swap Conversion Date. Market participants should consider the terms and impact of the Basis Swap Conversion as set out in this Advisory Notice and take appropriate action prior to the Basis Swap Conversion Date. Position holders that do not wish to participate in the Basis

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<sup>10</sup> The public overview is available on the CME Group website at: <https://www.cmegroup.com/content/dam/cmegroup/trading/interest-rates/files/cme-conversion-for-usd-libor-cleared-swaps.pdf>. CME conducted an operational "Dress Rehearsal" for the Conversion process on January 27, 2023, to simulate the processes for the Basis Swap Conversion Date. 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 Basis Swap Conversion simulation. See <https://www.cmegroup.com/content/dam/cmegroup/notices/clearing/2023/01/Chadv23-022.pdf>.

Swap Conversion must close out any positions in affected Basis Swap Contracts prior to the Basis Swap Conversion Date.

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

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

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

The Basis Swap Conversion will apply to all CME cleared trades in USD Basis Swaps, with the exception of USD LIBOR vs Fed Funds basis swaps, that are open at close of business (“COB”) on the Basis Swap Conversion Date (as defined in paragraph 1 below) and which do not mature on the Basis Swap Conversion Date (the “Affected Basis Swap Contracts”).

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

1. The Basis Swap Conversion Date shall be March 24, 2023 or such other date determined by the Clearing House in its sole and absolute discretion prior to the Basis Swap Conversion where implementation of the conversion process on March 24, 2023 or such other previously communicated date could, in the opinion of the Clearing House, result in an unacceptable level of operational or market disruption or where financial stability issues could threaten the orderly transition. In such circumstances, CME will communicate the Basis Swap Conversion Date to market participants as soon as practicable upon making such determination.
2. At or shortly after COB on the Basis Swap Conversion Date, CME Clearing will amend each cleared trade in the Affected Basis Swap Contracts (each, a “Pre-Conversion Basis Swap”).
3. In respect of each Pre-Conversion Basis Swap, CME Clearing will close out the Pre-Conversion Basis 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”).
4. 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.

5. Each Replacement Swap will be cleared by CME as an interest rate swap subject to the terms of the CME Rules.
6. The terms of this Advisory Notice and the Basis Swap Conversion process are binding on Clearing Members and position holders in all Affected Basis Swap Contracts, effective March 24, 2023. To the extent that there is any conflict between the Rules and the terms of this Advisory Notice with respect to the Basis Swap 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.

#### Withdrawal of Clearing Support for USD LIBOR Basis Swaps Following Basis Swap Conversion

From close of business on the Basis Swap Conversion Date, CME Clearing will cease to accept for clearing trades in the Affected Basis Swap Contracts. 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 Basis Swap Conversion Date.

Additional details regarding the Basis Swap Conversion may be viewed in **CME Submission No. [23-082](#)**.

Inquiries regarding the aforementioned may be directed to:

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