



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk

Ananda Radhakrishnan  
Director

CFTC Letter No. 13-52  
No-Action  
September 23, 2013  
Division of Clearing and Risk

Mr. David Gilberg  
Sullivan & Cromwell LLP  
125 Broad Street  
New York, New York 10004

Re: No-Action Relief with Regard to Clearing Swaps Executed on DCMs or SEFs

Dear Mr. Gilberg:

This is in response to your letter dated July 30, 2013 (“Letter”), to the Division of Clearing and Risk (“Division”) of the Commodity Futures Trading Commission (“Commission”). In the Letter you request, on behalf of LCH.Clearnet Ltd (“LCH”), a derivatives clearing organization (“DCO”) registered under Section 5b of the Commodity Exchange Act (“CEA”),<sup>1</sup> that the Division confirm that it will not recommend that the Commission commence an enforcement action against (1) LCH for clearing certain swaps (“DCM/SEF Swaps”) executed on, or subject to the rules of, designated contract markets (“DCMs”) or swap execution facilities (“SEFs”), and (2) clearing members of LCH for clearing DCM/SEF Swaps through LCH. You have requested that this relief be effective until LCH’s existing DCO registration orders are formally amended to permit LCH to clear DCM/SEF Swaps, and you have represented that LCH intends to apply soon for an amended DCO registration order that would permit it to clear DCM/SEF Swaps.

### Statement of Facts

Based upon the representations made by LCH to the Division, including the representations made in the Letter, we understand the relevant facts to be as follows:

LCH was the first non-U.S. clearinghouse to register as a DCO with the Commission,<sup>2</sup> and currently it operates pursuant to two DCO registration orders that were issued in 2001 and

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<sup>1</sup> 7 U.S.C. § 7a-1.

<sup>2</sup> Prior to registering as a DCO, LCH cleared products for U.S. participants pursuant to an exemptive order issued by the Commission under Section 4(c) of the CEA on March 23, 1999. *See* 64 FR 53346 (Oct. 1, 1999).

2004.<sup>3</sup> LCH is also a Recognised Clearing House in the United Kingdom, subject to the direct supervisory oversight of the Bank of England. LCH is wholly-owned by LCH.Clearnet Group Limited (“LCH Group”), a holding company incorporated in the United Kingdom that owns two other clearinghouses: LCH.Clearnet LLC, based in the United States, and LCH.Clearnet SA, based in France. On May 1, 2013, London Stock Exchange Group plc acquired a majority stake in LCH Group.

LCH is organized around several different clearing services divided by product line. Through its SwapClear, ForexClear, EnClear, and Nodal services, LCH offers clearing services to U.S. market participants for interest rate swaps, non-deliverable forwards, freight swaps and energy contracts, respectively. These products are executed in bilateral, over-the-counter (“OTC”) transactions, or are executed on markets that were previously exempt from most of the provisions of the CEA.<sup>4</sup>

LCH currently clears, among other products, interest rate swaps executed on Tradeweb LLC, an EBOT, and on Bloomberg L.P., a 2(d)(2) market. LCH also clears swaps received from MarkitSERV and Traiana, Inc., which are providers of swaps processing services that send transactions to LCH that are executed bilaterally or on other exempt markets.<sup>5</sup>

On June 4, 2013, Bloomberg SEF LLC (“Bloomberg SEF”), an affiliate of Bloomberg L.P., and on July 3, 2013, TW SEF LLC (“TW SEF”) and DW SEF LLC (“DW SEF”), affiliates of Tradeweb LLC, each submitted an application to the Commission to register as a SEF, pursuant to Section 5h of the CEA<sup>6</sup> and Commission regulations thereunder. In addition, each of these entities requested temporary registration as a SEF, pursuant to Commission Regulation

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<sup>3</sup> See In the Matter of the Application of London Clearing House For Registration as a Derivatives Clearing Organization, Order of Registration (Oct. 29, 2001); In the Matter of the Application of LCH.Clearnet Ltd For Registration as a Derivatives Clearing Organization, Amended Order of Registration (May 11, 2004).

<sup>4</sup> The Commodity Futures Modernization Act of 2000 (“CFMA”) established two categories of exempt markets under the CEA: exempt commercial markets (“ECMs”), under former Section 2(h)(3)-(7) of the CEA, and exempt boards of trade (“EBOTs”), under Section 5d of the CEA. The CFMA also permitted markets to operate pursuant to former Section 2(d)(2) of the CEA, which excluded bilateral transactions in excluded commodities from most CEA provisions (“2(d)(2) markets”). Subject to certain conditions, ECMs, EBOTs, and 2(d)(2) markets were exempt from most provisions of the CEA and were neither licensed nor registered with the Commission. See Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763 (2000).

<sup>5</sup> MarkitSERV and Traiana, Inc. are not required to register as SEFs solely to continue providing swap processing services. See 78 FR 33476, 33483 (“As noted in the SEF NPRM, entities that solely engage in trade processing would not meet the SEF definition in CEA section 1a(50) because they do not provide the ability to execute or trade a swap as required by the definition. Accordingly, swap processing services would not have to register as a SEF under CEA section 5h(a)(1)”).

<sup>6</sup> 7 U.S.C. § 7b-3.

37.3(c).<sup>7</sup> On July 30, 2013, Bloomberg SEF was granted temporary registration as a SEF, and on September 6, 2013, TW SEF and DW SEF were each granted temporary registration as a SEF.<sup>8</sup>

In discussions with the Division in July 2013, LCH indicated that it planned to begin clearing interest rate swaps executed on DCMs or SEFs in the near future. The Division advised LCH that it was not permitted under its current DCO registration orders to clear any DCM/SEF Swaps, and that LCH would not be permitted to clear for Bloomberg SEF, TW SEF, or DW SEF once these markets began operating as temporarily registered SEFs. In response, LCH submitted a draft application for an amended DCO registration order that would permit it to clear, among other things, DCM/SEF Swaps. LCH also requested that the Division grant the relief described above, in order to permit LCH to clear DCM/SEF Swaps until the Commission approves LCH's application for an amended DCO registration order.

### Applicable Legal Requirements

Section 5b(a) of the CEA provides that a DCO may not perform the functions of a DCO with respect to swaps unless the DCO is registered.<sup>9</sup> As noted above, LCH currently operates as a registered DCO pursuant to two orders of registration. On October 29, 2001, the Commission issued LCH's first DCO registration order ("Original Order"), which granted LCH registration as a DCO for the clearing of OTC derivatives contracts, agreements or transactions that were at the time excluded or exempt from the CEA. Specifically, the Original Order granted LCH authority to clear "OTC derivatives contracts, agreements or transactions excluded or exempt under sections 2(c), 2(d), 2(f), 2(g), 2(h) or 4(c) of the [CEA] or that are OTC derivative instruments as defined in section 408 of Federal Deposit Insurance Corporation Improvement Act of 1991 [( 'FDICIA ')]."<sup>10</sup>

On May 11, 2004, the Commission issued an additional order ("Supplemental Order") that permitted LCH "to clear certain types of futures contracts and options on such futures contracts... traded on or subject to the rules of U.S. designated contract markets... derivatives transaction execution facilities... and/or exempt boards of trade..." subject to the limitation that "futures contracts cleared by LCH for any U.S. Market will be based on financial instruments (including securities)..."<sup>11</sup> As the Supplemental Order did not replace or supersede the Original Order, both DCO orders are still in effect and LCH currently is permitted to clear all of the products described therein.

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<sup>7</sup> 17 C.F.R. 37.3(c).

<sup>8</sup> Several other entities that do not currently clear through LCH also have applied recently for SEF registration pursuant to Section 5h of the CEA and temporary SEF registration pursuant to Commission Regulation 37.3(c). The Division of Market Oversight is currently reviewing these entities' applications. Some of these entities have indicated their intention to obtain clearing services from LCH.

<sup>9</sup> See *infra* n. 1.

<sup>10</sup> Original Order at 1.

<sup>11</sup> See In the Matter of the Application of LCH.Clearnet Ltd For Registration as a Derivatives Clearing Organization, Amended Order of Registration (May 11, 2004) at 1-3.

The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) repealed the provisions of the CEA and FDICIA that established exempt market categories and that contained the definition of OTC derivative instruments, including the provisions referenced in the Original Order.<sup>12</sup> Therefore, as of July 16, 2011, the effective date of the Dodd-Frank Act,<sup>13</sup> LCH could no longer clear transactions executed on those exempt markets that had operated pursuant to those repealed provisions of the CEA and FDICIA.

However, in order to ensure that industry practices were not unduly disrupted during the transition to the Dodd-Frank Act regulatory regime, the Commission issued a series of exemptive orders (the “Exemptive Orders”) pursuant to its authority under Section 4(c) of the CEA<sup>14</sup> and Section 712(f) of the Dodd-Frank Act<sup>15</sup> that, among other things, provided exempt markets temporary relief from the effective date of the Dodd-Frank Act.<sup>16</sup> The Division of Market Oversight subsequently issued two no-action letters that provided time-limited no-action relief to those markets from December 31, 2012, the expiration date set forth in the Second Amendment to July 14, 2011 Order for Swap Regulation, to October 2, 2013.<sup>17</sup>

LCH may continue to clear for Bloomberg L.P. and Tradeweb LLC under the Original Order while these entities operate pursuant to the time-limited no-action relief.<sup>18</sup> However, LCH does not have authority under either the Original Order or the Supplemental Order to clear transactions executed on Bloomberg SEF, TW SEF, DW SEF, or any other temporarily registered SEF. Given that Bloomberg SEF, TW SEF and DW SEF may commence operations in the near future, and given that several other entities have recently requested temporary SEF

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<sup>12</sup> Sections 723 and 734 of the Dodd-Frank Act amended the CEA to repeal the provisions that created the various exempt market categories and Section 740 of the Dodd-Frank Act repealed Section 408 of FDICIA, which contained the definition of OTC derivative instruments.

<sup>13</sup> See Section 754 of the Dodd-Frank Act.

<sup>14</sup> 7 U.S.C. § 6(c).

<sup>15</sup> Section 712(f) of the Dodd-Frank Act.

<sup>16</sup> See 76 FR 42508 (Jul. 19, 2011) (“Effective Date for Swap Regulation”); 76 FR 80233 (Dec. 23, 2011) (“Amendment to July 14, 2011 Order for Swap Regulation”); 77 FR 41260 (Jul. 13, 2012) (“Second Amendment to July 14, 2011 Order for Swap Regulation”).

<sup>17</sup> See Commission No-Action Letter No. 12-48 (Dec. 11, 2012); Commission No-Action Letter No. 13-28 (June 17, 2013).

<sup>18</sup> Under the Original Order, LCH has authority to clear “OTC derivatives contracts, agreements or transactions excluded or exempt under...4(c) of the Act...” which is the section of the CEA pursuant to which the Commission issued the Exemptive Orders. See Original Order at 1.

In addition, the Exemptive Orders provided relief, subject to certain conditions, to “agreements, contracts, and transactions, *and any person or entity offering*, entering into, or rendering advice *or rendering other services with respect to*, any such agreement, contract, or transaction... including any agreement, contract, or transaction in an exempt or excluded (but not agricultural) commodity...” (emphasis added). 77 FR 41260, 41265. LCH’s clearing activities fall in the “other services” category.

registration, swaps may soon be executed on temporary SEFs that cannot be cleared through LCH, absent an amendment to LCH's DCO registration orders or no-action relief.

#### Discussion of Request for No-Action Relief

On behalf of LCH and in support of its request, you have represented that LCH is, and will continue to be, compliant in all other respects with the Core Principles set forth in Section 5b of the CEA and in Part 39 of the Commission's regulations, and that LCH will continue to fulfill its obligations thereunder in accordance with its DCO registration orders. Additionally, you have represented that the clearing processes and mechanisms to be used by LCH in connection with the clearing of DCM/SEF Swaps will be substantially identical to those currently used by LCH in connection with the clearing of OTC swaps.

The Division believes that the time-limited relief sought by LCH in this instance is appropriate, especially given that (i) LCH's request only extends to the same classes of swaps that it already clears, and (ii) LCH has submitted to the Division a draft application for an amended DCO registration order that would permit it to clear DCM/SEF Swaps, and it has indicated that it will submit a final application soon.

#### Grant of No-Action Relief

Based on the facts presented and the representations you have made, and subject to the conditions set forth herein, the Division will not recommend that the Commission take enforcement action against (1) LCH for clearing DCM/SEF Swaps, and (2) the clearing members of LCH for clearing DCM/SEF Swaps through LCH, subject to the following conditions:

- (1) Product Scope. This relief is limited to the same classes of swaps currently accepted for clearing by LCH.<sup>19</sup>
- (2) Participant Scope. This relief applies to current and future clearing members of LCH.
- (3) Limited Duration. This relief shall expire on the earlier of: (i) March 31, 2014, or (ii) the date upon which the Commission approves or denies LCH's application for an amended DCO registration order to permit it to clear DCM/SEF Swaps.<sup>20</sup>

The position taken herein concerns enforcement action only and does not represent a legal conclusion with respect to the applicability of any provision of the CEA or the Commission's regulations. In addition, the Division's position does not necessarily reflect the

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<sup>19</sup> The no-action relief granted herein does not extend to the contracts that are currently executed on Nodal Exchange, LLC.

<sup>20</sup> Should the Commission deny LCH's application for an amended DCO registration order, the Division will provide LCH and its clearing members with guidance and, as appropriate, no-action relief to facilitate the orderly disposition of open DCM/SEF Swaps positions.

Mr. David Gilberg  
September 23, 2013  
Page 6

views of the Commission or any other division or office of the Commission. Because this position is based upon the representations made by and on behalf of LCH to the Division, including the representations made in the Letter, it should be noted that any materially different, changed, or omitted facts or circumstances may require a different conclusion or render this letter void. Finally, as with all no-action letters, the Division retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

Sincerely,

Ananda Radhakrishnan  
Director