**U.S. COMMODITY FUTURES TRADING COMMISSION**

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Division of Clearing and Risk

Jeffrey M. Bandman
Acting Director

CFTC Letter No. 16-59
No-Action; Exemption
June 21, 2016
Division of Clearing and Risk

Mr. Jason Silverstein
Executive Director and Associate General Counsel
CME Group
1 North End Avenue
New York, NY 10282

RE: Request for No-Action Relief from the Written Acknowledgment Requirements of Commission Regulations 1.20(g) and 22.5 and for Exemptive Relief from Commission Regulation 1.49(d)(3)

Dear Mr. Silverstein:

This is in response to your letter dated December 9, 2015 ("Letter"), to the Division of Clearing and Risk ("Division") of the Commodity Futures Trading Commission ("Commission"). In the Letter, you request that the Division confirm that it will not recommend that the Commission take enforcement action against the Chicago Mercantile Exchange, Inc. ("CME") for failing to obtain, or provide the Commission with, an executed version of the template acknowledgement letter set forth in Appendix B to Regulation 1.20 ("Template Acknowledgement Letter"), as required by Regulations 1.20(g)(4) and 22.5, for customer accounts maintained at the Bank of Canada ("BoC"). You additionally request that the Division grant exemptive relief from Regulation 1.49(d)(3)(i), with respect to CME's holding of customer funds in the BoC, which is not a qualified depository for customer funds under the regulation.

## I. No-Action Relief from the Written Acknowledgement Requirements in Commission Regulations 1.20(g)(4) and 22.5

Regulations 1.20(g)(4) and 22.5 require, among other things, that a derivatives clearing organization ("DCO") obtain a Template Acknowledgement Letter from a depository prior to or

contemporaneously with the opening of a futures customer account or a cleared swaps customer account with the depository.[1]

A. Statement of Facts

The Division understands the relevant facts to be as follows:

The BoC is the central bank of Canada. It is wholly owned by the Government of Canada and is accountable to Parliament through the Minister of Finance. The BoC is managed by a Board of Directors composed of a Governor, a Deputy Governor, and twelve directors appointed in accordance with the Bank of Canada Act.[2]

The BoC's mandate, as defined in the Bank of Canada Act, is generally "to promote the economic and financial welfare of Canada."[3] To this end, the BoC contributes to the stability and efficiency of the Canadian financial system by providing liquidity and oversees key domestic payment, clearing, and settlement systems.[4] The BoC also works with other Canadian agencies and foreign organizations to monitor and respond to emerging financial risks in Canada and globally.[5]

The BoC's "operations are not constrained by its cash flow or by its holding of liquid assets, since its seignorage income is predictable and exceeds its expenses."[6] The BoC also has in place a remittance agreement with the Minister of Finance, and certain reserves, in order to prevent the possibility of a capital deficiency.[7]

CME seeks to maintain accounts at the BoC in which CME would hold customer funds. As noted above, CME must obtain an acknowledgment letter from the BoC for each such account. However, the BoC has proposed to execute with CME the Template Acknowledgment

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[1] *See* Enhancing Protections Afforded Customers and Customer Funds Held by Futures Commission Merchants and Derivatives Clearing Organizations, 78 Fed. Reg. 68,506 (Nov. 14, 2013).

[2] The Bank of Canada Act, R.S.C. 1985, c. B-2 (Can.).

[3] The Bank of Canada Act, R.S.C. 1985, c. B-2 (Can.).

[4] *See* Annual Report at 17.

[5] *Id.*

[6] Bank of Canada 2014 Annual Report (the "Annual Report"), at 61, available at http://www.bankofcanada.ca/wp-content/uploads/2015/03/annualreport2014.pdf. "Seignorage" is income generated from the assets backing Canadian bank notes in circulation, which the BoC has the exclusive right to issue.

[7] *Id.*

Letter modified in certain respects relative to the operations of a central bank ("BoC Acknowledgment Letter").

B. Discussion of Request for No-Action Relief and Applicable Legal Requirements

As a central bank, the BoC's provision of account services to CME is distinguishable from the provision of account services by a commercial bank. In adopting the Template Acknowledgment Letter requirements, the Commission explicitly recognized the "unique role" of the Federal Reserve Bank in excluding Federal Reserve Banks, when providing account services, from the requirement that depositories accepting customer funds from DCOs execute a Template Acknowledgement Letter.[8] Under Regulation 1.20(g)(4)(ii), a Federal Reserve Bank acting as a depository for customer funds need only provide "a written acknowledgement that (A) The Federal Reserve Bank was informed that the customer funds deposited therein are those of customers … and are being held in accordance with the provisions of section 4d of the Commodity Exchange Act ["CEA"] and Commission regulations thereunder; and (B) The Federal Reserve Bank agrees to reply promptly and directly to any request from [Commission staff] for confirmation of account balances or provision of any other information regarding or related to an account."[9]

The Division notes that both Title VIII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act") and the CPMI-IOSCO Principles for Financial Market Infrastructures ("PFMIs") support central banks acting as depositories for customer funds due to certain favorable policy considerations. In addition, a central bank does not present the same types of risks as traditional commercial banks, as it serves in the public interest and operates with the goal of maintaining stability in the financial markets. Further, deposits at a central bank have the lowest credit risk and are the source of liquidity with regard to their currency of issue;[10] CME would, therefore, face much lower credit and liquidity risk with a deposit at the BoC than it would with a deposit at a commercial bank. Thus, granting the relief requested is appropriate to permit CME to maintain customer accounts at the BoC.

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[8] *See* 78 Fed. Reg. at 68,535.

[9] 17 C.F.R. § 1.20(g)(4)(ii).

[10] *See* PFMIs, ¶ 3.9.3 (noting that "[c]entral banks have the lowest credit risk and are the source of liquidity with regard to their currency of issue"); *see also* PFMIs, Key Consideration 8 (specifying that a financial market infrastructure "with access to central bank accounts, payment services, or securities services should use these services, where practical, to enhance its management of liquidity risk," which is consistent with the standards set forth in section 806(a) of the Dodd-Frank Act, authorizing accounts at a Federal Reserve Bank for designated financial market utilities). *See* 12 U.S.C. § 5465(a).

Moreover, the Commission had contemplated the possibility that foreign depositories might require modifications to the Template Acknowledgement Letter in certain situations, in which case "the Commission would consider alternative approaches, including no-action relief, on a case-by-case basis."[11] The Division previously has granted no-action relief to DCOs in connection with the holding of customer funds at the Deutsche Bundesbank and Bank of England.[12] In light of the above, the Division believes it is appropriate to permit CME to use the BoC Acknowledgement Letter, set forth in an attachment to this letter.[13]

C. Terms and Conditions set forth in the BoC Acknowledgement Letter

The BoC Acknowledgement Letter incorporates provisions of the Template Acknowledgement Letter and the written acknowledgement requirements applicable to Federal Reserve Banks set forth in Regulation 1.20(g)(4)(ii), and includes certain provisions that are specific to the customer accounts maintained at the BoC. The terms of the BoC Acknowledgment Letter also are in accordance with those of the letters executed by the Bank of England pursuant to no-action relief previously granted by the Division. Specifically, paragraph 1 of the BoC Acknowledgement Letter identifies the subject matter of the letter and makes no substantive change to the first paragraph of the Template Acknowledgement Letter.

Paragraphs 2 and 3 of the BoC Acknowledgment Letter together fulfill the requirements of Commission Regulation 1.20(g)(4)(ii)(A), which is applicable to acknowledgment letters obtained from a Federal Reserve Bank. Specifically, the paragraphs state that CME has informed the BoC that it has opened the account for the purpose of depositing customer funds, as required by Commission regulations, and that the BoC has confirmed that the deposited funds will be treated in accordance with Commission regulations.

Paragraph 4 of the BoC Acknowledgement Letter refers to a provision in the account agreement between CME and the BoC ("Account Agreement") in which the BoC waived its right of set off against the account. This provision addresses the concerns addressed by paragraph 3 of the Template Acknowledgment Letter.

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[11] 78 Fed. Reg. at 68,536.

[12] *See* CFTC Letter No. 16-05 (Feb. 1, 2016) (granting relief to Eurex Clearing AG, permitting the use of a modified acknowledgment letter for customer accounts maintained at Deutsche Bundesbank) and CFTC Letters No. 14-123 (Oct. 8, 2014), and 14-124 (Oct. 8, 2014) (granting relief to ICE Clear Europe Limited and LCH.Clearnet Limited, respectively, permitting the use of a modified acknowledgment letter for customer accounts maintained at the Bank of England).

[13] Attached to this no-action letter are two versions of the BoC Acknowledgement Letter; one is for cleared swaps customer accounts, and the other is for futures customer accounts.

Consistent with paragraph 4 of the Template Acknowledgment Letter and Regulation 1.20(g)(4)(ii)(B), paragraph 5 of the BoC Acknowledgment Letter provides that the BoC will, as soon as reasonably practicable, reply to any request for confirmation of account balances or provision of any other information regarding or related to the account from the Division or the Division of Swap Dealer and Intermediary Oversight. This provision deviates from the language of Regulation 1.20(g)(4)(ii)(B) in one respect, *i.e.*, the BoC is to provide a response "as soon as reasonably practicable" rather than "promptly." This change is intended to take into account such circumstances as Canadian bank holidays which could impact the timing of the BoC's response.

Paragraph 6 of the BoC Acknowledgement Letter is derived from paragraph 6 of the Template Acknowledgement Letter, in that CME will not hold the BoC responsible for acting pursuant to Commission inquiries in paragraph 5. Finally, paragraph 7 of the BoC Acknowledgment Letter clarifies that except for the BoC's commitment to respond to Commission inquiries in paragraph 5, the BoC Acknowledgment Letter is not intended to amend the Account Agreement. This provision also acknowledges that the BoC is not making any representations as to CME's representations in the BoC Acknowledgment Letter, *e.g.*, the funds in the account are customer funds and CME is treating them in accordance with Section 4d of the CEA.

D. Grant of No-Action Relief

Based on the facts presented and the representations CME has made, the Division will not recommend that the Commission take enforcement action against CME for executing, and submitting to the Commission, the BoC Acknowledgment Letter, in place of the Template Acknowledgement Letter.

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. As with all no-action relief, 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.

## II. Exemptive Relief from the Requirements of Commission Regulation 1.49(d)(3)

As previously noted, CME has requested that the Division grant exemptive relief to permit it to hold customer funds at the BoC. The BoC is the central bank of Canada, a money center country, which the Commission has recognized as a permissible location for a depository

holding customer funds.[14] Regulation 1.49(d)(3) provides that, in order to hold customer funds with a depository located outside the United States, the depository must be: (i) a bank or trust company that has in excess of $1 billion of regulatory capital, (ii) a registered futures commission merchant, or (iii) a DCO.[15] The Division finds that Regulation 1.49(d)(3)(i) unintentionally precludes the BoC from acting as a depository for customer funds, notwithstanding that it is a central bank for a money center country, because the BoC cannot satisfy the regulatory capital requirement. Nonetheless, based on the following analysis, the Division is granting an exemption to CME from the requirements of Regulation 1.49(d)(3).[16]

In adopting Regulation 1.49, the Commission sought to address the various types of risks that arise in the context of holding customer funds with a depository. In requiring that a non-U.S. bank or trust company have at least $1 billion in regulatory capital, the Commission sought to ensure that customer funds would not be deposited with a small commercial bank or trust company, which, because of its size, would be unlikely to have the financial or operational resources to adequately administer customer accounts. The $1 billion regulatory capital requirement, therefore, serves as a proxy for a bank or trust company's suitability as a depository for customer funds, both in terms of financial strength and operational sophistication. While the BoC has adequate financial and operational resources to properly handle customer funds, it does not technically satisfy the $1 billion *regulatory* capital requirement. Regulatory capital consists of the capital required pursuant to a depository's regulatory regime, and is typically composed of Tier 1 capital (*i.e.*, common stock). Unlike commercial banks, central banks like the BoC are not held to regulatory capital requirements. Therefore, because the BoC does not by definition satisfy the requirements of Regulation 1.49(d)(3)(i), the Division finds that an exemption is appropriate to address the preclusive effect of the regulation's plain meaning.

The Division notes that Section 4d of the CEA, which establishes segregation requirements for futures and cleared swaps customer funds, similarly refers to "a bank or trust company" or "any depository institution," without distinguishing between a commercial or central bank, a large or small depository, or a depository located in the United States or in a

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[14] Regulation 1.49(c)(1)(ii) provides that customer funds may be held in a depository located in a money center country, which is defined to include Canada. *See* Regulation 1.49(a)(1) (defining "money center country").

[15] 17. C.F.R. § 1.49(d)(3).

[16] The Division has provided a similar exemption to the Deutsche Bundesbank and the Bank of England. *See* CFTC Letter No. 16-05 (Feb. 1, 2016) (granting relief to Eurex Clearing AG, permitting the Deutsche Bundesbank to act as a depository of customer funds) and CFTC Letters No. 14-123 (Oct. 8, 2014), and 14-124 (Oct. 8, 2014) (granting relief to ICE Clear Europe Limited and LCH.Clearnet Limited, respectively, permitting the Bank of England to act as a depository of customer funds).

foreign country.[17] In addition, Regulation 1.49(c)(1)(ii) permits customer funds to be held in a depository located in Canada. Section 4d of the CEA and Regulation 1.49(c)(1)(ii) can be read to permit the BoC to act as a depository for customer funds; however, Regulation 1.49(d)(3)(i), in its reference to *regulatory* capital, precludes the BoC in this regard.

As discussed in greater detail above, there are distinct financial safeguards afforded by holding customer funds at the BoC, as a central bank for a money center country, that merit an exemption in this regard.[18] Based on the foregoing, pursuant to delegated authority from the Commission, the Division hereby grants an exemption to CME from the requirements of Regulation 1.49(d)(3) to permit CME to hold customer funds at the BoC. The Division believes that granting the relief would not be contrary to the public interest or to the purposes of Regulation 1.49(d)(3).

## III. Conclusion

This letter is based upon the representations of CME and applicable laws and regulations in their current form; any new, different, or changed material facts or circumstances might render this letter void. Moreover, this letter represents the position of the Division only and does not necessarily represent the views of the Commission or those of any other division or office of the Commission. Should you have any questions, please do not hesitate to contact Andrea Musalem, Special Counsel, at (202) 418-5167.

Sincerely,

Jeffrey M. Bandman
Acting Director

Attachment

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[17] 7 U.S.C. § 6d. Additionally, Title VIII of the Dodd-Frank Act, in permitting systemically important DCOs to deposit customer funds at Federal Reserve Banks, thereby subjects the Federal Reserve Banks to compliance with the segregation requirements of Section 4d of the CEA. *See* Dodd-Frank Act, Pub. L. No. 111-203, 124. Stat 1376 (2010).

[18] *See* discussion *supra* Part I.B. (emphasizing the favorable policy considerations of holding customer funds at a central bank, as supported by Title VIII of the Dodd-Frank Act and the PFMIs). Regulation 1.49(d)(3) has not been updated to align with Title VIII of the Dodd-Frank Act, nor with the standards set forth in the PFMIs.

# **Exhibit 1**

Form of Proposed BoC Acknowledgment Letter (Futures)

[Date]

The Bank of Canada
234 rue Laurier Street
Ottawa, ON, Canada K1A 0G9

1. We refer to the Segregated Account which Chicago Mercantile Exchange, Inc. ("we" or "our") have opened with the Bank of Canada ("you" or "your") entitled: "Chicago Mercantile Exchange, Inc. Futures Customer Omnibus Cash Account, CFTC Regulation 1.20 Customer Segregated Account under Sections 4d(a) and 4d(b) of the Commodity Exchange Act", abbreviated as "[short title reflected in the depository's electronic system]", sort code: [ ], account number [ ] (the "Account").

2. We have informed you that we have opened the above-referenced Account for the purpose of depositing money ("Funds") of customers who trade commodities, options, swaps, and other products, as required by Commodity Futures Trading Commission ("CFTC") Regulations, including Regulation 1.20, as amended.

3. You have confirmed that the Funds held by you, hereafter deposited in the Account or accruing to the credit of the Account, will be separately accounted for and segregated on your books from our own funds and from any other funds or accounts held by us (which we have informed you is required pursuant to the provisions of the Commodity Exchange Act, as amended (the "Act"), and Part 1 of the CFTC's regulations, as amended). We have informed you that we will otherwise treat the Funds in accordance with the provisions of Section 4d of the Act and CFTC regulations thereunder .

4. You have also agreed to waive, in respect of the Account, your rights of set off by including in the Account Agreement that governs the Account a provision that waives your right of set off arising under the Account Agreement and general law.

5. You agree to reply as soon as reasonably practicable and directly to any request for confirmation of account balances or provision of any other information regarding or related to the Account from the director of the Division of Clearing and Risk of the CFTC or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees, and this letter constitutes the authorization and direction of the undersigned on our behalf to release the requested information without further notice to or consent from us.

6. We have informed you that we will not hold you responsible for acting pursuant to any information request from the director of the Division of Clearing and Risk of the CFTC or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees.

7. Except with respect to paragraph 5 above, this letter is not intended to amend the Account Agreement. For the avoidance of doubt, you provide no opinion on or agreement with information we have provided to you in this letter, including
with respect to matters of U.S. law.

Chicago Mercantile Exchange, Inc.

By: _____
Print Name:
Title:

ACKNOWLEDGED:

The Bank of Canada

By: _____
Print Name:
Title:
Contact Information: [Insert phone number and email address]
DATE:

Form of Proposed BoC Acknowledgment Letter (Cleared Swaps)

[Date]

The Bank of Canada
234 rue Laurier Street
Ottawa, ON, Canada K1A 0G9

1. We refer to the Segregated Account which Chicago Mercantile Exchange, Inc. ("we" or "our") have opened with the Bank of Canada ("you" or "your") entitled: "Chicago Mercantile Exchange, Inc. Cleared Swaps Customer Account, CFTC Part 22 Cleared Swaps Customer Account under Section 4d(f) of the Commodity Exchange Act", abbreviated as "[short title reflected in the depository's electronic system]", sort code: [ ], account number [ ] (the "Account").

2. We have informed you that we have opened the above-referenced Account for the purpose of depositing money ("Funds") of customers who trade commodities, options, swaps, and other products, as required by Commodity Futures Trading Commission ("CFTC") Regulations, including Regulation 22.5, as amended.

3. You have confirmed that the Funds held by you, hereafter deposited in the Account or accruing to the credit of the Account, will be separately accounted for and segregated on your books from our own funds and from any other funds or accounts held by us (which we have informed you is required pursuant to the provisions of the Commodity Exchange Act, as amended (the "Act"), and Part 22 of the CFTC's regulations, as amended). We have informed you that we will otherwise treat the Funds in accordance with the provisions of Section 4d of the Act and CFTC regulations thereunder.

4. You have also agreed to waive, in respect of the Account, your rights of set off by including in the Account Agreement that governs the Account a provision that waives your right of set off arising under the Account Agreement and general law.

5. You agree to reply as soon as reasonably practicable and directly to any request for confirmation of account balances or provision of any other information regarding or related to the Account from the director of the Division of Clearing and Risk of the CFTC or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees, and this letter constitutes the authorization and direction of the undersigned on our behalf to release the requested information without further notice to or consent from us.

6. We have informed you that we will not hold you responsible for acting pursuant to any information request from the director of the Division of Clearing and Risk of the CFTC or the director of the Division of Swap Dealer and Intermediary Oversight of the CFTC, or any successor divisions, or such directors' designees.

7. Except with respect to paragraph 5 above, this letter is not intended to amend the Account

Agreement. For the avoidance of doubt, you provide no opinion on or agreement with information we have provided to you in this letter, including with respect to matters of U.S. law.

Chicago Mercantile Exchange, Inc.

By: _____
Print Name:
Title:

ACKNOWLEDGED:

The Bank of Canada

By: _____
Print Name:
Title:
Contact Information: [Insert phone number and email address]
DATE: