



U.S. COMMODITY FUTURES TRADING COMMISSION

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CFTC Letter No. 18-31
No-Action
December 20, 2018
Division of Clearing and Risk

Heike Eckert, Chief Operating Officer
Oliver Haderup, Chief Compliance Officer
Eurex Clearing AG
Mergenthalerallee 61
65760 Eschborn, Germany

December 20, 2018

Re: No-Action Relief from Regulations 1.49(d)(3), 1.49(e)(1)(i), and 22.9 to Permit Futures Commission Merchants that are Clearing Members of Eurex Clearing AG to Deposit Customer-Owned Securities as Margin Collateral for Swap Transactions with Clearstream Banking AG

Dear Ms. Eckert and Mr. Haderup:

This is in response to your letter dated November 5, 2015 (“November 2015 Letter”) to the Division of Clearing and Risk (“DCR”) of the Commodity Futures Trading Commission (“CFTC” or “Commission”). In your November 2015 Letter, you requested that DCR exempt Eurex Clearing AG (“Eurex Clearing”), futures commission merchants (“FCMs”) that are clearing members of Eurex Clearing, and Clearstream Banking AG (“CBF”) from Commission Regulation 1.49(d)(3) in order to permit Eurex Clearing and its clearing member FCMs to maintain customer securities as margin for cleared swap transactions with CBF, a central securities depository (“CSD”) based in Germany.¹ The November 2015 Letter was supplemented by further written submissions dated January 20, 2016, March 7, 2017, March 27, 2018, April 27, 2018, May 25, 2018, and September 7, 2018.

DCR and the Division of Swap Dealer and Intermediary Oversight (“DSIO” and collectively with DCR, the “Divisions”) are jointly responding to your request as it extends to how customer securities are held as margin collateral for cleared swap transactions by both Eurex Clearing, as a registered derivatives clearing organization (“DCO”), and by FCMs as clearing members of Eurex Clearing.

¹ During the course of discussions with Commission Staff, you amended your request for exemption from Regulation 1.49(d)(3) to a request for no-action relief from Regulation 1.49(d)(3).

Relevant Statutory Provisions and Commission Regulations

Section 4d(f) of the Commodity Exchange Act (“CEA”)² requires each FCM to deal with all money, securities and property received from a customer to margin a swap cleared through a DCO as belonging to such customer.³ Section 4d(f) further provides that customer margin shall be separately accounted for and not commingled with the FCM’s own property.⁴ FCMs may, however, commingle the margin received from more than one swap customer and deposit such funds in an account with any bank, trust company, or DCO.⁵

Commission Regulations 1.49(d)(3) and 22.9 provide, in relevant part, that an FCM or DCO may hold customer funds deposited to margin cleared swap positions with banks located outside of the U.S. provided that such banks maintain regulatory capital in excess of \$1 billion.⁶

Commission Regulation 1.49(e)(1)(i) provides, in relevant part, that each FCM and DCO must hold in segregated accounts on behalf of customers sufficient U.S. dollars, held in the U.S., to meet all U.S. dollar obligations.⁷

2016 European Commission-CFTC Agreement

In February 2016, the CFTC and the European Commission (“EC”) reached an agreement regarding requirements for cross-border central counterparties (“CCPs”). Based on this agreement (referred to as “the 2016 EC-CFTC Agreement”), in March 2016, the CFTC issued a comparability determination for dually-registered CCPs located in the European Union (“EU”) with respect to certain EU rules. At the same time, CFTC staff issued CFTC Staff Letter No. 16-26, which provided no-action relief from certain Commission requirements for EU-based CCPs that are registered with the CFTC as DCOs in order to facilitate cross border regulatory cooperation.⁸

Further as set forth in the 2016 EC-CFTC Agreement, also in March 2016, the EC adopted an equivalence decision with respect to the CFTC’s regulatory regime for DCOs. The equivalence decision allows U.S.-based DCOs to obtain recognition by the European Securities and Markets Authority (“ESMA”) and to operate within the EU provided that the

² 7 U.S.C. §§ 1 *et seq.*

³ CEA §4d(f)(2)(A).

⁴ CEA §4d(f)(2)(B).

⁵ CEA §4d(f)(3)(A)(i).

⁶ 17 C.F.R. §§1.49(d)(3), 22.9. Regulation 1.49(d)(3) provides that to hold customer funds for cleared swap transactions, a depository located outside of the U.S. must be: (1) a bank or trust company that has in excess of \$1 billion of regulatory capital; (2) a registered futures commission merchant; or (3) a derivatives clearing organization.

⁷ 17 C.F.R. §1.49(e)(1)(i).

⁸ See CFTC Staff Letter No. 16-26 (Mar. 16, 2016), *available at* <https://www.cftc.gov/sites/default/files/idc/groups/public/@lrllettergeneral/documents/letter/16-26.pdf>.

U.S.-based DCOs have rules and procedures consistent with three specific EMIR requirements (known as the “Recognition Conditions”). To date, ESMA has granted recognition to five U.S.-based DCOs consistent with the terms laid out in the 2016 EC-CFTC Agreement.

The 2016 EC-CFTC Agreement has fostered cooperation and mutual respect between EU and the CFTC in regards to the regulation of cross-border CCPs. The no-action relief described in this letter is, in part, issued based upon this agreement as well as continued cooperation and mutual respect between the jurisdictions.

Background and Representations by Eurex Clearing

1. Eurex Clearing

Eurex Clearing is a DCO registered under section 5b of the CEA. Eurex Clearing is authorized by the Commission as a DCO to clear certain swap transactions, including swap transactions of customers of FCMs that are clearing members of Eurex Clearing.⁹

2. The Clearstream CSDs

CBF is a CSD based in Eschborn, Germany. CBF is licensed and regulated by the German Federal Financial Supervisory Authority (Bundesanstalt für Finanzdienstleistungsaufsicht – “BaFin”) as a deposit taking credit institution under the German Banking Act (Kreditwesengesetz) and is allowed to provide deposit business, credit business, and safe custody business, and to engage in proprietary trading.¹⁰ CBF is recognized as the German CSD under the German Safe Custody Act, and, as the German CSD, CBF is a custodian for securities accepted in Germany and issued by German and international issuers in the form of collective or individual certificates or registration rights.

CBF is affiliated with Clearstream Banking S.A. (“CBL”), an international CSD based in Luxembourg. CBL is supervised by the Luxembourg Commission de Surveillance du Secteur Financier and the Banque Centrale du Luxembourg. CBF and CBL are subsidiaries of Clearstream International S.A., which is part of the Deutsche Börse Group. Eurex Clearing is also part of the Deutsche Börse Group.

You represent that both CBF and CBL are subject to, and have applied for a license under, the EU’s Central Securities Depositories Regulation (“CSDR”), which sets forth enhanced regulations for EU-based CSDs.

⁹ *In the Matter of the Application of Eurex Clearing AG For Registration as a Derivatives Clearing Organization*, Order of Registration (Feb. 1, 2016), available at <https://www.cftc.gov/sites/default/files/idc/groups/public/@otherif/documents/ifdocs/orgdcoeurclorder212016.pdf>.

¹⁰ You also represent that, while Clearstream AG is licensed as a bank, it operates primarily as a CSD and the activities that it undertakes pursuant to its banking license are purely ancillary to its operations as a CSD.

3. International Standards for the Regulation of CSDs

The *Principles for Financial Market Infrastructures* (“PFMI”)¹¹ set forth international standards for the regulation of CSDs. According to the PFMI, CSDs “play a critical role in the protection of securities and help ensure the integrity of securities transactions.”¹² Guidance contained in the PFMI provides that CSDs “should support operationally the segregation of securities belonging to a participant’s customers on the participant’s books” and that “segregation of accounts typically helps provide appropriate protection against the claims of a CSD’s creditors or the claims of the creditors of a participant in the event of its insolvency.”¹³

You represent that CBF fulfills the PFMI guidance of holding securities in segregation and providing appropriate bankruptcy protection. Moreover, Germany has reported that it has implemented the PFMI related to CSDs,¹⁴ and the International Monetary Fund has concluded that CBF broadly or fully observes the principles in the PFMI that are applicable to CSDs.¹⁵

4. FCM Clearing Member Accounts at CBF

You represent that Eurex Clearing’s FCM clearing members will deposit customer-owned securities as margin collateral for cleared swap transactions with CBF. You represent that each FCM clearing member of Eurex Clearing will establish one or more segregated accounts at CBF to hold securities deposited by customers to margin their cleared swap transactions. You represent that each FCM clearing member that opens a customer securities account at CBF will obtain an acknowledgment letter from CBF in accordance with Commission Regulations 1.20 and 22.5. You acknowledge that CBF is obligated to provide daily account balance information for each FCM customer account it maintains to the relevant designated self-regulatory organization (either Chicago Mercantile Exchange (“CME”) or the National Futures Association (“NFA”)) pursuant to applicable CME/NFA rules in order to qualify as a depository for customer funds.

You represent that the customer securities maintained at CBF in the FCM’s account will be pledged in favor of Eurex Clearing under a German-law pledge agreement. According to your written submissions, the German-law pledge is perfected by Eurex Clearing’s requirement that the pledged securities accounts be titled as pledged accounts within CBF’s systems.

In the event of an FCM clearing member default, you represent that Eurex Clearing’s secured claim over the pledged securities would become due, and Eurex Clearing would be

¹¹ <https://www.bis.org/cpmi/publ/d101a.pdf>.

¹² PFMI, Principle 11.

¹³ PFMI, Principle 11, Explanatory Note 3.11.6.

¹⁴ See *Implementation Monitoring of PFMIs: Second Update to Level 1 Assessment Report*, at 28 (June 2015), available at <http://www.bis.org/cpmi/publ/d129.pdf>.

¹⁵ See *Luxembourg – Financial Sector Assessment Program* (Aug. 2017), available at <https://www.imf.org/~media/Files/Publications/CR/2017/cr17260.ashx>.

entitled under the pledge agreement to sell or appropriate the securities to satisfy its claim. You represent that, in such a situation, Eurex Clearing would notify CBF and would instruct it to transfer the securities in the pledged account accordingly. You further represent Eurex Clearing would, after application of Eurex Clearing's secured claim, direct CBF to return any securities remaining in the pledge account to the bankruptcy trustee for the defaulting FCM.

5. CBF's Use of Sub-Custodians

You represent that, while CBF holds German securities directly, CBF uses an international network of linked CSDs to hold non-German securities. Certain non-German securities are held at foreign CSDs with which CBF has a direct link. In such cases, CBF is fully liable for the negligence of the foreign CSD and is prohibited under German law from contracting out of such liability. You further represent that other non-German securities are held at foreign CSDs with which CBF has an indirect link through its affiliate CBL.¹⁶ In such cases, CBF's liability is limited to the diligent selection and instruction of the relevant sub-custodian.

You represent that the legal framework that applies to CBF with respect to directly and indirectly linked foreign CSDs offers protections for the customer securities deposited with CBF. In this regard, you represent that, under German law, in order to establish a relationship with a foreign CSD, CBF must obtain a "three-point declaration" that provides that the foreign CSD (a) recognizes that the securities deposited with it are customer securities of CBF; (b) will not assert any security interest or lien on the securities deposited by CBF (other than for claims that arise from the custody or administration of such securities); and (c) will not sub-deposit the securities deposited by CBF with a third party or transfer them to another country without the express consent of CBF. In addition, you represent that, in on-boarding a foreign CSD as a sub-custodian, CBF obtains an opinion of legal counsel confirming the foreign CSD's ability to perform as required under the custody agreement between CBF and the foreign CSD. Such legal opinion confirms, among other things, the enforceability of the foreign CSD's obligations, the segregation of the foreign CSD's assets from those of its customers, and the recoverability of customer securities in the event of a bankruptcy. You further represent that CBL obtains a three-point declaration and a similar opinion of counsel from the intermediaries and foreign CSDs with which it links.

You represent that, despite CBF's use of linked national CSDs and an international network of custodians, in the event of Eurex Clearing's insolvency, the situs of Eurex Clearing's customer accounts would be with CBF in Germany, the depository with which Eurex Clearing's FCM clearing members have established securities accounts.

During the course of discussions with staff of the Divisions, you proposed to restrict the scope of securities that FCM clearing members and their customers may use as initial margin for cleared swap transactions to securities of the following six jurisdictions:

¹⁶ CBL, in turn, links directly to other CSDs or indirectly to other CSDs through intermediary banks.

Germany, France, United States, Canada, United Kingdom, and Japan. You represent that each of the CSDs and intermediaries in the custody chains for these six jurisdictions is either (a) a bank with at least \$1 billion in regulatory capital; (b) a CSD regulated as a CSD consistent with the standards set forth in the PFMI; or (c) a central bank. You also represent that, at each financial institution within each of the custody chains in the six relevant jurisdictions, the relevant securities are held in omnibus accounts and, to the extent such accounts hold customer securities, they are clearly labelled as holding customer securities.

6. Holding of U.S. Dollar-Denominated Securities at CBF

You represent that, because Eurex Clearing is proposing to accept U.S. dollar-denominated securities as initial margin to collateralize cleared swap transactions, and because such U.S. dollar-denominated securities will be held at CBF in Germany, Eurex Clearing and its clearing member FCMs will also require no-action relief from Regulation 1.49(e)(1)(i).

You represent that U.S. dollar-denominated securities would be held through a network of custodians that include CBF, CBL, Citibank, N.A., and the issuer of the securities (either the Depository Trust Company (“DTC”) or Fedwire Securities).

Requested Relief

1. Regulations 1.49(d)(3) and 22.9

You requested an exemption from Regulations 1.49(d)(3) and 22.9 as it relates to Eurex Clearing’s FCM clearing members depositing customer securities with CBF to margin cleared swap transactions. You acknowledge that, while CBF is licensed as a bank and a deposit-taking credit institution under German law, it does not maintain regulatory capital in excess of \$1 billion as required under Regulations 1.49(d)(3) and 22.9.

In support of your request, you represent that CBF operates and is regulated primarily as a CSD. You represent that CBF’s activities pursuant to its banking license are purely ancillary to its operations as a CSD. In this connection, you represent that CBF does not accept customer deposits, make loans, or engage in proprietary trading.

2. Regulation 1.49(e)(1)(i)

You also requested relief from Regulation 1.49(e)(1)(i) on behalf of Eurex Clearing and its clearing member FCMs. You acknowledge that an FCM holding customer securities denominated in U.S. dollars at CBF (outside the U.S.) does not constitute the FCM holding U.S. dollar denominated assets in the U.S. to meet its U.S. dollar obligations to customers under Regulation 1.49(e)(1)(i).

In support of your request, you represent that in the event of insolvency of Eurex Clearing, an FCM, CBF, CBL, Citibank, N.A. or DTC, any U.S. dollar-denominated customer securities deposited at CBF would be fully protected from the claims of third-party creditors

under both German and Luxembourg law as they move through the custody chain back to the U.S.¹⁷

Grant of No-Action Relief

Based upon the facts and representations made in your submissions, the Divisions will not recommend that the Commission commence an enforcement action against Eurex Clearing or FCMs that are clearing members of Eurex Clearing to the extent Eurex Clearing and/or such FCMs maintain customer securities to margin swap transactions cleared by Eurex Clearing with CBF as a depository, notwithstanding the requirements in Regulations 1.49(d)(3), 1.49(e)(1)(i), and 22.9. This relief is subject to the following conditions:

- 1) The relief is limited to CBF's holding of customer-owned securities as margin for customer swap transactions cleared through Eurex Clearing, and does not extend to the holding of customer margin for futures contracts by CBF.
- 2) The relief is conditioned upon each FCM clearing member of Eurex Clearing providing each prospective Eurex Clearing Customer¹⁸ with a written disclosure statement prior to the Eurex Clearing Customer entering into swap transactions cleared by Eurex Clearing. The disclosure statement must describe (a) the Eurex Clearing clearing process; (b) the risks associated with the holding of customer securities in foreign jurisdictions, including the holding of customer securities at CSDs and sub-custodians; and (c) the operation of Framework 2 of Part 190 of the Commission's regulations in the event of an FCM bankruptcy.
- 3) In the event that an FCM clearing member of Eurex Clearing carries, for another (non-clearing) FCM, a customer omnibus account that includes swap positions cleared through Eurex Clearing, this relief is conditioned upon the FCM clearing member of Eurex Clearing taking steps reasonably designed to ensure that the non-clearing FCM has provided the written disclosure statement set forth in condition (2) above to its customers who are trading or intend to trade such swaps.
- 4) Each FCM clearing member of Eurex Clearing must, upon opening an account with CBF to hold customer securities as margin for cleared swap transactions, obtain an acknowledgment letter from CBF in accordance with Commission Regulations 1.20 and 22.5.

¹⁷ Similarly, with respect to any of the other currencies permitted under this relief, you represent that, in the event of an insolvency of Eurex Clearing, an FCM, CBF, CBL (if applicable), the intermediary bank (if applicable) and the relevant sub-custodian, securities will be fully protected from the claims of third-party creditors as those securities move through the custody chain back to the originating jurisdiction.

¹⁸ "Eurex Clearing Customer" is defined as each customer with an account at an FCM clearing member of Eurex Clearing for swap positions cleared through Eurex Clearing.

- 5) Eurex Clearing and its FCM clearing members may only accept customer-owned securities that are issued by the governments of, or issuers located in, the following six jurisdictions to margin swap transactions cleared through Eurex Clearing: Germany, France, United States, Canada, United Kingdom, and Japan.
- 6) Eurex Clearing must at least annually conduct due diligence to determine that each entity in the custody chain for each of the six relevant jurisdictions (as listed above) (1) continues to be either (i) a bank with at least \$1 billion in regulatory capital; (ii) a CSD regulated as a CSD consistent with the standards set forth in the PFMI; or (iii) a central bank; and (2) continues to be in good regulatory standing. To the extent Eurex Clearing determines that any of the entities in the custody chain does not meet one of those conditions, Eurex Clearing must notify the Commission and its FCM clearing members immediately, and, within 14 days thereafter, that entity will no longer be an eligible depository for purposes of this relief.
- 7) The amount of U.S. dollar-denominated securities held at CBF pursuant to the relief from regulation 1.49(e)(1)(i) shall be no greater than the sum of the amounts of such customer collateral authorized by the FCM's Eurex Clearing Customers to be held at or through CBF.
- 8) Eurex Clearing and its FCM clearing members are not excused from their obligation to comply with all other Commission regulations (both with respect to CBF and otherwise), including but not limited to, regulations 1.11 and 39.15.¹⁹

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 Divisions' position does not necessarily reflect the views of the Commission or any other division or office of the Commission. The Divisions' position is based upon the representations made in your submission, and any different, changed, or omitted material facts or circumstances may require a different conclusion.

Moreover, where relevant developments make it necessary for Division staff to reconsider the no-action relief issued in CFTC Staff Letter No. 16-26 such as a material increase in the EU legal and supervisory requirements that U.S. DCOs currently recognized in the EU must adhere to in order to maintain recognition status (*e.g.*, the Recognition Conditions), Division staff will, if appropriate, take action to rescind such relief with adequate notice to allow for an orderly transition. Division staff will review regulatory developments

¹⁹ Though under Eurex's proposed structure, the accounts at CBF are not in Eurex Clearing's name, Staff interprets regulation 39.15(c) as applying to Eurex Clearing in that Eurex Clearing must establish arrangements for the holding of customer assets in such a way as to minimize the risk of loss or delay in the access by the DCO to such assets.

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in the EU affecting U.S. DCOs on a regular basis to determine whether such relief will be rescinded. Further, a repeal of the relief under CFTC Staff Letter No. 16-26, will lead to a reconsideration of the no-action relief provided herein, as this relief has been granted, in relevant part, based on the interests of comity and cross-border coordination set forth in the 2016 EC-CFTC Agreement.

Finally, as with all no-action letters, the Divisions retain the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

Should you have any questions, please do not hesitate to contact Andrée Goldsmith, Special Counsel, Division of Clearing and Risk, at (202) 418-6624; or Josh Beale, Associate Director, Division of Swap Dealer and Intermediary Oversight, at (202) 418-5446.

Sincerely,

Brian A. Bussey
Director, DCR

Matthew B. Kulkin
Director, DSIO