



## U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and Intermediary Oversight  
Division of Market Oversight

Re: Request for No-Action Position Concerning the Applicability of the Margin Rules for Uncleared Swaps and Certain Swap Data Reporting Requirements to Certain Listed Warrants

Dear Sir or Madam:

This letter is in response to a request dated June 3, 2019, as revised on December 23, 2019, received by the Division of Swap Dealer and Intermediary Oversight (“DSIO”) and the Division of Market Oversight (“DMO”) of the Commodity Futures Trading Commission (“CFTC” or “Commission”) (together, “Divisions”) from [Firm A] seeking the above-captioned no-action position. For the reasons discussed below, [Firm A] requests a no-action position for failure to comply with Commission regulations 23.150 through 23.161 (the “Margin Rules”)<sup>1</sup> and Commission regulations 45.3, 45.4, 45.5, 45.6, 45.7, 45.14, 46.3, 46.4, and 46.11 (the “Reporting Rules”)<sup>2</sup> with respect to certain warrants linked to foreign exchange (“FX”) rates or commodity prices issued by [Firm A] and listed on various exchanges in the European Union (“EU”) (collectively, the “FX/Commodity Warrants”).

### **Relevant Statutory Provisions and Commission Regulations**

Section (2)(a)(13)(G) of the Commodity Exchange Act (“CEA”)<sup>3</sup> requires all swaps, whether cleared or uncleared, to be reported to swap data repositories (“SDRs”). Section 4r(a)(2)(A) provides for the reporting of pre-enactment swaps, and section 2(h)(5) provides for the reporting of transition swaps. Section 4r(a)(1) requires that each swap not accepted for clearing by any

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<sup>1</sup> See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016). The Margin Rules, which became effective on April 1, 2016, are codified in part 23 of the Commission’s regulations. 17 CFR 23.150 - 23.159, 23.161. In May 2016, the Commission amended the Margin Rules to add Commission regulation 23.160, providing rules on the cross border application of the Margin Rules. See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants – Cross-Border Application of the Margin Requirements, 81 FR 34818 (May 31, 2016); 17 CFR 23.160.

<sup>2</sup> See Swap Data Recordkeeping and Reporting Requirements, 77 FR 2136 (Jan. 13, 2012); see also Swap Data Recordkeeping and Reporting Requirements: Pre-Enactment and Transition Swaps, 77 FR 35200 (June 12, 2012).

<sup>3</sup> 7 U.S.C. § 1 *et. seq.*

derivatives clearing organization be reported to an SDR (or to the Commission if no SDR accepts reporting for the swap). Section 21(b)(1)(A) directs the Commission to prescribe standards specifying the data elements for each swap to be collected and maintained by each registered SDR. Section 4s(e) requires the Commission to adopt margin requirements for uncleared swaps for swap dealers (“SD”) and major swap participants (“MSPs”) for which there is no “Prudential Regulator.”<sup>4</sup>

Consistent with these mandates, the Commission adopted, among other regulations, the Reporting Rules, which set forth swap data reporting requirements, and the Margin Rules, which set forth margin requirements for uncleared swaps.

### **Background**

[Firm A], a subsidiary of [Group B], represents that [Affiliate C], an SD provisionally registered with the Commission and organized in the United Kingdom (“UK”), provides investment services, including swap dealing services, to EU counterparties pursuant to a “passport” under the revised EU Markets in Financial Instruments Directive (“MiFID II”). [Firm A] states that following the UK’s withdrawal from the EU (“Brexit”), [Affiliate C] expects that it will no longer be able to rely on a MiFID II passport. In preparation for that event, [Affiliate C] has transferred parts of its swap business, including swap trading relationships with relevant European counterparties and certain U.S. persons, to [Firm A].<sup>5</sup>

[Firm A] states that it is a [Country D] securities broker-dealer regulated by [Country D’s] financial regulator (“[Regulator E]”). As a result of the transfer of [Affiliate C’s] swap trading relationships to [Firm A], [Firm A] has crossed the \$8 billion aggregate gross notional amount threshold for the SD *de minimis* exception and is therefore required to register as an SD with the Commission. [Firm A] filed an application to register as an SD on [Date F],<sup>6</sup> and is expected to become provisionally registered no later than [Date H].

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<sup>4</sup> See 7 U.S.C. 1a(39) (defining the term “Prudential Regulator” to include the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency). The Commission’s margin requirements for uncleared swaps apply only to SDs and MSPs for which there is not a Prudential Regulator. See 7 U.S.C. 6s(e)(1)(B). SDs and MSPs for which there is a Prudential Regulator must meet the margin requirements for uncleared swaps established by the applicable Prudential Regulator. 7 U.S.C. 6s(e)(1)(A). The Prudential Regulators published final margin requirements in November 2015. See Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015). Firm A is not a bank and does not engage in banking activity. As such, Firm A will be required to comply with the CFTC’s Margin Rules rather than the Prudential Regulators’ margin requirements.

<sup>5</sup> Given that Affiliate C has already transferred its swap business to Firm A, the no-action relief set out in this letter is not dependent on the occurrence or non-occurrence of Brexit.

<sup>6</sup> Group B contacted the Divisions [on Date G, after Date F] about the FX/Commodity Warrants and raised the issue of no-action relief.

[Firm A] states that, among other businesses, it has a listed warrants program,<sup>7</sup> with approximately 175,000 warrants listed across six exchanges in Germany, France, Portugal, the Netherlands, Finland, and Sweden. The overall trading volume is roughly [Amount I] trades per day across Europe. [Firm A] has represented in communications with the Divisions that the vast majority of the warrants relate to securities or security index options that do not implicate the Commission's jurisdiction. A small portion of the warrants, however, are linked to FX rates or commodity prices.

[Firm A] states that the outstanding market value of the FX/Commodity Warrants demonstrates that they are not a source of systemic risk. As of [Date J], the outstanding market value of the FX/Commodity Warrants was less than USD [Amount K] million in the aggregate. [Firm A] further represents that it imposes offering and transfer restrictions designed to prevent the offer, sale, or resale of the FX/Commodity Warrants to any investor who is defined as a U.S. person.<sup>8</sup>

[Firm A] states that the FX/Commodity Warrants, which are comprehensively regulated as securities in the EU,<sup>9</sup> could be treated as swaps under the CEA. If treated as swaps, they would become subject to the Margin and Reporting Rules.<sup>10</sup> Accordingly, [Firm A] requests relief from the Margin and Reporting Rules for these instruments.

[Firm A] represents that the FX/Commodity Warrants are frequently traded anonymously on an exchange and cleared and settled through a central clearinghouse, with investors holding the FX/Commodity Warrants through a broker-dealer or other custodian, and settlement occurring on a delivery-versus-payment basis against the clearing organization. [Firm A] does not know

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<sup>7</sup> Key product features of the FX/Commodity Warrants include: (i) investors fully pay for each warrant upon purchase; (ii) tenors can range from a few months to two years, unless the warrants are open-ended; and (iii) each warrant entitles the investor to a payment from [Firm A] contingent on the performance of a specified FX rate or commodity price relative to a strike level. Investors in FX/Commodity Warrants are not required to make any margin or settlement payments during the life of the FX/Commodity Warrants or at maturity. [Firm A] is not subject by the terms of the FX/Commodity Warrants to mark-to-market margining requirements.

<sup>8</sup> See 17 C.F.R. 23.160 (defining the term "U.S. person"). See also Interpretive Guidance and Policy Statement Regarding Compliance With Certain Swap Regulations, 78 FR 45292 (July 26, 2013) (commonly known as the "Cross-Border Guidance"), available at: <https://www.gpo.gov/fdsys/pkg/FR2013-07-26/pdf/2013-17958.pdf>.

<sup>9</sup> [Firm A] represents that the FX/Commodity Warrants are subject to regulation as securities under the EU Prospectus Directive and Regulation, MiFID II and the Markets in Financial Regulation, and the Packaged Retail and Insurance-Based Investment Products Regulations. [Firm A] further represents that it offers the FX/Commodity Warrants through a prospectus. The prospectus is filed with [Regulator E] and includes extensive disclosures regarding the risks of investing in FX/Commodity Warrants, including [Firm A] credit risk, and also includes key financial information regarding [Firm A] as the issuer of the FX/Commodity Warrants.

<sup>10</sup> [Firm A] states that it would generally be eligible for substituted compliance with the European Market Infrastructure Regulation's ("EMIR") margin requirements in lieu of compliance with the Margin Rules if the FX/Commodity Warrants were deemed to be swaps. However, because the instruments do not qualify as OTC derivatives under EMIR, the FX/Commodity Warrants fall outside the scope of substituted compliance. See Comparability Determination for the European Union: Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 82 FR 48394 (Oct. 18, 2017).

the identities of the ultimate beneficial owners of the FX/Commodity Warrants except in the rare event that a beneficial owner is separately a brokerage client of [Firm A] or an affiliate.

In most instances, [Firm A] does not even know when an investor has sold an FX/Commodity Warrant to another investor or broker-dealer because investors can trade FX/Commodity Warrants anonymously with third parties on an exchange or over-the-counter through their brokers without consulting [Firm A]. Accordingly, because [Firm A] does not have a direct relationship with FX/Commodity Warrants investors, [Firm A] states that it would be unable to determine whether the investors are financial end users with whom [Firm A] would be required to exchange margin under the Margin Rules, nor would it be feasible for [Firm A] to exchange margin with those persons.<sup>11</sup>

As result of the lack of visibility into the identity of the investors, [Firm A] also states that it would be unable to report information about its counterparties or lifecycle event data to an SDR under the Reporting Rules. However, [Firm A] states that the exchanges on which roughly 24 percent (by number of trades) of the FX/Commodity Warrants are transacted obligate [Firm A] to provide two-way bid and offer quotes in outstanding FX/Commodity Warrants and that, accordingly, there is extensive pre-trade price transparency in the form of two-way bid and offer quotes on these exchanges. [Firm A] also states that the FX/Commodity Warrants are subject to post-trade transparency reporting as required under MiFID II.

### **No-Action Position**

The Divisions acknowledge that it may not be practicable, or in some cases possible (e.g., in the case of legal entity identifiers), for [Firm A] to fulfill its obligations under the Margin and Reporting Rules with respect to the FX/Commodity Warrants because, among other reasons, transactions involving such instruments are generally intermediated, and, as a result, [Firm A] does not know the identity of the owners of the instruments or lacks direct access to such persons. Without reaching a conclusion as to whether the FX/Commodity Warrants are swaps subject to the Margin and Reporting Rules, the Divisions believe that a no-action position with respect to the FX/Commodity Warrants, as requested by [Firm A], is appropriate under the circumstances described herein.

Based on the foregoing, the Divisions will not recommend that the Commission take enforcement action against [Firm A] for failure to comply with the Margin Rules or for failure to comply with the Reporting Rules with respect to the FX/Commodity Warrants, subject to the following conditions:

1. [Firm A] registers with the CFTC as an SD prior to [Date H].

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<sup>11</sup> As noted in footnote 7, *supra*, the FX/Commodity Warrants are fully paid at the time of purchase, and accordingly do not trigger variation margin under the Margin Rules.

2. [Firm A] is unable to identify the person who acquires or owns the FX/Commodity Warrants, unless such person is a brokerage client of [Firm A], [Group B], or an affiliate of either.
3. No clearing organization or derivatives clearing organization, as these terms are defined in Commission regulation 1.3, clears the FX/Commodity Warrants.
4. [Firm A] notifies DMO if the daily arithmetic average of the fair value/mark-to-market value of the FX/Commodity Warrants over the prior calendar quarter surpasses a EUR [Amount L] threshold.
5. [Firm A] continues to report the FX/Commodity Warrants in Europe pursuant to MiFID II.
6. [Firm A] imposes offering and transfer restrictions designed to prevent the offer, sale, or resale of the FX/Commodity Warrants to any investor who is defined as a U.S. person under Commission regulation 23.160 and the Cross-Border Guidance and other potentially relevant Commission rules, guidance, and updates thereto.

This letter, and the positions taken herein, represent the view of the Divisions only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in the Commission Regulations issued thereunder. Further, this letter, and the positions taken herein, is based upon the representations made to the Divisions. Any different, changed, or omitted material facts or circumstances might render this no-action position void. As with all no-action letters, the Divisions retain the authority to, in their discretion, further condition, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein.

Should you have any questions concerning the content of this staff no-action letter, please contact Carmen Moncada-Terry, Special Counsel, at (202) 418-5795 or [cmoncadaterry@cftc.gov](mailto:cmoncadaterry@cftc.gov); Warren Gorlick, Associate Director, at (202) 418-5195 or [wgorlick@cftc.gov](mailto:wgorlick@cftc.gov); Thomas J. Smith, Deputy Director, at (202) 418-5495 or [tsmith@cftc.gov](mailto:tsmith@cftc.gov), in DSIO, or David E. Aron, Special Counsel, at (202) 418-6621 or [daron@cftc.gov](mailto:daron@cftc.gov), or Eliezer Mishory, Special Counsel, at (202) 418-5609 or [emishory@cftc.gov](mailto:emishory@cftc.gov), in DMO.

Sincerely,

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