



Division of Clearing and Risk

U.S. COMMODITY FUTURES TRADING COMMISSION

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Clark Hutchison
Director

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RE: Request for No-Action Letter with regard to Section 4d(f) of the Commodity Exchange Act and Commission Regulations 1.20(g)(4) and 22.5; Request for Exemptive Letter with regard to Commission Regulation 1.49(d)(3)

Dear Ms. Poilvet-Clédière:

This is in response to your letter dated September 8, 2023 (“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 LCH SA (“LCH”) for failing to obtain, or provide the Commission with, an executed version of the template acknowledgment letter set forth in Appendix B to Regulation 1.20 (“Template Acknowledgment Letter”), as required by Regulations 1.20(g)(4) and 22.5, for customer accounts maintained at the Banque de France (“BdF”). You additionally request that, in connection with holding customer funds at the BdF, the Division grant an exemption from the requirements of Regulation 1.49(d)(3)(i), thereby permitting the BdF to hold customer funds, notwithstanding the fact that it does not hold regulatory capital.

I. No-Action Letter regarding the Written Acknowledgment 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 Acknowledgment Letter from each depository with which the DCO deposits futures customer funds or cleared swaps customer funds.¹ By letter

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). Regulation

dated September 8, 2023, LCH informed the Division that the BdF, a depository with which LCH seeks to maintain customer accounts, had indicated that it required certain modifications to the Template Acknowledgment Letter.

A. Statement of Facts

The Division understands the relevant facts to be as follows:

In addition to its registration with the Commission as a DCO, LCH is also a clearing agency regulated by the Securities Exchange Commission and an authorized central clearing counterparty under the European Market Infrastructure Regulation regulated by the Autorité de Contrôle Prudentiel et de Résolution, the BdF, and the Autorité des Marchés Financiers. As the central bank of the French Republic, the BdF is the issuer of bank notes within France, holds the French exchange reserves in gold and foreign currency, exercises the sovereign functions of overseeing market infrastructure, payment systems and credit institutions, and acts as lender of last resort. Under French law, the BdF may not be made insolvent.

LCH seeks to maintain accounts at the BdF into which LCH may deposit customer funds. In this regard, the BdF has indicated to LCH that it requires certain modifications to the Template Acknowledgment Letter associated with such accounts.

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

The Division notes that the BdF is a central bank for a money center country, which the Commission has recognized as a permissible location for a depository holding customer funds.² As a central bank, the BdF's provision of account services to LCH 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 Acknowledgment Letter.³

Further, the Commission contemplated the possibility that foreign depositories might require modifications to the Template Acknowledgment Letter in certain situations, in which

22.5 applies the Template Acknowledgment Letter requirements of Regulation 1.20(g)(4) to DCOs in connection with the holding of cleared swaps customer collateral.

² See Regulation 1.49(a)(1) (defining "money center country").

³ See 78 Fed. Reg. at 68,535. The Commission subsequently issued an exemption under Section 4(c) of the Commodity Exchange Act which exempts, in part, the Federal Reserve Banks from requirements relating to the provision of customer accounts. Order Exempting the Federal Reserve Banks From Sections 4d and 22 of the Commodity Exchange Act, 81 Fed. Reg. 53,467 (Aug. 12, 2016).

case the Commission would consider “alternative approaches” on a case-by-case basis.⁴ In recognition of this issue, the Division previously issued no-action letters to DCOs in connection with the holding of customer funds at the Bank of Canada, Deutsche Bundesbank, and the Bank of England.⁵ In light of the above, the Division has had discussions with the BdF regarding a mutually acceptable version of the Template Acknowledgment Letter, *i.e.*, the BdF Acknowledgment Letter, set forth in an attachment to this letter.

The Division further notes that both Title VIII of the Dodd-Frank Act and the CPMI-IOSCO Principles for Financial Market Infrastructures (“PFMIs”)⁶ support central banks acting as depositories for customer funds, due to certain favorable policy considerations. The BdF, in its capacity as a central bank for a money center country, 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;⁷ LCH would, therefore, face much lower credit and liquidity risk with a deposit at the BdF than it would with a deposit at a commercial bank. Thus, granting the requested no-action letter is appropriate to permit LCH to maintain customer accounts at the BdF.

C. Terms and Conditions set forth in the BdF Acknowledgment Letter

The BdF Acknowledgment Letter incorporates essential provisions of the Template Acknowledgment Letter and includes certain provisions that are specific to the customer accounts maintained at the BdF. Specifically, paragraph 1 of the BdF Acknowledgment Letter is consistent with the first clause of the second paragraph of the Template Acknowledgment Letter, stating that LCH has informed the BdF that it has opened the accounts for the purpose of depositing customer funds, as required by Commission regulations. Paragraph 2 of the BdF Acknowledgment Letter identifies the subject matter of the letter and makes no substantive change to the first paragraph of the Template Acknowledgment Letter.

⁴ 78 Fed. Reg. at 68,536.

⁵ See CFTC Letter No. 16-59 (June 21, 2016) (use of a modified acknowledgment letter for customer accounts maintained by the Chicago Mercantile Exchange, Inc. at the Bank of Canada); CFTC Letter No. 16-05 (Feb. 1, 2016) (use of a modified acknowledgment letter for customer accounts maintained by Eurex Clearing AG at Deutsche Bundesbank); and CFTC Letters No. 14-123 (Oct. 8, 2014), and 14-124 (Oct. 8, 2014) (use of a modified acknowledgment letter for customer accounts maintained by ICE Clear Europe Limited and LCH Ltd, respectively, at the Bank of England).

⁶ The PFMIs are a set of international risk management standards for financial market infrastructures, including DCOs, which have been adopted and implemented by many jurisdictions.

⁷ 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).

Paragraph 3 of the BdF Acknowledgment Letter is consistent with the second and third clauses of the second paragraph of the Template Acknowledgment Letter, including the requirement that funds in the accounts be separately accounted for, segregated from LCH's own funds, and otherwise treated in accordance with Section 4d of the Commodity Exchange Act ("CEA"). Paragraph 4 of the BdF Acknowledgment Letter refers to a provision in the account agreement between LCH and the BdF ("Account Agreement") in which the BdF waived its right of set off against the account. This provision is consistent with the third paragraph of the Template Acknowledgment Letter.

Paragraph 5 of the BdF Acknowledgment Letter provides that the BdF 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 of Clearing and Risk or the Market Participants Division. This provision deviates from the fourth paragraph of the Template Acknowledgment Letter in one respect, *i.e.*, the BdF is to provide a response "as soon as reasonably practicable" rather than "promptly." This change is intended to take into account such circumstances as time zone differences and French bank holidays which could impact the timing of the BdF's response.

Paragraph 6 of the BdF Acknowledgment Letter is consistent with the sixth paragraph of the Template Acknowledgment Letter, specifying that LCH will not hold the BdF responsible for acting pursuant to Commission inquiries in paragraph 5. Finally, paragraph 7 of the BdF Acknowledgment Letter clarifies that except for the BdF's commitment to waive its right of set off against the account in paragraph 4 and to respond to Commission inquiries in paragraph 5, the BdF Acknowledgment Letter is not intended to amend the Account Agreement. This provision also acknowledges that the BdF is not making any representations as to LCH's representations in the BdF Acknowledgment Letter, *e.g.*, the funds in the account are customer funds and LCH is treating them in accordance with Section 4d of the CEA.

D. Grant of No-Action Letter

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

The positions taken herein represent the views of the Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The staff positions taken in this letter do not excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in Commission regulations. Further, this letter, and the positions taken herein, are based upon the facts and circumstances presented to the Division. Any different, changed, or omitted material facts or circumstances might render the staff positions taken in this letter void.

II. Exemption from the Requirements of Commission Regulation 1.49(d)(3)

In the context of maintaining customer accounts at the BdF, LCH has requested that the Division grant an exemption from Regulation 1.49(d)(3) to permit LCH to hold customer funds at the BdF. Regulation 1.49(d)(3) provides that, in order to hold customer funds with a depository located outside of 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.⁸ The Division finds that Regulation 1.49(d)(3)(i) unintentionally precludes the BdF from acting as a depository for customer funds, notwithstanding that it is a central bank for a money center country, because the BdF cannot satisfy the regulatory capital requirement. Nonetheless, based on the following analysis, the Division is granting an exemption to LCH from the requirements of Regulation 1.49(d)(3).

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. The BdF, while it has adequate financial and operational resources to properly handle customer funds,⁹ 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 BdF, are not held to regulatory capital requirements. Therefore, because the BdF 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 foreign country.¹⁰ In addition, Regulation 1.49(c)(1)(ii) permits customer funds to be held in a depository located in France.¹¹ Section 4d of the CEA and Regulation 1.49(c)(1)(ii) can be read

⁸ 17 C.F.R. § 1.49(d)(3).

⁹ The BdF holds reserves of 2,436 tonnes of gold valued at approximately 133.6 billion Euros. See BdF Annual Report (2022), available at https://publications.banque-france.fr/sites/default/files/medias/documents/arb-2022_accounts_web.pdf.

¹⁰ 7 U.S.C. § 6d.

¹¹ 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 France. See Regulation 1.49(a)(1) (defining "money center country").

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January 16, 2024

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to permit the BdF to act as a depository for customer funds; however, Regulation 1.49(d)(3)(i), in its reference to *regulatory* capital, precludes the BdF in this regard.

As discussed in greater detail above,¹² there are distinct financial safeguards afforded by holding customer funds at the BdF, as a central bank for a money center country, that merit an exemption in this regard. The BdF, in its capacity as a central bank for a money center country, 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; LCH would, therefore, face much lower credit and liquidity risk with a deposit at the BdF than it would with a deposit at a commercial bank. The Division believes that granting the exemption would not be contrary to the public interest or to the purposes of Regulation 1.49(d)(3). Based on the foregoing, pursuant to delegated authority from the Commission, the Division hereby grants an exemption to LCH from the requirements of Regulation 1.49(d)(3) to permit LCH to hold customer funds at the BdF.

This exemption is based upon the representations of LCH and applicable laws and regulations in their current form; any new, different, or changed material facts or circumstances might render this exemption void. The positions taken herein do not excuse persons relying on the exemption from compliance with any other applicable requirements contained in the CEA or in Commission regulations.

Should you have any questions, please do not hesitate to contact Gavin Young, Special Counsel, at gyoung@cftc.gov, or (202) 418-5976.

Sincerely,

Clark Hutchison
Director

Attachment

¹² 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).