U.S. COMMODITY FUTURES TRADING COMMISSION
Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5430
Facsimile: (202) 418-5547

Division of Clearing and Risk

Re: No-Action Letter for EU-Based and UK-Based Registered Derivatives Clearing Organizations Regarding Certain Requirements under Parts 22 and 39 of the Commission's Regulations

Ladies and Gentlemen:

The Division of Clearing and Risk ("Division") of the Commodity Futures Trading Commission (the "Commission" or "CFTC") is replacing CFTC Letter 16-26,[1] which applied to European Union ("EU")-based central counterparties ("CCPs") that are registered with the Commission as derivatives clearing organizations ("DCOs"). This letter addresses the same Commission requirements discussed in CFTC Letter 16-26 for EU-based DCOs and extends the no-action position taken therein to DCOs based in the United Kingdom ("UK") that are registered with the Commission (together "DCOs/CCPs"):

(1) Regulation 39.12(b)(6)'s requirement that, upon a DCO's acceptance of a swap for clearing, the original swap is extinguished and it is replaced by an equal and opposite swap between the DCO and each clearing member (acting as a principal for a house trade or an agent for a customer trade) will not apply in the context of a DCO/CCP where neither party is a U.S. clearing member or a futures commission merchant ("FCM") clearing member;

(2) Part 22 of CFTC Regulations and its "legally segregated but operationally commingled" ("LSOC") account model for cleared swaps customer accounts will not apply in the context of a DCO/CCP to clearing members that are not FCMs;

(3) Regulation 39.13(g)(8)(i)'s requirement that a DCO calculate and collect

[1] CFTC Letter No. 16-26 (Mar. 16, 2016).

initial margin for customer accounts cleared by an FCM on a gross basis will not apply in the context of a DCO/CCP to non-FCM clearing member intermediaries;

(4) Regulation 39.13(g)(8)(ii)'s requirement that a DCO collect initial margin at a level that is not less than 100% of the DCO's clearing initial margin requirements for positions of FCM customers will not apply in the context of a DCO/CCP to such positions of the customers of non-FCM clearing member intermediaries;

(5) Regulation 39.12(a)(2)(iii)'s prohibition that a DCO not set a minimum capital requirement of more than $50 million for any person that seeks to become a clearing member to clear swaps will not apply in the context of a DCO/CCP to non-U.S. clearing members or non-FCM clearing members;

(6) Regulation 39.12(b)(7)'s requirement that DCOs utilize "straight-through-processing" of swaps submitted for clearing will not apply to trades that are not executed on or subject to the rules of a designated contract market ("DCM") or a swap execution facility ("SEF") and for which neither clearing member is an FCM, a swap dealer, or a major swap participant; and

(7) Regulation 39.13(h)(5)'s requirement that DCOs must require their clearing members to maintain written risk management policies and procedures and that DCOs must have the authority to obtain information and documents from clearing members regarding their risk will still apply; however, a DCO/CCP may implement different oversight programs for U.S./FCM clearing members and non-U.S. clearing members.[2]

CFTC Letter 16-26 was issued simultaneously with the Commission's comparability determination[3] regarding the European Market Infrastructure Regulation ("EMIR")[4] (the "EU comparability determination"). In particular, the EU comparability determination concludes that certain laws and regulations applicable in the EU provide a sufficient basis for an affirmative finding of comparability with respect to certain regulatory obligations applicable to DCOs that are registered with the Commission and are authorized to operate as CCPs in the EU.

[2] CFTC Letter 16-26 also covered Regulations 39.11(f) and 39.19(c)(3)(ii), which together required DCOs to prepare and submit to the Commission quarterly financial resources reports and audited year-end financial statements in accordance with U.S. generally accepted accounting principles ("GAAP"), and allowed a DCO/CCP to prepare and submit these materials using International Financial Reporting Standards ("IFRS"). A no-action position is no longer needed with respect to these provisions because, following the 2020 amendment of Regulation 39.11(f), non-U.S. DCOs now have the option to submit these materials in either GAAP or IFRS. *See* Derivatives Clearing Organization General Provisions and Core Principles, 85 Fed. Reg. 4800, 4838 (Jan. 27, 2020).

[3] Comparability Determination for the European Union: Dually-Registered Derivatives Clearing Organizations and Central Counterparties, 81 Fed. Reg. 15260 (Mar. 22, 2016).

[4] *See* Regulation (EU) No 648/2012 of the European Parliament and the Council on OTC derivatives, central counterparties and trade repositories of 4 July 2012, Art. 25(6).

Under the EU comparability determination, EU-based DCOs that are registered with the Commission and that are authorized to operate as CCPs in the EU may demonstrate compliance with certain Commission requirements for financial resources, risk management, settlement procedures, and default rules and procedures by complying with the terms of corresponding requirements under the EMIR Framework, as defined in the EU comparability determination.

After the UK's withdrawal from the EU in 2019,[5] the UK subsequently adopted and retained the EMIR regulatory framework for UK-based CCPs, in what is referred to as "UK EMIR."[6] Thereafter, in late 2023, HM Treasury published a statutory instrument concluding that the Commission's regime for the regulation of DCOs is equivalent to the UK's regime for the regulation of CCPs set forth in UK EMIR.[7] Given these developments with respect to UK-based DCOs, and the Commission's ongoing efforts to facilitate cross-border regulatory coordination, cooperation, and comity, the Division is extending the no-action position taken in CFTC Letter 16-26 to UK-based DCOs.

Background

The Commodity Exchange Act ("CEA") does not impose geographic limitations on the registration of DCOs. Nor does it mandate that clearing of futures traded on U.S. exchanges must take place in the United States.[8] To the contrary, it permits futures traded on exchanges in the United States to be cleared outside the United States. However, the CEA and CFTC regulations require that foreign-based CCPs that wish to clear such futures be registered with the Commission and comply with CFTC regulations.[9]

Under this regulatory framework, a number of foreign-based CCPs have been registered with the Commission for some time. LCH Ltd., which is based in London, for example, has been registered with the Commission since 2001, and thus has been subject to dual supervision by UK authorities and the Commission since long before the EU adopted its current regulatory scheme – EMIR. This dual registration system has been a foundation on which the cleared swaps market grew to be a global market. In addition to LCH Ltd., there are currently four other registered foreign-based DCOs that are subject to the dual registration of the Commission and their home country regulator(s): LCH SA (home country regulators are the Autorité de contrôle prudentiel et résolution, the Autorité des marchés financiers, and the Banque de

[5] *See* Agreement on the withdrawal of the United Kingdom of Great Britain and Northern Ireland from the European Union and the European Atomic Energy Community 2019/C 384 I/01 (Nov. 12, 2019), *available at* https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX%3A12019W/TXT%2802%29.

[6] *See* European Union (Withdrawal) Act 2018. This Act transposed relevant EU law and regulations into UK law and regulations, and granted existing authority vested in certain EU institutions to the Financial Conduct Authority, the Bank of England including the Prudential Regulation Authority, and HM Treasury.

[7] *See* The Central Counterparties (Equivalence) (United States of America) (Commodity Futures Trading Commission) Regulations 2023. *See also* Joint Statement by UK and US on Continuity of Derivatives Trading and Clearing Post-Brexit, *available at* https://www.cftc.gov/PressRoom/PressReleases/7876-19 (announcing the Commission's commitment to extending existing staff action to EU firms, including UK firms, to UK firms at the point of the UK's withdrawal from the EU).

[8] 7 USC § 7a-1(a).

[9] *See generally* 7 USC §§ 7(d)(9)(iii) and (11); 17 CFR § 38.601.

France), ICE Clear Europe Ltd. (home country regulator is the Bank of England), ICE NGX Canada Inc. (home country regulator is the Alberta Securities Commission) and Eurex Clearing AG (home country regulators are Bundesanstalt für Finanzdienstleistungsaufsicht (BaFin) and Deutsche Bundesbank).

Following the financial crisis of 2008, the United States and the EU undertook efforts to regulate over-the-counter ("OTC") derivatives markets and market participants. For swaps, Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank Act")[10] amended the CEA to, among other things, establish a comprehensive statutory framework for the execution and clearing of swaps. Section 5b(a) of the CEA, as amended by the Dodd-Frank Act, establishes a comprehensive regulatory framework for clearing organizations that clear swaps, including (i) registration, operation, and compliance requirements for DCOs; and (ii) 17 core principles.[11] Applicants and registered DCOs are required to comply with the core principles as a condition of obtaining and maintaining their registration as a DCO. Thus, the registration of foreign-based CCPs clearing U.S. markets or serving U.S. persons is an important part of the Commission's regulatory scheme. Nevertheless, the Commission has taken steps to calibrate its regulatory approach to non-U.S. DCOs over time to balance the interests of comity and cross-border regulatory coordination with the requirements of the DCO core principles in the CEA and the regulations promulgated thereunder.

The EU comparability determination is an example of this approach. Other examples are the exemptions from DCO registration that the Commission has provided for non-U.S. CCPs that clear proprietary swap positions for their U.S. members and affiliates.[12]

More recently, the Commission adopted regulations to permit non-U.S. DCOs to be registered with the Commission yet comply with the DCO core principles set forth in the CEA through compliance with their home country regulatory regimes, subject to certain conditions and limitations.[13] Additionally, the Commission adopted regulations that formalize the framework the Commission has used to grant exemptions from DCO registration.[14]

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[10] Section 701 *et seq*. of the Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010).

[11] 7 USC § 7a-1(a); 17 CFR § 39.3; *see also* 7 USC § 2(i) (providing that the CEA's swap-related provisions shall not apply to activities outside the United States unless those activities "have a direct and significant connection with activities in, or effect on, commerce of the United States" or "contravene such rules or regulations as the Commission may prescribe or promulgate as are necessary or appropriate to prevent the evasion of any provision of [the CEA]").

[12] *See* In re Petition of ASX Clear (Futures) Pty Limited for Exemption from Registration as a Derivatives Clearing Organization (Aug. 18, 2015); In re Petition of Japan Securities Clearing Corp. for Exemption from Registration as a Derivatives Clearing Organization (Oct. 26, 2015); In re Petition of Korea Exchange, Inc. for Exemption from Registration as a Derivatives Clearing Organization (Oct. 26, 2015); In re Petition of OTC Clearing Hong Kong Ltd. for Exemption from Registration as a Derivatives Clearing Organization (Dec. 21, 2015); In re Application of Taiwan Futures Exchange Corporation for Exemption from Registration as a Derivatives Clearing Organization (Feb. 14, 2024).

[13] *See* Registration With Alternative Compliance for Non-U.S. Derivatives Clearing Organizations, 85 Fed. Reg. 67160 (Oct. 21, 2020).

[14] *See* Exemption From Derivatives Clearing Organization Registration, 86 Fed. Reg. 949 (Jan. 7, 2021).

Consistent with this approach, and for the reasons discussed below in this letter, the Division has determined to issue this no-action letter with regard to the application of certain Commission regulations to discrete aspects of a DCO/CCP's non-U.S. clearing activities.

Discussion of Limited No-Action Position

The Division acknowledges that clearing organizations operate in different jurisdictions and under different regulatory regimes and that the differences between these various regimes may lead to regulatory arbitrage. Previously, and as discussed above, the Commission provided exemptions to registration for foreign-based DCOs who clear proprietary swaps positions for their U.S. members and affiliates but that do not clear for U.S. customers generally. (These foreign-based DCOs also do not clear futures traded on DCMs.) These exemptions have been issued pursuant to Section 5b(h) of the CEA, which permits the Commission to exempt a clearing organization from DCO registration for the clearing of swaps where the Commission determines that such clearing organization is subject to comparable, comprehensive supervision by appropriate government authorities in the clearing organization's home country.[15] Pursuant to this authority, the Commission granted exemptions to clearing organizations in Australia, Japan, South Korea, Hong Kong, and Taiwan. Each of these exemptions require that each exempt CCP limit direct clearing by U.S. persons and FCMs to certain specified circumstances.[16]

Thus, consistent with the interests of comity and facilitating cross-border regulatory coordination, the Division has determined to issue this no-action letter with regard to the application of certain Commission regulations to discrete aspects of a DCO/CCP's non-U.S. clearing activities, subject to the restrictions identified below.

1. Regulation 39.12(b)(6)

Regulation 39.12(b)(6) requires that, upon a DCO's acceptance of a swap for clearing, the original swap is extinguished and it is replaced by an equal and opposite swap between the DCO and each clearing member acting as a principal for a house trade or an agent for a customer trade.

For the reasons set forth above, the Division will not require DCOs/CCPs to apply this "futures clearing model" to trades where neither party is a U.S. clearing member or an FCM clearing member.

2. Part 22 of CFTC's Regulations

[15] 7 USC § 7a-1(h).

[16] In particular, the Commission requires that each CCP maintain rules that limit clearing services for U.S. persons and FCMs to the following circumstances: (1) "A U.S. person that is a clearing member of the exempt [CCP] may clear swaps for itself and those persons identified in the definition of 'proprietary account' set forth in § 1.3"; (2) "A non-U.S. person that is a clearing member of the exempt [CCP] may clear swaps for any affiliated U.S. person identified in the definition of 'proprietary account' set forth in § 1.3"; and (3) "An entity that is registered with the Commission as [an FCM] may be a clearing member of the exempt [CCP], or otherwise maintain an account with an affiliated broker that is a clearing member, for the purpose of clearing swaps for itself and those persons identified in the definition of 'proprietary account' set forth in § 1.3." *See* 17 CFR § 39.6(b)(1).

Part 22 of the CFTC's Regulations sets forth the LSOC account model for cleared swaps customer accounts.

For the reasons set forth above, the Division will not require DCOs/CCPs to apply Part 22's LSOC account model to their clearing members that are not FCMs.

3. Regulation 39.13(g)(8)(i)

Regulation 39.13(g)(8)(i) requires that initial margin for customer accounts cleared by an FCM must be calculated and collected on a gross basis. Regulation 39.13(g)(8)(i) further prohibits a DCO from permitting FCM clearing members to net customer positions.

For the reasons set forth above, the Division will not require DCOs/CCPs to apply this regulation to non-FCM clearing member intermediaries.

4. Regulation 39.13(g)(8)(ii)

Regulation 39.13(g)(8)(ii) requires a DCO to collect initial margin at a level that is greater than 100% of the DCO's initial margin requirements for the non-hedge positions of FCM customers.

For the reasons set forth above, the Division will not require DCOs/CCPs to apply this regulation to such non-hedge positions of the customers of non-FCM clearing member intermediaries.

5. Regulation 39.12(a)(2)(iii)

Regulation 39.12(a)(2)(iii) prohibits a DCO from setting a minimum capital requirement of more than $50 million for any person that seeks to become a clearing member to clear swaps. Regulation 39.12(a)(2)(iii) is designed to ensure that participation requirements do not unreasonably restrict any entity from becoming a clearing member while, at the same time, limiting risk to the DCO and its clearing members.

For the reasons set forth above, the Division will not require DCO/CCPs to apply this requirement to non-U.S. clearing members or non-FCM clearing members.

6. Regulation 39.12(b)(7)

Regulation 39.12(b)(7) requires "straight-through-processing" of swaps submitted for clearing.

For the reasons set forth above, the Division will not require DCOs/CCPs to apply straight-through-processing requirements to trades that are not executed on or subject to the rules of a DCM or a SEF and for which neither clearing member is an FCM, a swap dealer, or a major swap participant.

7. Regulation 39.13(h)(5)

Regulation 39.13(h)(5) requires DCOs to require that their clearing members maintain written risk management policies and procedures and further requires that DCOs must have the authority to obtain information and documents from clearing members regarding their risk.

For the reasons set forth above, although Regulation 39.13(h)(5) will still apply, the Division will permit DCOs/CCPs to implement different oversight programs for U.S./FCM clearing members and non-U.S. clearing members.

Conclusion

The positions set forth above 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 no-action position taken herein does not bind the Commission or Commission staff outside of the Division. 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 and upon the Division's understanding of the regulatory provisions applicable in the EU and in the UK. Any different, changed, or omitted material facts or circumstances may render the staff positions in this letter void.

Sincerely,

Clark Hutchison
Director
Division of Clearing and Risk