



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

CFTC Letter No. 16-56
No-Action
May 31, 2016
Division of Clearing and Risk

Mr. Karl Chen
Chief Financial Officer
Shanghai Clearing House
No. 2 East Beijing Road
Huangpu District
Shanghai, People's Republic of China

Re: No-Action Relief with Regard to Section 5b(a) of the Commodity Exchange Act and Commission Regulations Thereunder

Dear Mr. Chen:

This is in response to your letter dated April 15, 2016 ("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 Shanghai Clearing House ("SHCH") for failing to register as a derivatives clearing organization ("DCO") pursuant to Section 5b(a) of the Commodity Exchange Act ("CEA")¹ and Commission regulations thereunder.

Under the requested relief, SHCH would be permitted temporarily to clear certain swaps subject to mandatory clearing in the People's Republic of China ("PRC") for the proprietary trades of SHCH clearing members that are U.S. persons or affiliates of U.S. persons. You request that such relief be effective for one year.

You represent in the Letter that SHCH intends to petition the Commission for an exemption from the DCO registration requirement by a date no later than six months following the effective date of the no-action relief. You also represent that SHCH meets the requirements of the Principles for Financial Market Infrastructures ("PFMIs") developed by the Committee on Payment and Settlement Systems of the Bank for International Settlements and the Technical Committee of the International Organization of Securities Commissions.

¹ 7 U.S.C. § 7a-1(a).

Statement of Facts

Based on the representations made in the Letter, as well as representations made by SHCH to the Division in meetings and telephone conversations and via electronic mail, we understand the relevant facts to be as follows:

SHCH has been authorized by the People's Bank of China ("PBOC"), which is the central bank of the PRC, to act as the central counterparty for the PRC's over-the-counter derivatives market. SHCH has provided clearing services since December 19, 2011 and currently clears, *inter alia*, renminbi-denominated ("RMB") interest rate swaps, RMB standard bond forwards, foreign exchange forwards, and foreign exchange swaps. SHCH is currently neither a registered nor an exempt DCO.

Effective July 1, 2014, the PBOC requires clearing of certain RMB interest rate swaps. The PBOC has also indicated that it may mandate the clearing of additional swaps in the future. Certain U.S. financial institutions or their affiliates participate in the market for products subject to mandatory clearing in the PRC and would like to become clearing members of SHCH. SHCH has represented that a PRC-based branch of a U.S. bank meets the requirements to become a clearing member of SHCH and has completed preparation work including business qualification training and system testing with SHCH.

SHCH has also indicated that it intends to accept additional U.S. persons as clearing members, including but not limited to branches of U.S. banks located in the PRC and/or their affiliates. SHCH has indicated that it will not provide clearing services to U.S. persons in their capacities as customers or clients of clearing members.

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

SHCH has represented that the swaps that it seeks to clear for proprietary trades of U.S. clearing members are swaps under the CEA and Commission regulations, and the Division accepts SHCH's representation without independent analysis.² Section 5b(a) of the CEA provides that a clearing organization may not perform the functions of a DCO with respect to swaps unless it is registered with the Commission.³ However, Section 5b(h) of the CEA⁴ states that

² The CEA's statutory definition of "swap" includes interest rate swaps. See Section 1a(47)(A) of the CEA, 7 U.S.C. § 1a(47)(A) ("[T]he term 'swap' means any agreement, contract, or transaction . . . (iii) that provides on an executory basis for the exchange, on a fixed or contingent basis, of 1 or more payments based on the value or level of 1 or more interest or other rates . . . including any agreement, contract, or transaction commonly known as – (I) an interest rate swap . . .").

³ Section 5b(a) of the CEA, 7 U.S.C. § 7a-1(a), states: "Except as provided in paragraph (2), it shall be unlawful for a derivatives clearing organization, directly or indirectly, to make use of the mails or any means or instrumentality of interstate commerce to perform the functions of a derivatives clearing organization with respect to . . . (B) a swap. (2) EXCEPTION. – Paragraph (1) shall not apply to a derivatives clearing organization that is registered with the Commission."

⁴ 7 U.S.C. § 7a-1(h).

The Commission may exempt, conditionally or unconditionally, a derivatives clearing organization from registration under this section for the clearing of swaps if the Commission determines that the derivatives clearing organization is subject to comparable, comprehensive supervision and regulation by...the appropriate government authorities in the home country of the organization.

In accordance with Section 5b(h) of the CEA, the Commission has exempted several non-U.S. clearing organizations from the DCO registration requirement to allow them to clear swaps for their U.S. clearing members on a proprietary basis.⁵ The Commission determined that each of these clearing organizations satisfies the “comparable, comprehensive supervision and regulation” requirement of Section 5b(h) of the CEA through its respective home country regulator requiring compliance with the PFMI.

The Division has granted no-action relief to these and other non-U.S. clearing organizations to permit them to clear certain swaps for U.S. persons prior to being exempted from registration.⁶ SHCH’s request for relief is generally consistent with the requests that prompted such relief. Granting the relief requested by SHCH with respect to swaps subject to mandatory clearing pending consideration of its anticipated petition for an exemption pursuant to Section 5b(h) of the CEA is appropriate in order to facilitate the centralized clearing of RMB interest swaps and other swaps subject to mandatory clearing in the PRC. The Division notes that SHCH, which has represented that it meets the PFMI and provided certification from the PBOC that it complies with the PFMI, has committed to petitioning the Commission for an exemption from the DCO registration requirement no later than six months following the effective date of the no-action relief granted herein. Accordingly, the Division believes that it is in the public interest to grant no-action relief on a temporary basis for limited clearing services with respect to swaps currently subject to mandatory clearing in the PRC, or that become subject to mandatory clearing in the PRC during the period covered by this relief, while permitting SHCH to take the time needed to prepare its petition for exemption and to allow the Commission to thoroughly review and assess that petition. This relief is limited to clearing by U.S. persons who are SHCH clearing members only for themselves (or their affiliates). It does not cover customer clearing. In addition, the Division’s grant of no-action relief herein should not be interpreted to mean that the Commission will exempt SHCH from registration as a DCO.

⁵ The exempted clearing organizations include ASX Clear (Futures) Pty Limited (*see* <http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/asxclearamdorderdcoexemption.pdf>), Japan Securities Clearing Corporation (*see* <http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/jscddcoexemptorder10-26-15.pdf>),⁵ Korea Exchange, Inc. (*see* <http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/krxdcexemptorder10-26-15.pdf>),⁵ and OTC Clearing Hong Kong Limited (*see* <http://www.cftc.gov/idc/groups/public/@otherif/documents/ifdocs/otcclearcoexemptorder12-21-15.pdf>).

⁶ *See* CFTC No-Action Letter No. 14-107 (Aug. 18, 2014) (granting no-action relief to the Clearing Corporation of India Ltd.); CFTC No-Action Letter No. 14-87 (June 26, 2014) (granting no-action relief to Korea Exchange, Inc.); CFTC No-Action Letter No. 14-68 (May 7, 2014) (granting no-action relief to OTC Clearing Hong Kong Limited); CFTC No-Action Letter No. 14-07 (Feb. 6, 2014) (granting no-action relief to ASX Clear (Futures) Pty Limited); and CFTC No-Action Letter No. 12-56 (Dec. 17, 2012) (granting no-action relief to Japan Securities Clearing Corporation and certain of its clearing members).

Grant of No-Action Relief

Based on the facts presented and the representations SHCH has made, the Division will not recommend that the Commission take enforcement action against SHCH for failure to register as a DCO pursuant to the requirements of Section 5b(a) of the CEA, subject to the following conditions:

- (1) Product Scope. The relief is limited to the clearing of swaps accepted for clearing by SHCH and subject by the PBOC to mandatory clearing in the PRC. Any swaps accepted for clearing by SHCH that are not subject by the PBOC to mandatory clearing in the PRC as of the date of this letter, but that become subject to such mandatory clearing prior to the expiration of this letter, shall be included within the scope of the relief provided herein without any further action.
- (2) Participant Scope. The relief applies to SHCH's clearing of proprietary trades⁷ of U.S. clearing members.
- (3) Reporting. If a clearing member clears through SHCH a swap that has been reported to a Commission-registered swap data repository ("SDR") pursuant to Part 45 of the Commission's regulations,⁸ then SHCH must report to an SDR, pursuant to Part 45, data regarding the two swaps resulting from the novation of the original swap that had been submitted to SHCH for clearing. SHCH must also report the termination of the swap accepted for clearing by SHCH to the SDR to which the swap was originally reported.⁹
- (4) Limited Duration. The no-action relief shall expire at the earlier of: (i) May 31, 2017, or (ii) the date on which the Commission exempts SHCH from registration as a DCO under Section 5b(h) of the CEA.

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 Division's position does not necessarily reflect the views of the Commission or any other division or office of the Commission. Because this position is based on the representations contained in the Letter, any different, changed, or omitted material facts or circumstances may require a different conclusion or render this letter void. Finally, as with all no-action letters, 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.

⁷ See 17 C.F.R. § 1.3(y) (definition of "proprietary account").

⁸ See Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136 (Jan. 13, 2012) (adopting Part 45).

⁹ In order to avoid duplicative reporting for such transactions, SHCH should have rules that prohibit the Part 45 reporting of the two new swaps by the original counterparties to the original swap. These rules should make it clear to market participants that SHCH is reporting the two new swaps as if it were a registered DCO under the Part 45 rules.

Mr. Karl Chen
May 31, 2016
Page 5

Should you have questions regarding this matter, please contact Brian Baum, Special Counsel (bbaum@cftc.gov, 202-418-5654), Laura Astrada, Associate Director (lastrada@cftc.gov, 202-418-7622) or Eileen Donovan, Deputy Director (edonovan@cftc.gov, 202-418-5096).

Sincerely,

Jeffrey M. Bandman
Acting Director