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Division of Clearing and Risk

CFTC Letter No. 13-25
No-Action
June 10, 2013
Division of Clearing and Risk

David H. Kaufman
Morrison & Foerster
1290 Avenue of the Americas
New York, NY 10104-0050

Re: No-Action Relief for Corporación Andina de Fomento from the Swap Clearing Requirement in Section 2(h)(1) of the Commodity Exchange Act and Commission Regulations 50.2 and 50.4

Dear Mr. Kaufman:

On January 31, 2013, you sent a letter on behalf of Corporación Andina de Fomento ("CAF") (the "Request Letter"), to the Division of Clearing and Risk (the "Division") of the Commodity Futures Trading Commission ("Commission") requesting relief from the swap clearing requirement of Section 2(h)(1) of the Commodity Exchange Act ("CEA") ("the Clearing Requirement"). Based on the facts described in the Request Letter, the Division has decided to not recommend that the Commission take enforcement action against CAF for failure to comply with the Clearing Requirement as implemented by Commission Regulations 50.2 and 50.4.[1] The Division believes that granting this no-action to CAF would be consistent with the final Federal Register release adopting the end-user exception to the clearing requirement ("End-User Exception"),[2] in which the Commission determined that certain international financial institutions should not be subject to the Clearing Requirement.[3]

[1] Clearing Requirement Determination under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012) ("Clearing Requirement Determination").

[2] End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,560 (July 19, 2012) ("End-User Exception"). The Commission subsequently recodified the End-User Exception from § 39.16 to § 50.50 in order to allow market participants to locate all rules related to the Clearing Requirement in one part of the Code of Federal Regulations. See Clearing Requirement Determination, supra.

[3] End-User Exception, supra, at 42,561-42,562.

Applicable Regulatory Requirements

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 (the "Dodd-Frank Act")[4] amended the CEA by adding Section 2(h), which establishes the Clearing Requirement. Under Section 2(h)(1)(A) of the CEA, it is unlawful for a person to engage in a swap that is required to be cleared by the Commission unless the swap is submitted for clearing to a derivatives clearing organization. The Commission has determined that two classes of credit default swaps and four classes of interest rate swaps are required to be cleared.[5] However, pursuant to the End-User Exception, certain non-financial entities may enter into non-cleared swaps that would otherwise be subject to the clearing requirement to hedge or mitigate commercial risks associated with their underlying businesses, such as energy exploration, manufacturing, farming, transportation, or other commercial activities.[6] In addition, in the final release adopting the End-User Exception, the Commission concluded that based on considerations of public policy and international comity, certain international financial institutions, as well as foreign governments and foreign central banks, "should not be subject to" the Clearing Requirement.[7]

The Commission provided the following reasons for its conclusion that international financial institutions should not be subject to the Clearing Requirement. First, because many international financial institutions operate with the benefit of certain privileges and immunities under U.S. law, they may be treated similarly in other contexts under certain circumstances. Second, the Commission noted that there is nothing in the text or history of the swap-related provisions of the Dodd-Frank Act to establish that Congress intended to deviate from the traditions of the international system by subjecting international financial institutions to the Clearing Requirement. Third, the Commission stated that it expects that if any international financial institution of which the U.S. is a member were to engage in swap transactions in foreign jurisdictions, then the actions of those entities with respect to those transactions would not be subject to foreign regulation.[8]

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[4] Pub. L. 111-203, 124 Stat. 1376 (2010).

[5] Clearing Requirement Determination, supra.

[6] End-User Exception, supra, and Regulation 50.50.

[7] End-User Exception, supra, at 42,562.

[8] Id. For the purposes of the final release adopting the End-User Exception, the Commission considered international financial institutions as those institutions that are defined as "international financial institutions" in 22 U.S.C. 262r(c)(2)(Annual Report by Chairman of National Advisory Council on International Monetary and Financial Policies) and those institutions defined as "multilateral development banks" in the Proposal for the Regulation of the European Parliament and of the Council on OTC Derivative Transactions, Central Counterparties and Trade Repositories, Council of the European Union Final Compromise Text, Article 1(4a(a)) (Mar. 19, 2012) (published in final form on July 4, 2012 with no change to Article 1(4a(a)). CAF is not included on either list.

Summary of Request for Relief

The Request Letter represents that CAF seeks to foster and promote sustainable economic development in Latin America and the Caribbean. CAF's activities consist primarily of project and corporate lending and trade finance, generally in circumstances under which borrowers would not have access to traditional commercial lending sources. In making loans and guarantees, CAF incurs interest and exchange rate risk. In order to hedge and reduce exposure to these risks, CAF enters into interest rate swaps and currency swaps. Pursuant to CAF's internal policies, CAF will not hold any derivatives for trading or speculative purposes. In addition, the open derivatives positions it does hold may not exceed 1% of its current liquid assets.

CAF was established pursuant to an international treaty, which has been ratified by the legislatures of ten countries.[9] The governments of those nations ("the principal shareholder countries"), as well as the governments of eight other nations,[10] own 99.9% of CAF and elect seventeen of the eighteen members of CAF's board of directors.[11] The Minister of Finance or equivalent officeholder of each principal shareholder country usually serves as a board member. Fourteen financial institutions own the remaining 0.1% and elect one board member. Due to a combination of shareholdings, share classifications and voting rights, limitations on share transfers and other governance mechanisms, the principal shareholder countries are assured control over CAF. The principal shareholder countries recognize CAF as a suprafinancial institution and have granted it various immunities and privileges. These include: immunity from expropriation; free convertibility and transferability of its assets; exemption from all taxes and tariffs on income, properties or assets; and exemption from any restrictions, regulations, controls or moratoria with respect to its property or assets.

The Request Letter also asserts that the policy considerations on which the Commission relied to exclude international financial institutions from the Clearing Requirement apply to CAF. Specifically, the Request Letter claims that "the canons of statutory construction and the longstanding traditions of the international system"[12] apply to CAF to the same as extent that they apply to the international financial institutions referenced in the final release adopting the End-User Exception.

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[9] Argentina, Bolivia, Brazil, Colombia, Ecuador, Panama, Paraguay, Peru, Uruguay, and Venezuela.

[10] Chile, Costa Rica, Dominican Republic, Jamaica, Mexico, Portugal, Spain, and Trinidad and Tobago.

[11] Shareholder countries may transfer their shares to a government-designated social or public purpose institution. A limited percentage of certain classes of shares owned by shareholder countries may be transferred to private individuals or entities. As a result, it is possible that as many as two seats on the board could be transferred to private entities from governments or government-designated institutions.

[12] The final release adopting the End-User Exception referred to these concepts in describing non-cleared swaps entered into by an international financial institution opposite a counterparty who is subject to the CEA and Commission regulations with regard to that transaction. End-User Exception, supra, at 42, 562.

Grant of No-Action Relief

Based on the facts described by the Request Letter, the Division will not recommend that the Commission take enforcement action against CAF for failure to comply with the Clearing Requirement. This letter does not, however, provide relief from other provisions of the CEA and Commission regulations, such as the recordkeeping and reporting requirements under Parts 23 and 45 of the Commission's regulations, which would apply to a non-cleared swap entered into by CAF opposite a counterparty who is subject to the CEA and Commission regulations with regard to that transaction.[13]

This letter represents the position of the Division only and does not necessarily represent the views of the Commission or those of any other division or office of the Commission. Because this position is based upon the representations contained in the Request Letter, it should be noted that any different, changed, or omitted material facts or circumstances may require a different conclusion or render this no-action 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.

Should you have questions regarding this matter, please contact Peter Kals, Special Counsel, at (202) 418-5466.

Sincerely,

Ananda Radhakrishnan
Director

[13] Id.