



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk

Ananda Radhakrishnan
Director

CFTC Letter No. 14-68
No Action
May 7, 2014
Division of Clearing and Risk

Mr. Gerald Greiner
Chief Executive
OTC Clearing Hong Kong Limited
One International Finance Centre
1 Harbour View Street
Central, Hong Kong

RE: Request for No-Action Relief with Regard to Sections 5b(a) and 2(h)(1)(A) of the
Commodity Exchange Act and Commission Regulations Thereunder

Dear Mr. Greiner:

This is in response to your letter dated February 20, 2014 (“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 (1) OTC Clearing Hong Kong Limited (“OTC Clear”) for failure to register as a derivatives clearing organization (“DCO”) pursuant to Section 5b(a) of the Commodity Exchange Act (“CEA”),¹ or (2) clearing members of OTC Clear that are U.S. persons or affiliates of U.S. persons (each a “U.S. Clearing Member”) for failure to clear certain interest rate swaps (“IRS”) and certain non-deliverable forwards (“NDFs”) through a registered DCO pursuant to Section 2(h)(1)(A) of the CEA and the implementing regulations thereunder.

Under this requested relief, OTC Clear would be permitted to clear IRS denominated in four currencies—Chinese Renminbi (“RMB”), Hong Kong Dollar, U.S. Dollar, and Euro—and NDFs denominated in four currencies—RMB, Taiwan Dollar, Korean Won, and Indian Rupee—for the proprietary trades of U.S. Clearing Members. You request that such relief be effective until the earlier of December 31, 2014, or the date upon which the Commission, acting pursuant to its authority under Section 5b(h) of the CEA, exempts OTC Clear from the DCO registration

¹ 7 U.S.C. § 7a-1(a).

requirement of the CEA.² You further represent that OTC Clear intends to apply for an exemption from registration as a DCO once the Commission addresses the process or specific criteria and conditions necessary to obtain exemptive relief.

Statement of Facts

Based upon the representations made by OTC Clear to the Division in the Letter, we understand the relevant facts to be as follows:

OTC Clear is a wholly-owned subsidiary of Hong Kong Exchanges and Clearing Limited. OTC Clear was recognized as a clearing organization by the Securities and Futures Commission (“SFC”) of Hong Kong on October 25, 2013, and has been clearing inter-dealer IRS and NDFs as of November 25, 2013.³

Currently, OTC Clear provides clearing services for inter-dealer over-the-counter (“OTC”) derivatives transactions between institutions regulated by the Hong Kong Monetary Authority or corporations regulated by the SFC. As part of its plan to prepare for the introduction of the mandatory clearing regime in Hong Kong, OTC Clear intends to expand its clearing services to support the clearing of OTC derivatives transactions entered into by clients of its clearing members. OTC Clear also intends to accept certain U.S. persons, including Hong Kong branches of U.S. banks, as clearing members in connection with their own proprietary clearing business.

With regard to the regulation and supervision of OTC Clear, OTC Clear is a recognized clearing house under the supervision of the SFC. As part of the recognition process, OTC Clear was required to demonstrate, to the satisfaction of the SFC, its ability to observe the Principles for Financial Market Infrastructure developed by the Bank for International Settlements’ Committee on Payment and Settlement Systems and the Technical Committee of the International Organization of Securities Commissions.

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

The Division accepts, without independent analysis, OTC Clear’s representation that the IRS and foreign exchange NDF contracts subject to its request are swaps under the CEA and Commission regulations. The Division also accepts, without further inquiry, that certain of OTC Clear’s prospective clearing members may be U.S. persons.

² Section 5b(h) of the CEA, 7 U.S.C. § 7a-1(h), permits the Commission to exempt a clearing organization from registration for the clearing of swaps if the Commission determines that the clearing organization is subject to comparable, comprehensive supervision and regulation by the Securities and Exchange Commission or the appropriate government authorities in the clearing organization’s home country.

³ OTC Clear has proposed to also clear: (1) IRS based on CNH Hong Kong Interbank Offered Rate fixing; (2) NDFs denominated in Philippine Peso, Malaysian Ringgit, and Indonesian Rupiah; and (3) non-deliverable IRS denominated in Indian Rupee, South Korean Won, Taiwan New Dollar, Indonesian Rupiah, Philippine Peso, and Thai Baht.

The statutory definition of the term “swap,” as further defined in the implementing regulations thereunder, includes IRS and foreign exchange NDFs.⁴ Section 5b(a) of the CEA provides that a derivatives clearing organization may not perform the functions of a DCO with respect to swaps unless it is registered with the Commission.⁵ Section 2(h)(1)(A) of the CEA states that swaps that are required to be cleared must be submitted to a registered DCO or a DCO that is exempt from registration.⁶

OTC Clear’s request for relief is consistent with recent requests for Division no-action letters permitting similarly-situated non-U.S. clearing organizations to clear swaps for U.S. persons prior to becoming registered with the Commission as a DCO.⁷ Granting the relief requested by OTC Clear during the pendency of its application for an exemption pursuant to Section 5b(h) of the CEA is appropriate in order to facilitate the centralized clearing of certain IRS and foreign exchange NDF contracts, and to promote competition and enhance choice in clearing services for such contracts. The Division notes, however, that the Commission has not established a regulatory framework for exempting a clearing organization from registration as a DCO pursuant to Section 5b(h) of the CEA. Accordingly, the Division’s granting of no-action relief herein should not be interpreted to mean that the Commission will exempt OTC Clear from registration as a DCO.

Grant of No-Action Relief

Based on the facts presented and the representations you have made, the Division will not recommend that the Commission take enforcement action against (1) OTC Clear for failure to register as a DCO pursuant to the requirements of Section 5b(a) of the CEA, or (2) OTC Clear’s

⁴ Section 1a(47)(A) of the CEA, 7 U.S.C. § 1a(47)(a), states: “[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 . . .” Regulation 1.3(xxx), 17 C.F.R. § 1.3(xxx), further includes a non-deliverable forward involving foreign exchange within the definition of the term “swap.”

⁵ 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.”

⁶ See *supra* text accompanying note 2.

⁷ See CFTC No-Action Letter No. 14-07 (Feb. 6, 2014) (granting no-action relief to ASX Clear (Futures) Pty Limited and certain of its clearing members); CFTC No-Action Letter No. 13-73 (Dec. 19, 2013) (extending previous grant of no-action relief to Japan Securities Clearing Corporation and certain of its clearing members); CFTC No-Action Letter No. 13-43 (July 11, 2013) (granting no-action relief to LCH.Clearnet SA and certain of its clearing members); CFTC No-Action Letter No. 13-33 (July 11, 2013) (granting no-action relief to Eurex Clearing AG and certain of its clearing members); CFTC No-Action Letter No. 12-63 (Dec. 21, 2012) (granting no-action relief to Singapore Exchange Derivatives Clearing Limited and certain of its clearing members); 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).

U.S. Clearing Members for failure to clear IRS or foreign exchange NDFs through a registered or exempt DCO pursuant to the requirements of Section 2(h)(1)(A) of the CEA and the implementing regulations thereunder, subject to the following conditions:

- (1) Product Scope. The relief is limited to the following contracts accepted for clearing by OTC Clear: IRS denominated in RMB, Hong Kong Dollar, U.S. Dollar, and Euro; and NDFs denominated in RMB, Taiwan Dollar, Korean Won, and Indian Rupee.
- (2) Participant Scope. The relief applies to OTC Clear's clearing of the proprietary trades⁸ of U.S. Clearing Members.
- (3) Reporting. If a clearing member clears through OTC Clear a swap (referred to as the "alpha" swap) that has been reported to a Commission-registered swap data repository ("SDR") pursuant to Part 45 of the Commission's regulations,⁹ then OTC Clear must report to an SDR, pursuant to Part 45, data regarding the two swaps resulting from the novation of the alpha swap that had been submitted to OTC Clear for clearing (referred to as "beta" and "gamma" swaps).¹⁰
- (4) Limited Duration. The no-action relief shall expire at the earlier of: (i) December 31, 2014, or (ii) the date upon which the Commission either registers OTC Clear as a DCO under Section 5b(a) of the CEA or exempts OTC Clear 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

⁸ See 17 C.F.R. § 1.3(y) (definition of "proprietary account").

⁹ See Swap Data Recordkeeping and Reporting Requirements, 77 Fed. Reg. 2136 (Jan. 13, 2012) (adopting Part 45).

¹⁰ Pursuant to Regulation 39.12(b)(6), 17 C.F.R. § 39.12(b)(6), during the clearing process, a swap submitted for clearing to a registered DCO (the alpha swap) is extinguished or terminated, and two new swaps (the beta and gamma swaps) are created. The registered DCO must then report the beta and gamma swaps to an SDR under Part 45 and associate the unique swap identifier of the alpha swap with the beta and gamma swaps in order for the Commission to confirm that such alpha swap was cleared. See Statement of the Commission concerning CME Rule 1001 (March 6, 2013), page 6, available at:

<http://www.cftc.gov/ucm/groups/public/@newsroom/documents/file/statementofthecommission.pdf>; see also 17 C.F.R. § 45.4(a) ("[R]eporting counterparties and [DCOs] required to report swap continuation data must do so in a manner sufficient to ensure that all data in the [SDR] concerning the swap remains current and accurate, and includes all changes to the primary economic terms of the swap occurring during the existence of the swap."); 77 Fed. Reg. at 2153 ("[T]he final rule requires registered entities and reporting counterparties to report continuation data in a manner sufficient to ensure that the information in the SDR concerning the swap is current and accurate, and includes all changes to any of the primary economic terms of the swap.").

In order to avoid duplicative reporting for such transactions, OTC Clear should have rules that prohibit the Part 45 reporting of the beta and gamma swaps by the original counterparties to the alpha swap. These rules should make it clear to market participants that OTC Clear is reporting the beta and gamma swaps as if it were a registered DCO under the Part 45 rules.

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views of the Commission or any other division or office of the Commission. Because this position is based upon the representations contained in the Letter, it should be noted that 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.

Should you have any questions, please do not hesitate to contact me at (202) 418-5188, or Parisa Abadi, Attorney-Advisor, at (202) 418-6620.

Sincerely,

Ananda Radhakrishnan
Director