



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk

July 1, 2019

Mr. Laurian Cristea
General Counsel
Eris Clearing, LLC
227 West Monroe Street
Suite 2070
Chicago, IL 60606

RE: Request for Relief from Certain Derivatives Clearing Organization Regulations

Dear Mr. Cristea:

This no-action letter responds to your request dated July 2, 2018 (“Request”) for relief from certain provisions of Commodity Futures Trading Commission (“Commission”) regulations applicable to registered derivatives clearing organizations (“DCOs”). According to the Request, Eris Clearing, LLC (“Eris Clearing”) seeks relief from certain provisions of Part 39 of the Commission’s regulations due to the nature of Eris Clearing’s fully-collateralized clearing model. The Division of Clearing and Risk (“Division”) has determined to issue Eris Clearing no-action relief.¹ The specific provisions from which Eris Clearing seeks relief and the responsive no-action relief granted by the Division are discussed below.

I. Overview of Eris Clearing

Eris Clearing submitted an application for DCO registration on July 3, 2018, and the Commission issued to Eris Clearing an order of registration on July 1, 2019. Section 5b(c)(2)(A)(i) of the Commodity Exchange Act (“CEA”)² provides that to be registered and to maintain registration with the Commission as a DCO, a DCO must comply with the CEA’s core principles applicable to DCOs and with the Commission’s implementing regulations (*i.e.*, Part 39). Eris Clearing’s application did not address all of the Part 39 regulations, however, due to the nature of Eris Clearing’s clearing model.

¹ Under Regulation 140.99(a)(2), the Division, acting under delegated authority from the Commission, may issue a written statement that it will not recommend enforcement action to the Commission for failure to comply with specific provisions of the Commodity Exchange Act or of a rule, regulation or order issued thereunder by the Commission. Only the party requesting a no-action letter may rely on the letter. Commission regulations referred to herein are found at 17 C.F.R. Ch. I (2017).

² 7 U.S.C. § 7a-1(c)(2)(A)(i) (2017).

Eris Clearing is a fully-collateralized DCO, meaning that a participant must provide Eris Clearing with eligible collateral sufficient to cover the maximum potential loss of the contract before the trade can be executed.³ Eris Clearing performs a pre-trade credit check to ensure each participant has sufficient eligible collateral at Eris Clearing or an Eris Clearing-approved depository to cover the participant's maximum potential loss or delivery obligation. Eris Clearing accepts U.S. dollars and the commodity underlying the contract (*i.e.*, bitcoin) as eligible collateral.

Eris Clearing has rules to allow participants to either self-clear or clear through a futures commission merchant ("FCM"). Eris Clearing's initial participants will consist solely of self-clearing members. Eris Clearing will initially clear only for its own designated contract market, Eris Exchange, LLC. Eris Clearing participants must satisfy certain eligibility criteria before they can clear contracts through Eris Clearing.

II. Specific Provisions of Part 39

A. Financial Resources

Regulation 39.11(c)(1). Regulation 39.11(c)(1) requires a DCO to perform monthly stress testing in order to make a reasonable calculation of the financial resources it would need in the event of a default by the clearing member creating the largest exposure. Eris Clearing asserts that the monthly stress testing requirement in Regulation 39.11(c)(1) is not applicable to Eris Clearing because of its fully-collateralized clearing model. Eris Clearing indicates that by requiring participants to fully collateralize a position prior to execution, it ensures that it has enough funds on deposit to cover each participant's maximum loss. Because collateral sufficient to cover the maximum possible loss is already on deposit, Eris Clearing represents that it achieves the goal of the stress testing requirement in Regulation 39.11(c)(1), and any stress testing is therefore unnecessary. Thus, Eris Clearing seeks relief from the requirement to stress test its financial resources on a monthly basis pursuant to Regulation 39.11(c)(1).

Regulation 39.11(e)(1)(ii). Regulation 39.11(e)(1)(ii) requires a DCO to have financial resources sufficiently liquid to enable the DCO to fulfill its obligations as a central counterparty during a one-day settlement cycle. It further requires that a portion of those financial resources be in the form of cash, U.S. Treasury obligations, or high quality, liquid, general obligations of a sovereign nation, and sets forth the method for calculating that portion. Eris Clearing represents that it maintains sufficient liquidity by requiring that participants deposit collateral in the form of the participant's obligation, either cash or the underlying asset, prior to trade execution. Eris Clearing further indicates that the calculation required by Regulation 39.11(e)(1)(ii) would demonstrate that it holds liquid collateral in an amount equal to its obligations as a central counterparty during a one-day settlement cycle, and that the result of the calculation would not

³ Fully-collateralized positions are designed to have on deposit a sufficient amount of funds, at all times, to cover the maximum potential loss that could be incurred in connection with a position. Full collateralization prevents a DCO from being exposed to credit risk stemming from the inability of a clearing member or customer of a clearing member to meet a margin call or a call for additional capital. This limited exposure and full collateralization of that exposure renders certain provisions of part 39 inapplicable or unnecessary.

change from day to day because it operates as a fully-collateralized DCO. As a result, Eris Clearing seeks relief from Regulation 39.11(e)(1)(ii).

Relief

Based on Eris Clearing's representations, it is the Division's understanding that Eris Clearing would not need to perform monthly stress testing, because it would ensure that 100% of any exposure on a trade is fully collateralized before the trade can be executed. Based on the facts presented and representations Eris Clearing has made, the Division will not recommend that the Commission take enforcement action against Eris Clearing for not stress testing its financial resources on a monthly basis pursuant to Regulation 39.11(c)(1). With respect to the calculation requirement in Regulation 39.11(e)(1)(ii), Eris Clearing indicates that even if it performed this calculation, the result of the calculation would not change from day to day because it is fully collateralized. Based on the facts presented and representations Eris Clearing has made, the Division will not recommend that the Commission take enforcement action against Eris Clearing for not complying with the requirements of Regulation 39.11(e)(1)(ii) because it maintains sufficient liquidity by having funds on hand sufficient to meet daily obligations.

B. Product and Participant Eligibility

Regulation 39.12(a)(5)(i). Under Regulation 39.12(a)(5)(i), a DCO must require all of its clearing members, including those that are not FCMs, to provide the DCO with periodic financial reports that contain any financial information that the DCO determines is necessary to assess whether participation requirements are being met on an ongoing basis. The regulation further requires that the DCO require its non-FCM clearing members to make these reports available to the Commission upon Commission request, or for the DCO itself to provide the reports to the Commission. Eris Clearing seeks relief from these requirements for its non-FCM participants.⁴ Eris Clearing represents that its participants would present no credit or default risk to Eris Clearing because they must fully collateralize trades. In addition, Eris Clearing expects that participants will be individuals or entities that are not registered with the Commission.

Relief

The purpose of Regulation 39.12(a)(5)(i) is to ensure that a DCO has the means to assess its clearing members' compliance with the DCO's participation requirements. The Division's understanding is that Eris Clearing requires its participants to fully collateralize any trade before the trade may be executed; as a result, Eris Clearing's participants present no credit or default risk to Eris Clearing. Therefore, Eris Clearing would not need to receive periodic financial reports from participants in order to assess their compliance with Eris Clearing requirements. Accordingly, based on the facts presented and representations Eris Clearing has made, the Division will not recommend that the Commission take enforcement action against Eris Clearing

⁴ Eris Clearing has limited its request for relief in this regard to its non-FCM participants. To the extent that Eris Clearing has one or more FCM participants in the future, the Eris Clearing Rulebook requires each FCM to provide Eris Clearing with financial statements as may be required from time to time.

for not complying with the requirements of Regulation 39.12(a)(5)(i) with respect to its non-FCM participants.

C. Risk Management

Regulation 39.13(h)(3). Regulation 39.13(h)(3) requires a DCO to conduct stress testing on a daily basis with respect to each large trader who poses significant risk to a clearing member or the DCO, and on at least a weekly basis with respect to each clearing member account, by house origin and by each customer origin. Eris Clearing represents that because it is not a margined DCO and requires full collateralization prior to trade execution, it would not need to conduct stress tests with respect to large traders to achieve the intended risk management goals of the tests.

Relief

Based on Eris Clearing's representations, it is the Division's understanding that Eris Clearing would not need to conduct daily stress testing because it would ensure that 100% of any exposure on a trade is fully collateralized before the trade can be executed. Based on these facts and representations, the Division will not recommend that the Commission take enforcement action against Eris Clearing for not complying with the requirements of Regulation 39.13(h)(3).

D. Treatment of Funds

Regulation 39.15(d). Regulation 39.15(d) requires a DCO to have rules providing that the DCO will promptly transfer all or a portion of a customer's portfolio of positions and related funds at the same time from the carrying clearing member of the DCO to another clearing member of the DCO, without requiring the close-out and re-booking of the positions prior to the requested transfer, subject to certain conditions. Eris Clearing has indicated that it will not have any FCM participants at the outset of its clearing operations, and it seeks relief from Regulation 39.15(d) so long as it has one or fewer FCM participants.

Relief

It is the Division's understanding that Eris Clearing will not initially have FCM participants, which means there will be no clearing on behalf of customers. Accordingly, the requirements of Regulation 39.15(d) do not apply to Eris Clearing under the present circumstances, as the purpose of the transfer provision is to permit a customer to move positions and funds from one FCM to another without having to close out and re-book those positions. Based on the facts presented and representations made by Eris Clearing, the Division will not recommend that the Commission take enforcement action against Eris Clearing for not complying with the requirements of Regulation 39.15(d) so long as Eris Clearing has one or fewer FCM participants. In the event that Eris Clearing adds only one FCM participant, then that participant would not have another FCM to which it could transfer the positions of its customers. In the event that Eris Clearing adds more than one FCM participant, however, the Division would expect Eris Clearing to comply with Regulation 39.15(d) as it pertains to those participants.

E. Daily Reporting

Regulation 39.19(c)(1)(i)(B). Regulation 39.19(c)(1)(i)(B) requires a DCO to provide to the Commission, on a daily basis, a report containing information on daily variation margin payments, separately listing the mark-to-market amount collected from or paid to each clearing member, by house origin and by each customer origin. Eris Clearing seeks relief from this requirement because it requires full collateralization prior to the execution of a trade and, therefore, will not collect or pay daily variation margin.

Regulation 39.19(c)(1)(i)(D). Regulation 39.19(c)(1)(i)(D) requires a DCO to provide to the Commission, on a daily basis, a report containing the end-of-day positions for each clearing member, by house origin and by each customer origin. Eris Clearing seeks relief from this requirement because it requires full collateralization prior to the execution of a trade.

Regulation 39.19(c)(1)(ii). Regulation 39.19(c)(1)(ii) requires that the reports discussed above include information regarding: (A) all futures and options positions, as applicable; (B) all swaps positions; and (C) all securities positions that are held in a customer account subject to Section 4d of the CEA or are subject to a cross-margining agreement. For the reasons stated above, Eris Clearing seeks relief from this requirement as it pertains to paragraphs (c)(1)(i)(B) and (c)(1)(i)(D) of Regulation 39.19.

Relief

Eris Clearing has indicated that it requires full collateralization and, therefore, will not collect or pay daily variation margin. It is the Division's understanding that, due to the full collateralization, Eris Clearing's participants' positions do not pose any risk to the DCO or its other participants. Consequently, the Commission does not need access to end-of-day position data to monitor the risk at Eris Clearing. Based on these facts and representations, the Division will not recommend that the Commission take enforcement action against Eris Clearing for not complying with the requirements of Regulations 39.19(c)(1)(i)(B) and (D). By virtue of the no-action relief from these provisions, the Division also will not recommend that the Commission take enforcement action against Eris Clearing for not complying with the requirements of Regulation 39.19(c)(1)(ii) as it pertains to paragraphs (c)(1)(i)(B) and (c)(1)(i)(D) of Regulation 39.19.⁵

F. Public Information

Regulation 39.21 (c)(3), (4), and (6). Paragraphs (c)(3), (4), and (6) of Regulation 39.21 respectively require public disclosure of a DCO's margin-setting methodology, the size and composition of the financial resource package available in the event of a clearing member default, and its default rules and procedures. Eris Clearing has indicated that, due to its fully-collateralized clearing model, it does not use a margin methodology and does not face the risk of

⁵ Although this letter exempts Eris Clearing from certain daily reporting under Regulation 39.19(c)(1), the Commission retains the right to obtain reports upon request under Regulation 39.19(c)(5).

a participant default. As a result, Eris Clearing seeks relief from complying with paragraphs (c)(3), (4), and (6) of Regulation 39.21.

Regulation 39.21(d). Regulation 39.21(d) requires a DCO to make its rulebook, a list of all current clearing members, and the information listed in paragraph (c) (as discussed immediately above) readily available to the general public in a timely manner, by posting the information on the DCO's website. Eris Clearing requests relief from the requirement to make public a list of its participants, except for those that are FCMs. Eris Clearing anticipates that its participants that are not FCMs will be individuals or entities that are not registered with the Commission, and consequently believes it is not appropriate to publicly disclose their names.

Relief

In a previous letter,⁶ the Division expressed its view that a DCO's full-collateralization requirement satisfies the requirements of Regulations 39.11(a)(1) (the requirement to have sufficient financial resources to withstand a clearing member default), 39.13(g) (the requirement to have a risk-based margin methodology), and 39.16 (the requirement to have default rules and procedures). In light of this, the Division interprets Eris Clearing's full-collateralization requirement as satisfying Regulation 39.21(c)(3), (4), and (6).

The Division understands that initially, Eris Clearing's participants will be individuals or entities that are not registered with the Commission. The Division notes that the purpose of publishing a list of clearing members is to provide market participants with sufficient information to enable them to identify and evaluate the risks and costs associated with using the DCO's services. Because each Eris Clearing participant must fully collateralize its own trades, and Eris Clearing does not have a mutualized default fund, participants do not face the risk of needing to cover fellow participant losses. Therefore, based on these facts and representations, the Division will not recommend that the Commission take enforcement action against Eris Clearing for not complying with Regulation 39.21(d), except that Eris Clearing must make public a list of any of its FCM participants.

III. Conclusion

This letter is based upon the representations of Eris Clearing, as well as applicable laws and regulations. The Division believes that granting the Request would not be contrary to the public interest or to the purposes of those provisions of the Commission regulations from which Eris Clearing has sought relief. However, any new, different or changed material facts or circumstances could change the Division's position and render this letter void. Moreover, 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.

⁶ See CFTC Interpretative Letter No. 14-05 (Jan. 16, 2014) (responding to a request from North American Derivatives Exchange, Inc. for an interpretation of certain Commission regulations applicable to registered DCOs).

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If you have any questions, please do not hesitate to contact Brian Baum, Special Counsel, at (202) 418-5654 or Abigail Knauff, Special Counsel, at (202) 418-5123.

Sincerely,

Brian A. Bussey
Director