



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000
Facsimile: (202) 418-5521
www.cftc.gov

Division of Clearing and Risk

CFTC Letter No. 12-63
No-Action
December 21, 2012
Division of Clearing and Risk

Mr. Muthukrishnan Ramaswami
Director
Singapore Exchange Derivatives Clearing Limited
2 Shenton Way, #19-00 SGX Centre 1
Singapore 068804

Re: No-Action Relief with Regard to Section 5b(a) and Section 4d(f) of the
Commodity Exchange Act

Dear Mr. Ramaswami:

This is in response to your letter dated December 21, 2012 (“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) Singapore Exchange Derivatives Clearing Limited (“SGX-DC”) for failing to register as a derivatives clearing organization (“DCO”) under section 5b(a) of the Commodity Exchange Act (“CEA”)¹ or (2) SGX-DC’s clearing members (“Clearing Members”) for failing to register as futures commission merchants (“FCMs”) under section 4d(f)(1) of the CEA,² in relation to the clearing and carrying of existing or new positions in certain swaps identified in Appendix A of the Letter (“OTC Commodity Contracts”)³ entered into by certain U.S. customers (“Affected U.S. Persons”).⁴ You have requested that such relief be effective until the registration of SGX-DC as a DCO and the transfer of all positions in OTC Commodity Contracts cleared for Affected U.S. Persons to an FCM that is also a Clearing Member of SGX-DC.⁵

¹ 7 U.S.C. § 7a-1(a).

² 7 U.S.C. § 6d(f)(1).

³ The OTC Commodity Contracts include certain bulk commodity swaps (consisting of iron ore and coal swaps), freight swaps, oil swaps, and freight and iron ore options. *See* Letter at Appendix A.

⁴ The term “Affected U.S. Persons,” as used in the Letter and as used herein, refers to “current U.S. customers of Clearing Members who hold open interest and current U.S. customers of Clearing Members who happen to not be holding open positions as at the time of the no-action relief...” *See* Letter at 2 n.1.

⁵ SGX-DC submitted a no-action request to the Division, dated October 18, 2012, which was withdrawn and superseded by the Letter. SGX-DC represents that the Letter contains revised terminology to more precisely reflect

Statement of Facts

Based upon the representations made by SGX-DC to the Division, including the representations contained in SGX-DC's draft DCO application and in the Letter, the Division understands the relevant facts to be as follows:

SGX-DC, a wholly-owned subsidiary of Singapore Exchange Limited, is a Singapore-based clearing house that has been in operation for more than 20 years. SGX-DC provides clearing services for futures contracts and options on futures contracts that are listed and traded on Singapore Exchange Derivatives Trading Limited, and it also provides clearing services for certain OTC commodity and financial derivatives products. SGX-DC's clearing services include a customer clearing platform for exchange-traded products and OTC commodity products. SGX-DC is regulated by the Monetary Authority of Singapore as a designated clearing house under the Securities and Futures Act of Singapore.

On December 6, 2011, SGX-DC submitted a draft application to be registered as a DCO. Since that time, SGX-DC has had discussions with the Division regarding the development of an FCM customer clearing model that would enable U.S. customers to continue to clear swaps, including OTC Commodity Contracts. As of October 12, 2012, the date on which the Commission's regulatory definition of "swap" became effective,⁶ there were Clearing Members that were clearing OTC Commodity Contracts for Affected U.S. Persons. These Clearing Members are not registered as FCMs and SGX-DC represents that the OTC Commodity Contracts are likely to fall under the regulatory definition of "swap."⁷

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

The Division accepts, without independent analysis, SGX-DC's representation that the OTC Commodity Contracts are likely to fall under the definition of swap. It also accepts, without further inquiry, that the customers identified as Affected U.S. Persons are in fact U.S. persons whose clearing of swaps is subject to the CEA and Commission regulations.

Section 5b(a) of the CEA provides that a DCO may not perform the functions of a DCO with respect to swaps unless the DCO is registered.⁸ Section 5b(h) of the CEA permits the Commission to exempt a DCO from registration for the clearing of swaps if it determines that the

the intended scope of the requested no-action relief and does not impact the representations made in the previous no-action request, including representations related to market data. *See* Letter at 1.

⁶ *See* 77 Fed. Reg. 48,208 (Aug. 13, 2012).

⁷ Letter at 3.

⁸ Section 5b(a) of the CEA 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."

DCO is subject to comparable supervision by the Securities and Exchange Commission or a foreign regulator.⁹

Section 4d(f)(1) of the CEA¹⁰ states that it shall be unlawful for any person to accept money, securities or property (“funds”) to margin a swap cleared through a DCO unless the person is registered as an FCM. The purpose of this provision is to establish a customer protection regime for swaps customers, which is broadly similar to the regime for futures customers and options on futures customers under Sections 4d(a) and (b) of the CEA.¹¹ Any cleared swaps customer funds held by a DCO are also subject to the segregation requirements of Section 4d(f)(2) of the CEA, and in order for a customer to achieve protection of the 4d(f) regime, particularly in an insolvency context, its funds must be carried by a registered FCM and deposited with a registered DCO. Absent that chain of registration, the swap customer’s funds cannot be treated as customer property held by a “commodity broker” under Subchapter IV of Chapter 7 of the U.S. Bankruptcy Code¹² and Part 190 of the Commission’s regulations.¹³

The Division is mindful of the potential costs and disruptions to current market practices faced by DCOs (including foreign-based DCOs) and market participants transitioning to a new regulatory regime. In light of these considerations, and with the recognition that it will take a period of time for completion of global migration to a cleared environment that is subject to a new regulatory framework, the Division believes that the time-limited relief sought by SGX-DC in this instance is appropriate, especially given SGX-DC’s submission of its draft DCO registration application.

⁹ Section 5b(h) of the CEA, 7 U.S.C. § 7a-1(h), states “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 Securities and Exchange Commission or the appropriate government authorities in the home country of the organization.” At the present time, no DCO has sought or been granted an exemption from registration for the clearing of swaps.

¹⁰ Section 4d(f)(1) of the CEA states “It shall be unlawful for any person to accept any money, securities, or property (or to extend any credit in lieu of money, securities, or property) from, for, or on behalf of a swaps customer to margin, guarantee, or secure a swap cleared by or through a derivatives clearing organization (including money, securities, or property accruing to the customer as the result of such a swap), unless the person shall have registered under this chapter with the Commission as a futures commission merchant, and the registration shall not have expired nor been suspended nor revoked.”

¹¹ 7 U.S.C. §§ 6d(a) and (b).

¹² 11 U.S.C. §§ 761-767.

¹³ 17 C.F.R. part 190 (2012).

Grant of No-Action Relief

Based on the facts presented and the representations SGX-DC has made, the Division will not recommend that the Commission take enforcement action against (i) SGX-DC for failing to register as a DCO pursuant to the requirements of Section 5b(a) of the CEA or (ii) SGX-DC's Clearing Members for failing to register as FCMs pursuant to the requirements of Section 4d(f)(1) of the CEA, if SGX-DC and its Clearing Members continue to carry existing positions in OTC Commodity Contracts entered into by Affected U.S. Persons, and clear and carry new positions in OTC Commodity Contracts entered into by Affected U.S. Persons, subject to the following conditions:

- (1) Product Scope. The no-action relief is limited to the OTC Commodity Contracts identified in Appendix A to the Letter.
- (2) Participant Scope. The no-action relief applies to SGX-DC and its Clearing Members whose customers include Affected U.S. Persons as of the date of this relief. The relief granted herein permits these Clearing Members to accept, clear, and carry new positions in OTC Commodity Contracts for Affected U.S. Persons.
- (3) Disclosure Requirement. SGX-DC must provide to its Clearing Members a standard form of disclosure and require distribution of this disclosure statement by its Clearing Members to Affected U.S. Persons. The disclosure must explain: (a) that accounts holding customer positions in OTC Commodity Contracts and related customer property are not subject to Section 4d(f) of the CEA; (b) such positions and related property will not be subject to, and therefore will not receive the protections of, Subchapter IV of Chapter 7 of the U.S. Bankruptcy Code and Part 190 of the Commission's regulations; and (c) the treatment of the customer positions and related property in the event of an insolvency proceeding of SGX-DC or any of its Clearing Members will be subject to Singapore's laws. SGX-DC shall comply with this condition within a reasonable period of time following receipt of this letter, and shall demonstrate compliance by providing the Division with a copy of the disclosure statement and written instructions to its Clearing Members regarding mandatory distribution of the disclosure statement, contemporaneous with the issuance of the aforementioned.
- (4) Limited Duration. The no-action relief granted herein shall expire at the earlier of: (i) December 31, 2013, or (ii) the date upon which SGX-DC registers as a DCO, such date by which the positions of Affected U.S. Persons shall be held only by Clearing Members that are registered FCMs.

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 upon the representations made by SGX-DC to the Division, including the

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representations contained in SGX-DC's draft DCO application and 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 Phyllis Dietz, Deputy Director, at (202) 418-5449.

Sincerely,

Ananda Radhakrishnan
Director