



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Swap Dealer and
Intermediary Oversight

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Director

CFTC Letter No. 17-34
No-Action
July 24, 2017
Division of Swap Dealer and Intermediary Oversight

Re: Commission Regulations 23.150-159, 161: No-Action Position with Respect to Uncleared Swaps with the European Stability Mechanism

Ladies and Gentlemen:

This letter is in response to a request for a no-action position received by the Division of Swap Dealer and Intermediary Oversight (“**DSIO**”) of the Commodity Futures Trading Commission (“**Commission**”) from the European Stability Mechanism (the “**ESM**”), which enters into swaps with swap dealers (“**SDs**”) that are registered with the Commission and subject to the Commission’s rules regarding margin requirements for uncleared swaps.¹ Specifically, the ESM asked that DSIO provide relief for SDs from the Final Margin Rule (as defined below) when entering into uncleared swaps with the ESM.

I. Regulatory Background

Pursuant to section 4s(e) of the Commodity Exchange Act (“**CEA**”),² the Commission is required to promulgate margin requirements for uncleared swaps applicable to each SD for which there is no Prudential Regulator.³ The Commission published the Final Mar-

¹ The Commission’s margin requirements for uncleared swaps apply only to SDs and major swap participants for which there is not a prudential regulator. *See* 7 U.S.C. 6s(e)(1)(B). SDs and major swap participants for which there is a prudential regulator must meet the margin requirements for uncleared swaps established by the applicable prudential regulator. 7 U.S.C. 6s(e)(1)(A). *See also* 7 U.S.C. 1a(39) (defining the term “Prudential Regulator” to include the Board of Governors of the Federal Reserve System; the Office of the Comptroller of the Currency; the Federal Deposit Insurance Corporation; the Farm Credit Administration; and the Federal Housing Finance Agency). The Prudential Regulators published final margin requirements in November 2015. *See* Margin and Capital Requirements for Covered Swap Entities, 80 FR 74840 (Nov. 30, 2015).

² 7 U.S.C. § 1 et. seq.

³ *See* 7 U.S.C. 6s(e)(1)(B).

gin Rule for such SDs in January 2016 (the “**Final Margin Rule**”).⁴ Among other things, the Final Margin Rule establishes initial and variation margin requirements for these SDs. However, the Final Margin Rule does not require such SDs to collect margin from, or post margin to, a counterparty that is neither a swap entity nor a financial end user.⁵

II. Summary of Request for No-Action Position

DSIO has received a request from the ESM for a Commission staff no-action position pursuant to which SDs would not have to comply with the Final Margin Rule when entering into uncleared swaps with the ESM.

Based on the representations made by the ESM, we understand the relevant facts to be as follows:

1. The ESM was created following the euro area debt crisis by the Treaty Establishing the European Stability Mechanism made in 2012 among those countries within the European Union which use the euro as their currency (the “**euro zone**”).⁶ The ESM is an intergovernmental international financial institution that provides financial assistance to euro area member states in or threatened by severe financial distress for national or regional development similar to the multilateral development banks listed in Commission regulation 23.151 (including, for example, the International Bank for Reconstruction and Development, the Asian Development Bank, and the European Investment Bank) (collectively, “**Multilateral Development Banks**”) which are excluded from the Final Margin Rule’s definition of financial end user.⁷ This assistance is granted to safeguard the financial stability of the euro zone as a whole and of its member states. Under the Europe-

⁴ See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016). The Final Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission’s regulations. See §§ 23.150-159, 161. The Commission’s regulations are found in Chapter 17 of the Code of Federal Regulations, 17 CFR 1 et. seq.

⁵ “Swap entity” and “financial end user” are defined in Commission regulation 23.151. 17 CFR 23.151.

⁶ See https://www.esm.europa.eu/sites/default/files/20150203_-_esm_treaty_-_en.pdf (last visited July 7, 2017).

⁷ See Commission regulation 23.151. 17 CFR 23.151. In addition to the specified Multilateral Development Banks in the regulation, the definition of Multilateral Development Bank includes any other entity that provides financing for national or regional development in which the U.S. government is a shareholder or contributing member or which the Commission determines poses comparable credit risk.

an Market Infrastructure Regulation,⁸ the ESM is expressly exempt from EMIR's margin rules for OTC derivative contracts not cleared by a central counterparty.⁹

2. To accomplish its policy goals, the ESM utilizes several financial assistance instruments, including loans in various forms which can be used for multiple purposes (e.g. budgetary needs, clearance of arrears, and recapitalization of financial institutions) and are offered only subject to bespoke specified conditions, including economic reforms. The ESM regularly enters the international capital markets to fund these loans. It intends to enter into uncleared swaps with SDs to hedge the interest rate and currency risks it faces as a result of entering into and funding these loans and to hedge interest rate and currency risks associated with the investment of its contributed capital. The ESM does not, and will not, enter into uncleared swaps for speculative purposes.
3. With respect to its credit risk, as part of its emergency procedure, the ESM's member states have irrevocably agreed to contribute a total of approximately €624 billion in additional capital should the ESM face financial distress. Further, the ESM is subject to limits on its lending and borrowing, and the ESM's property, funding, and assets in its member states are immune from search, requisition, confiscation, expropriation, or any other form of seizure, taking, or foreclosure. In addition, to the extent necessary to carry out its activities, all property, funding, and assets of the ESM are free from restrictions, regulations, controls, and moratoria of any nature. The combined application of these rules and limits is effective in keeping the ESM's total liabilities well below its available capital. As a result of its capital position, among other reasons, in June 2016 the ESM received favorable credit ratings from Fitch Ratings¹⁰ and Moody's Investors Service.¹¹

III. DSIO No-Action Position

Based on the foregoing, DSIO believes that no-action relief is warranted. Accordingly, DSIO will not recommend an enforcement action against an SD that is registered with

⁸ Regulation (EU) No 648/2012 of the European Parliament and the Council of July 4, 2012 is more commonly known as the European Market Infrastructure Regulation or "**EMIR**."

⁹ See EMIR, Article 1(5). An OTC derivative is a derivative which is not executed on a regulated market or on a third-country market considered as equivalent to a regulated market. See EMIR, Article 2(7). While there may be differences between the definitions of "swap" and "uncleared swap" under the CEA and Commission regulations and the definition of "OTC derivative" and "non-centrally cleared OTC derivative" under EMIR, DSIO believes that such definitions largely cover the same products and instruments.

¹⁰ See press release at <https://www.fitchratings.com/site/pr/1005929> (last visited July 7, 2017).

¹¹ See press release at https://www.moody.com/research/Moodys-European-Stability-Mechanisms-ratings-benefit-from-strong-shareholder-support--PR_351127 (last visited July 7, 2017).

the Commission and subject to the Final Margin Rule¹² that does not comply with the Final Margin Rule solely in respect of uncleared swaps between such SD and the ESM.

DSIO believes that this approach is appropriate as, like the Multilateral Development Banks which the Commission has excluded from the definition of financial end user, the ESM generally poses less systemic risk to the financial system as its activities generally have a different purpose in the financial system leading to a lower risk profile in addition to posing less counterparty risk to an SD.

This letter, and the positions taken herein, represent the views of DSIO only and do not necessarily represent the positions or views of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse persons relying on it from compliance with any other applicable requirements contained in the CEA or in the Commission regulations issued thereunder. Further, this letter and the positions taken herein are based upon the facts presented and representations made to DSIO. Any different, changed or omitted material facts or circumstances might render this letter void. This letter does not create or confer any rights or obligations on any person or persons subject to compliance with the CEA that bind the Commission or any of its other offices or division. As with all no-action letters, DSIO retains the authority to condition further, modify, suspend, terminate, or otherwise restrict the terms of the no-action relief provided herein, at its discretion.

Should you have any questions, please contact me at (312) 596-0600 or Frank Fisanich, Chief Counsel, at (202) 418-5949.

Very truly yours,

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¹² See supra note 1.