



U.S. COMMODITY FUTURES TRADING COMMISSION

Three Lafayette Centre
1155 21st Street, NW, Washington, DC 20581
Telephone: (202) 418-5000

Division of Swap Dealer and
Intermediary Oversight

Joshua B. Sterling
Director

Re: Commission Regulations 23.150-159, 23.161: Revised No-Action Position with Respect to Uncleared Swaps with the European Stability Mechanism

Ladies and Gentlemen:

Pursuant to CFTC Staff No-Action Letter 17-34,¹ the Division of Swap Dealer and Intermediary Oversight (“**DSIO**”) of the Commodity Futures Trading Commission (“**Commission**”) provided a position of no-action stating that DSIO would not recommend an enforcement action against a swap dealer (“**SD**”) that is registered with the Commission and subject to the Commission’s uncleared swap margin requirements² that does not comply with such requirements solely in respect of uncleared swaps between such SD and the European Stability Mechanism (the “**ESM**”).

On October 16, 2019, the Commission approved a proposal to exclude ESM from the definition of “financial end user” in Commission regulation 23.151, which would have the effect of excluding swaps between certain SDs and ESM from the Commission’s uncleared swap margin requirements, rendering the DSIO no-action position under CFTC No-Action Letter 17-34 moot. Accordingly, this letter modifies the DSIO no-action position under CFTC No-Action Letter 17-34 to provide that such position will expire on the sooner of the effective date of final Commission action on its proposal or 180 days from the date of this letter. DSIO believes that, absent direction from the Commission to the contrary, if the Commission has not acted on its proposal within 180

¹ See CFTC No-Action Letter 17-34 (July 24, 2017), available on the Commission’s website.

² See Margin Requirements for Uncleared Swaps for Swap Dealers and Major Swap Participants, 81 FR 636 (Jan. 6, 2016) (hereinafter, the “**Final Margin Rule**”). The Final Margin Rule, which became effective April 1, 2016, is codified in part 23 of the Commission’s regulations. See §§ 23.150-159, 23.161. The Commission’s regulations are found in Chapter 17 of the Code of Federal Regulations, 17 CFR 1 et. seq.

days, then the relief provided by this revised letter should expire. However, by this letter, DSIO also makes clear that swaps entered into with the ESM in reliance on the relief provided by CFTC Staff No-Action Letter 17-34 will continue to benefit from such relief.

This revised letter is in response to a request for a no-action position received by DSIO from 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.³ Specifically, the ESM asked that DSIO provide relief for SDs from the Final Margin Rule when entering into uncleared swaps with the ESM.

I. Regulatory Background

Pursuant to section 4s(e) of the Commodity Exchange Act (“CEA”),⁴ the Commission is required to promulgate margin requirements for uncleared swaps applicable to each SD for which there is no Prudential Regulator.⁵ The Commission published the Final Margin Rule for such SDs in January 2016. 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.⁶

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.

³ 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).

⁴ 7 U.S.C. § 1 et. seq.

⁵ *See* 7 U.S.C. 6s(e)(1)(B).

⁶ “Swap entity” and “financial end user” are defined in Commission regulation 23.151. 17 CFR 23.151.

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**”).⁷ 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.⁸ This assistance is granted to safeguard the financial stability of the euro zone as a whole and of its member states. Under the European Market Infrastructure Regulation,⁹ the ESM is expressly exempt from EMIR’s margin rules for OTC derivative contracts not cleared by a central counterparty.¹⁰
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

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

⁸ 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.

⁹ 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**.”

¹⁰ 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.

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, ESM continues to receive favorable credit ratings from Fitch Ratings and Moody's Investors Service.

III. DSIO No-Action Position

DSIO recognizes that, 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.

Based on the foregoing and in light of the Commission's proposal to exclude the ESM from the definition of "financial end user" in Commission regulation 23.151, DSIO believes that time limited no-action relief is warranted. Accordingly, DSIO will not recommend an enforcement action against an SD that is registered with the Commission and subject to the Final Margin Rule that does not comply with the Final Margin Rule solely in respect of uncleared swaps between such SD and the ESM entered into during the period beginning on the date of this letter and ending on the earlier of (i) April 14, 2020, at 11:59 pm (Eastern Time) or (ii) the effective date of final Commission action addressing the application of the Final Margin Rule to swaps between SDs and ESM.

In addition, DSIO believes that the position of no-action provided under CFTC Staff No-Action Letter 17-34 should continue with respect to uncleared swaps entered into in reliance on such letter. Accordingly, DSIO will not recommend an enforcement action against an SD that is registered with the Commission and subject to the Final Margin Rule that does not comply with the Final Margin Rule solely in respect of uncleared swaps between such SD and the ESM entered into on or after the date of CFTC Staff No-Action Letter 17-34, but prior to the date of this letter. Other than with respect to such

swaps, this letter supersedes the no-action relief provided to SDs by DSIO under CFTC Staff No-Action Letter 17-34 in its entirety.

For the avoidance of doubt, final Commission action addressing the application of the Final Margin Rule to swaps between SDs and ESM may include, without limitation, a rulemaking, an order, or a published determination not to take action with respect to such requirements.

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 (202) 418-6056 or Frank Fisanich, Chief Counsel, at (202) 418-5949.

Very truly yours,

Joshua B. Sterling
Director
Division of Swap Dealer and Intermediary Oversight

Cc: Regina Thoele, Compliance
National Futures Association, Chicago