U.S. COMMODITY FUTURES TRADING COMMISSION
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Division of Clearing and Risk

M. Clark Hutchison III
Director

Re: Extension of No-Action Relief for the European Stability Mechanism from the Swap Clearing Requirement in Section 2(h)(1) of the Commodity Exchange Act and Commodity Futures Trading Commission Regulations 50.2 and 50.4

Ladies and Gentlemen:

The Division of Clearing and Risk ("Division") of the Commodity Futures Trading Commission ("CFTC" or "Commission") is extending the relief provided by CFTC Letter No. 20-13[1] to the European Stability Mechanism ("ESM"). The relief provided by this letter supersedes relief provided to ESM under CFTC Letter No. 20-13, which modified previously granted relief.

On November 7, 2017, the Division published CFTC Letter No. 17-58[2] explaining that the Division would not recommend that the Commission take enforcement action against ESM for failure to comply with the Commission's clearing requirement under section 2(h)(1) of the Commodity Exchange Act ("CEA") as implemented by Commission regulations 50.2 and 50.4 ("Clearing Requirement").[3]

On October 16, 2019, the Division published CFTC Letter No. 19-23 to revise its earlier relief granted to ESM by including an expiration date of the earlier of: (i) April 14, 2020, at 11:59 pm (Eastern Time); or (ii) the effective date of final Commission action applicable to swaps entered into by ESM that would otherwise be subject to the Commission's Clearing Requirement. In CFTC Letter No. 20-13, this relief was extended again until the earlier of: (i) September 30, 2020, at 11:59 pm (Eastern Time); or (ii) the effective date of final Commission action applicable to swaps entered into by ESM that would otherwise be subject to the Commission's Clearing Requirement.

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[1] CFTC Letter No. 20-13 (April 14, 2020), available at https://www.cftc.gov/csl/20-13/download (extending CFTC Letter No. 19-23 (Oct. 16, 2019), available at: https://www.cftc.gov/csl/19-23/download)).

[2] CFTC Letter No. 17-58 (November 7, 2017), available at: https://www.cftc.gov/csl/17-58/download.

[3] Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012) and Clearing Requirement Determination Under Section 2(h) of the CEA for Interest Rate Swaps, 81 Fed. Reg. 71,202 (Oct. 14, 2016).

The Division continues to believe that this no-action position regarding ESM is consistent with the final Federal Register release adopting the end-user exception to the Clearing Requirement ("End-User Exception").[4] The Division has no reason to believe that any material facts or circumstances in the original request letter submitted to the Division on July 10, 2017 ("Request Letter") have changed.

Accordingly, the Division will not recommend that the Commission take enforcement action against the ESM for failure to comply with the Clearing Requirement, until the earlier of: (i) December 31, 2020, at 11:59 pm (Eastern Time); or (ii) the effective date of final Commission action applicable to swaps entered into by ESM that would otherwise be subject to the Commission's Clearing Requirement.

I. Applicable Regulatory Requirements

Title VII of the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010 ("Dodd-Frank Act")[5] amended the CEA by adding section 2(h), which establishes the Clearing Requirement. Under section 2(h)(1)(A) of the CEA and Commission regulation 50.2, it is unlawful for a person to engage in a swap that is required to be cleared by the Commission unless the swap is submitted for clearing to an eligible derivatives clearing organization. The Commission has determined that two classes of credit default swaps and four classes of interest rate swaps are required to be cleared. However, pursuant to the End-User Exception, certain non-financial entities may enter into non-cleared swaps that would otherwise be subject to the Clearing Requirement to hedge or mitigate commercial risks associated with their underlying businesses, such as energy exploration, manufacturing, farming, transportation, or other commercial activities.[6] In addition, in the final Federal Register release adopting the End-User Exception, the Commission concluded that based on considerations of public policy and international comity, certain international financial institutions, as well as foreign governments and foreign central banks, "should not be subject to" the Clearing Requirement.[7]

The Commission provided the following reasons for its conclusion that foreign governments, foreign central banks, and international financial institutions should not be subject to the Clearing Requirement. First, because many international financial institutions operate with the benefit of certain privileges and immunities under U.S. law, they may be treated similarly in other contexts under certain circumstances. Second, the Commission noted that there is nothing

[4] End-User Exception to the Clearing Requirement for Swaps, 77 Fed. Reg. 42,560 (July 19, 2012).

[5] Pub. L. 111-203, 124 Stat. 1376 (2010).

[6] End-User Exception and Commission regulation 50.50.

[7] *Id.* at 42,562.

in the text or history of the swap-related provisions of the Dodd-Frank Act to establish that Congress intended to deviate from the traditions of the international system by subjecting foreign governments, foreign central banks, or international financial institutions to the Clearing Requirement. Third, the Commission stated that it expects that if the U.S. government, a Federal Reserve Bank, or any international financial institution of which the U.S. is a member were to engage in swap transactions in foreign jurisdictions, then the actions of that entity with respect to those transactions would not be subject to foreign regulation.[8]

In 2013, the Division granted a request for relief from the Clearing Requirement to Corporación Andina de Fomento ("CAF") because the Division found that CAF's mission and ownership structure were analogous to the missions and ownership structures of the international financial institutions referenced in the End-User Exception preamble discussion.[9]

II. Summary of Request for Relief

The Request Letter asserts that the policy considerations on which the Commission relied to exclude international financial institutions from the Clearing Requirement apply to ESM due to ESM's public interest mission and ownership by sovereign nations.

The Request Letter represents that ESM's mission is to provide financial assistance to a European Union member state that is also a member of the Eurozone in the event that such country is unable to raise money in the capital markets. ESM may provide financial assistance by making a loan to a Eurozone member state, purchasing such country's bonds, or recapitalizing a financial institution located in such country. ESM may decide to enter into interest rate swaps subject to the Clearing Requirement in order to hedge interest rate risk arising out of ESM's borrowing or investment activities.

ESM was established in 2012 pursuant to an international treaty among the 17 European Union member states that were Eurozone members at that time.[10] Currently, all 19 Eurozone member states are ESM members.[11] Each of these countries is an ESM shareholder and has paid

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[8] *Id.* For the purposes of the final release adopting the End-User Exception, the Commission considered international financial institutions as those institutions that are defined as "international financial institutions" in 22 U.S.C. 262r(c)(2)(Annual Report by Chairman of National Advisory Council on International Monetary and Financial Policies) and those institutions defined as "multilateral development banks" in the Proposal for the Regulation of the European Parliament and of the Council on OTC Derivative Transactions, Central Counterparties and Trade Repositories, Council of the European Union Final Compromise Text, Article 1(4a(a)) (Mar. 19, 2012) (published in final form on July 4, 2012 with no change to Article 1(4a(a))). ESM is not included on either list.

[9] CFTC Letter No. 13-25 (June 10, 2013), available at: https://www.cftc.gov/csl/13-25/download.

[10] ESM website, available at: https://www.esm.europa.eu.

[11] The current Eurozone members are: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Slovakia, Slovenia, and Spain.

in capital to ESM. There are no other shareholders. ESM is governed by a Board of Governors and a Board of Directors. Each of the 19 ESM member states appoints representatives to these governing bodies. The Board of Governors is chaired by the President of the "Eurogroup" (the finance ministers of the Eurozone countries). Currently, the President of the Eurogroup is the Minister for Finance of Portugal. The Request Letter represents that ESM, together with its income, property, and other assets, is exempt from taxation and that ESM's property and assets are free from controls, expropriation, moratoria, regulations, or restrictions of any nature. The Request Letter represents further that ESM poses a credit risk comparable to the international financial institutions referenced in the final Federal Register release adopting the End-User Exception. Finally, according to the Request Letter, ESM is generally exempt from the European Market Infrastructure Regulation ("EMIR")[12], including the obligation to clear certain classes of derivatives. ESM is still subject to EMIR swap reporting requirements.

In summary, the Request Letter asserts that the policy considerations on which the Commission relied to exclude international financial institutions from the Clearing Requirement, and on which the Division subsequently relied to grant no-action relief from the Clearing Requirement to CAF, apply to ESM. Like CAF and other international financial institutions, ESM provides financial assistance to certain member countries, serves the public interest, and is owned by sovereign nations each of which grants ESM legal privileges and immunities.

III. Extending Grant of No-Action Relief

For the foregoing reasons, the Division is extending the relief provided by CFTC Letter No. 20-13 and will not recommend that the Commission take enforcement action against ESM for failure to comply with the Clearing Requirement until the earlier of: (i) December 31, 2020, at 11:59 pm (Eastern Time); or (ii) the effective date of final Commission action applicable to swaps entered into by ESM that would otherwise be subject to the Commission's Clearing Requirement. For the avoidance of doubt, the Division confirms that swaps entered into by ESM in reliance on the relief provided under CFTC Letter No. 17-58 may continue to rely on such relief. Other than with respect to such swaps, this letter supersedes the no-action relief provided to ESM by the Division under CFTC Letter Nos. 17-58, 19-23, and 20-13. This letter does not provide relief from other provisions of the CEA and Commission regulations, such as the recordkeeping and reporting requirements under parts 23 and 45 of the Commission's regulations, which would apply to a non-cleared swap entered into by ESM opposite a counterparty that is subject to the CEA and Commission regulations with regard to that transaction.[13]

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.

[12] Regulation (EU) No 648/2012 of the European Parliament and the Council of July 4, 2012.

[13] End-User Exception, 77 Fed. Reg. at 42,562.

Because this position is based upon the representations contained in the Request Letter, it should be noted that any different, changed, or omitted material facts or circumstances may require a different conclusion or render this no-action 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 questions regarding this matter, please contact me at (202) 418-6070, or Sarah E. Josephson, Deputy Director, at (202) 418-5684.

Sincerely,

M. Clark Hutchison
Director