



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk

CFTC Letter No. 14-144
No-Action
November 26, 2014
Division of Clearing and Risk

RE: No-Action Relief from the Clearing Requirement for Swaps Entered into by Eligible Treasury Affiliates

The purpose of this letter is to amend the no-action relief previously granted by the Division of Clearing and Risk (“Division”) of the Commodity Futures Trading Commission (“Commission”) under No-Action Letter 13-22 to address certain challenges faced by treasury affiliates in undertaking hedging activities on behalf of non-financial affiliates within a corporate group. Those challenges pertained to certain conditions in the prior relief. The Division in this letter is altering some of those conditions to enable additional market participants to avail themselves of the treasury affiliate relief originally set forth in No Action Letter 13-22.

Treasury Affiliate Exemption from Clearing

On June 4, 2013, the Division granted no-action relief from the clearing requirement under section 2(h)(1) of the Commodity Exchange Act (“CEA”) and part 50 of the Commission’s regulations, for swaps entered into by certain affiliates acting on behalf of non-financial affiliates within a corporate group for the purpose of hedging or mitigating commercial risk (hereinafter referred to as “treasury affiliates”).¹

No-Action Letter 13-22 was issued based on the Division’s understanding that treasury affiliates were undertaking hedging activities on behalf of non-financial affiliates that were eligible to elect the end-user exception from clearing,² but were themselves ineligible to elect the exception. As discussed further below, because treasury affiliates can act in a wider capacity as treasury centers that provide financial services for all or most of the affiliates within a corporate group, including daily cash management, debt administration, and risk hedging and mitigation, treasury affiliates met the definition of “financial entity” under section 2(h)(7)(C)(i)(VIII) of the CEA and thus could not elect the end-user exception. As a result, the Division granted treasury affiliates relief to continue entering into non-cleared swaps on behalf of the non-financial affiliates, subject to specific conditions and requirements.

¹ See Staff No-Action Letter 13-22, available at <http://www.cftc.gov/ucm/groups/public/@lrllettergeneral/documents/letter/13-22.pdf>.

² End-User Exception to the Clearing Requirement for Swaps, 77 FR 42559 (July 19, 2012) (codified at 17 C.F.R. § 50.50).

The Division has since learned that there are treasury affiliates precluded from electing the relief in No-Action Letter 13-22 because they do not meet certain conditions contained in the letter. As discussed below, based on input from market participants, the Division is hereby issuing this letter to amend some of the conditions and requirements contained in No-Action Letter 13-22 to allow additional treasury affiliates to rely on the relief from clearing.

Applicable Regulatory Requirements

Under section 2(h)(1)(A) of the CEA, it is unlawful for any person to engage in a swap unless that person submits such swap for clearing to a derivatives clearing organization (“DCO”) that is registered under the CEA or exempt from registration if the swap is required to be cleared. On November 29, 2012, the Commission adopted its first clearing requirement determination, requiring that swaps meeting certain specifications within four classes of interest rate swaps and two classes of credit default swaps be cleared.³

Pursuant to section 2(h)(7) of the CEA and § 50.50 of the Commission’s regulations, a counterparty to a swap that is subject to the clearing requirement may elect the end-user exception from required clearing provided that such counterparty is not a financial entity,⁴ as defined in section 2(h)(7)(C) of the CEA, and otherwise meets the requirements of § 50.50 of the Commission’s regulations.⁵ Thus, the end-user exception from required clearing may be elected for swaps that are entered into between two non-financial entities, or between a non-financial entity and a financial entity, for swaps that hedge or mitigate commercial risk.

As noted above, the Division granted relief from required clearing for treasury affiliates of non-financial companies that fall within the definition of “financial entity” under section 2(h)(7)(C)(i)(VIII) of the CEA when acting on behalf of affiliates that otherwise would be eligible to elect the end-user exception from required clearing.⁶ As such, No-Action Letter 13-22 effectively allowed treasury affiliates, subject to certain additional requirements and conditions, to

³ Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284 (Dec. 13, 2012) (codified at 17 C.F.R. § 50).

⁴ Certain small financial institutions, captive finance companies, and affiliate agents may also use the end-user exception under certain circumstances. See CEA sections 2(h)(7)(C)(iii) and 2(h)(7)(D); see also Commission regulation 50.50(d).

⁵ In addition to being a non-financial entity, entities electing the end-user exception must: (i) be using the swap to hedge or mitigate commercial risk; and (ii) report certain information about the swap and the counterparties to a swap data repository. See Commission regulation 50.50.

⁶ In the final rule adopting the end-user exception, the Commission specifically noted that a financial entity acting solely on behalf of and as agent for an affiliate that satisfies the criteria for the end-user exception is deemed to satisfy the statutory criteria for “acting on behalf of the person and as an agent,” as permitted by section 2(h)(7)(D)(i) of the CEA. End-User Exception to the Clearing Requirement for Swaps, 77 FR at 42563. Market participants indicated, however, that treasury affiliates often enter into swaps on behalf of non-financial affiliates as principal to the swap and not as agent, and are thus unable to take advantage of the relief from clearing provided in section 2(h)(7)(D).

take advantage of the end-user exception from clearing that its non-financial affiliates in the corporate group would otherwise have been eligible to elect had they entered into the transactions directly.

Summary of Relief

Since the Division issued No-Action Letter 13-22, market participants have highlighted several requirements and conditions that make use of the relief granted thereunder impractical for many treasury affiliates. As discussed below, the Division is therefore amending the following requirements and conditions.

- i. The requirement that the ultimate parent of a treasury affiliate identify all wholly- and majority-owned affiliates and ensure a majority qualify for the end-user exception.

Market participants have expressed concerns about the second condition for eligible treasury affiliate status in No-Action Letter 13-22. The second condition requires that the ultimate parent of a treasury affiliate identify all wholly- and majority-owned affiliates within the corporate group and ensure that a majority qualify for the end-user exception.

Market participants have noted the ratio of the absolute number of financial entities to non-financial entities does not necessarily provide meaningful information about the corporate family as a whole, and adds on-going surveillance responsibilities and expenses for the corporate family. The Division agrees and has removed the requirement accordingly in the revised relief set forth herein.

- ii. The requirement that the treasury affiliate is not itself or is not affiliated with a systemically important nonbank financial company.

Market participants have also expressed concerns about the fourth condition for eligible treasury affiliate status in No-Action Letter 13-22. The fourth condition prohibits the treasury affiliate from being, or being affiliated with, a nonbank financial company that has been designated as systemically important by the Financial Stability Oversight Council. As explained above, section 2(h)(7)(D) of the CEA permits affiliates acting as an agent and on behalf of entities eligible for the end-user exception to elect the end-user exception themselves, unless the affiliate is one of seven enumerated types of entities listed in section 2(h)(7)(D)(ii). Among others, these prohibited entities include swap dealers, commodity pools, and bank holding companies with over \$50 billion in consolidated assets.

Market participants have pointed out that the fourth condition for eligible treasury affiliate status provides a list of entities that generally tracks the list in section 2(h)(7)(D)(ii), except for the addition of systemically important nonbank financial companies. The Division believes that additional restrictions relating to systemically important nonbank financial companies are appropriate. As a result, the Division is maintaining the requirement that the treasury affiliate itself cannot be a systemically important nonbank financial company. However, the Division also

recognizes that certain corporate families with significant non-financial operations are precluded from using the existing relief because of the affiliation with a systemically important nonbank financial company, regardless of the degree to which the operations of the financial and non-financial entities are conducted separately.

The Division believes restricting the treasury affiliate from (i) entering into transactions with, or on behalf of, a systemically important nonbank financial company⁷ and (ii) providing any services, financial or otherwise, to such a designated entity,⁸ provides sufficient protection from the risks of systemically important affiliate, while allowing the treasury affiliate to provide the necessary support to its related operating entities. The Division is amending the conditions relating to systemically important nonbank financial companies accordingly.

iii. The requirement that treasury affiliates act only on behalf of certain types of related affiliates.

Market participants have indicated that the definition of “related affiliates” under No-Action Letter 13-22 unnecessarily excludes certain entities that perform a cash pooling function for a corporate family that includes a financial entity. The definition of related affiliate currently includes either: (i) a non-financial entity that is, or is directly or indirectly wholly- or majority-owned by, the ultimate parent; or (ii) a person that is another eligible treasury affiliate for an entity described in (i).

Market participants claim that the limitation is unnecessary, highlighting that the third General Condition to the Swap Activity already precludes an eligible treasury affiliate from entering into swaps with, and on behalf of, its financial affiliates. The Division agrees the definition is problematic because the collection and disbursement of cash within the corporate family is a core function of a treasury affiliate. Given the existing restrictions on swap activity by the eligible treasury affiliate with or on behalf of a financial affiliate, the Division has amended the related affiliate definition to allow entities that provide financial services on behalf of a financial entity to nonetheless qualify as an eligible treasury affiliate.

iv. The requirement that treasury affiliates transfer the risk of related affiliates through the use of swaps.

Market participants have expressed concern with the first General Condition to Swap Activity in No-Action Letter 13-22. The condition requires the eligible treasury affiliate enter into the exempted swap for the sole purpose of hedging or mitigating the commercial risk of one or more related affiliates that was transferred to the eligible treasury affiliate by operation of one or more swaps with such related affiliates.

⁷ See the third General Condition to the Swap Activity set forth below, as applies to transaction with, or on behalf of, “financial affiliates” generally.

⁸ See clause (vi) of the definition of Eligible Treasury Affiliate set forth below.

According to market participants, there are a number of ways for commercial risk to be transferred between affiliates, and that the risk that a treasury affiliate may have been seeking to hedge or mitigate would not necessarily be transferred from the operating affiliate to the treasury affiliate by way of a swap transaction as required by No-Action Letter 13-22. The method by which the risk is transferred can be dependent on the type of risk being hedged. For example, it may be more common for foreign exchange risk to be transferred between affiliates through the use of book-entry transfers, as opposed to interest rate risk, where the use of back-to-back swaps may be more prevalent. The Division agrees that this limitation is unnecessarily strict and is revising the condition accordingly. However, as the transfer of risk from the related affiliate to the treasury affiliate will no longer be evinced by back-to-back swaps, the Division will require that the treasury affiliate be able to identify the related affiliate or affiliates on whose behalf the swap was entered into by the treasury affiliate.

- v. The requirement that treasury affiliates do not enter into swaps other than for hedging or mitigating the commercial risk of one or more related affiliates.

Market participants have questioned whether an eligible treasury affiliate would lose its status if the entity entered into hedging transactions that were mitigating a commercial risk of the treasury affiliate itself. The second General Condition to the Swap Activity states that the eligible treasury affiliate cannot enter into swaps with related affiliates or unaffiliated counterparties other than for the purposes of hedging or mitigating the commercial risk of one or more related affiliates.

The Division agrees that a treasury affiliate should not lose its status as an eligible treasury affiliate simply because it entered into a hedging transaction on its own behalf. The Division is therefore amending the language in the second condition to allow an eligible treasury affiliate to enter into its own hedging transactions. However, the Division notes that such transactions entered into by the eligible treasury affiliate on its own behalf would not be “exempted swaps” as defined below, and may be required to be cleared if subject to the Commission’s clearing requirement and no other exception or exemption to clearing applied. Further, the Division notes that treasury affiliates entering into any speculative transaction, on its own behalf or otherwise, would not be consistent with this condition.

- vi. The requirement that related affiliates entering into swaps with the treasury affiliate, or the treasury affiliate itself, may not enter into swaps with or on behalf of any affiliate that is a financial entity.

Market participants have expressed confusion as to whether a related affiliate can enter into transactions with multiple eligible treasury affiliates under the third General Condition to the Swap Activity in No-Action Letter 13-22. The third condition states that neither any related affiliate that enters into swaps with the eligible treasury affiliate nor the eligible treasury affiliate, may enter into swaps with or on behalf of any affiliate that is a financial entity (a “financial affiliate”), or otherwise assumes, nets, combines, or consolidates the risk of swaps entered into by any financial affiliate.

No-Action Letter 13-22 contemplated the use of multiple eligible treasury affiliates within a corporate family, but the Division agrees with market participants that the third condition does not accurately reflect this. The Division is accordingly amending the third condition to clarify that the restriction on related affiliates and eligible treasury affiliates from entering into swap transactions with financial entity affiliates does not preclude the circumstance where the financial entity affiliate is an eligible treasury affiliate.

- vii. The requirement for the payment obligations of the treasury affiliate to be guaranteed.

Market participants expressed concern with respect to the fifth General Condition to the Swap Activity in No-Action Letter 13-22. The fifth condition states that the payment obligations of the eligible treasury affiliate on the exempted swap must be guaranteed by: (i) its non-financial parent; (ii) an entity that wholly-owns or is wholly-owned by its non-financial parent; or (iii) the related affiliates for which the swap hedges or mitigates commercial risk.

Market participants have explained that corporate parents and structures may avail themselves of other types of support arrangements, such as keepwell agreements, letters of credit, or revolving credit facilities for example, which would not satisfy the requirements of No-Action Letter 13-22. As a result, the Division is removing the condition to accommodate the additional support arrangements that may exist with regard to the eligible treasury affiliate's payment obligations.

Division No-Action Position

The Division recognizes the benefits that arise from the use of treasury affiliates within corporate groups and has determined to provide the following no-action relief, described below.

For purposes of this no-action letter only, the following definitions shall apply:

Eligible treasury affiliate means a person that meets each of the following qualifications:

- (i) The person is (A) directly, wholly-owned⁹ by a non-financial entity or another eligible treasury affiliate (its "non-financial parent"), and (B) is not indirectly majority-owned¹⁰ by a financial entity, as defined in section 2(h)(7)(C)(i) of the CEA;

⁹ An entity is wholly-owned by a person if the person, directly or indirectly, holds 100% of the equity securities of the entity, or the right to receive upon dissolution, or the contribution of, 100% of the capital of a partnership of the entity, and the entity's financial results are included in the financial statements of the person as prepared on a consolidated basis under Generally Accepted Accounting Principles or International Financial Reporting Standards.

¹⁰ An entity is majority-owned by a person if the person, directly or indirectly, holds a majority of the equity securities of the entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership of

- (ii) The person's ultimate parent¹¹ is not a financial entity as defined in section 2(h)(7)(C)(i) of the CEA¹²;
- (iii) The person is a financial entity as defined in section 2(h)(7)(C)(i)(VIII) of the CEA solely as a result of acting as principal to swaps with, or on behalf of, one or more of its related affiliates, or providing other services that are financial in nature to such related affiliates;
- (iv) The person is not, and is not affiliated with, any of the following:
 - (A) a swap dealer;
 - (B) a major swap participant;
 - (C) a security-based swap dealer; or
 - (D) a major security-based swap participant.
- (v) The person is not any of the following:
 - (A) a private fund as defined in section 202(a) of the Investment Advisors Act of 1940 (15 U.S.C. § 80-b-2(a));
 - (B) a commodity pool;
 - (C) an employee benefit plan as defined in paragraphs (3) and (32) of section 3 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. § 1002);
 - (D) a bank holding company;
 - (E) an insured depository institution;
 - (F) a farm credit system institution;
 - (G) a credit union;
 - (H) a nonbank financial company that has been designated as systemically important by the Financial Stability Oversight Council;¹³ or

the entity, and the entity's financial results are included in the financial statements of the person as prepared on a consolidated basis under Generally Accepted Accounting Principles or International Financial Reporting Standards.

¹¹ For purposes of this no-action letter, a person's ultimate parent is the top most, direct or indirect, majority owner of the person, in the corporate hierarchy of which the person is a member.

¹² For purposes of this no-action relief as relevant to section 2(h)(7)(C)(i)(VIII) of the CEA, the Division notes that the Board of Governors of the Federal Reserve System (Federal Reserve) recently issued a final rule establishing, among other things, the requirements for determining whether a company is "predominately engaged in financial activities" for the purposes of Title I of the Dodd-Frank Act. See Definitions of "Predominantly Engaged In Financial Activities" and "Significant" Nonbank Financial Company and Bank Holding Company, 78 FR 20756 (Apr. 5, 2013). It is the Division's view that market participants that otherwise meet the conditions of this no-action relief, and for the sole purpose of determining whether they are eligible for the relief provided in this no-action letter, may look to the Federal Reserve's final rule for guidance in determining whether such entity is "predominately engaged in financial activities" pursuant to section 2(h)(7)(C)(i)(VIII) of the CEA.

¹³ For the purposes of this letter, "designated as systemically important by the Financial Stability Oversight Council" means that the Financial Stability Oversight Council has issued a final determination pursuant to 12 CFR Part 1310.

(I) an entity engaged in the business of insurance and subject to capital requirements established by an insurance governmental authority of a State, a territory of the United States, the District of Columbia, a country other than the United States, or a political subdivision of a country other than the United States that is engaged in the supervision of insurance companies under insurance law.

(vi) The person does not provide any services, financial or otherwise, to any affiliate that is a nonbank financial company that has been designated as systemically important by the Financial Stability Oversight Council.

Non-financial entity means a person that is not a financial entity as defined in section 2(h)(7)(C)(i) of the CEA.

Related affiliate means with respect to an eligible treasury affiliate:

- (i) A non-financial entity that is, or is directly or indirectly wholly- or majority-owned by, the ultimate parent; or
- (ii) A person that is another eligible treasury affiliate.

The Division will not recommend that the Commission commence an enforcement action against an eligible treasury affiliate for its failure to comply with the requirements under section 2(h)(1)(A) of the CEA and part 50 of the Commission's regulations to clear a swap with an unaffiliated counterparty or another eligible treasury affiliate (the "exempted swap") that is subject to required clearing pursuant to § 50.4 of the Commission's regulations, subject to the following conditions:

General Conditions to the Swap Activity

- (i) The eligible treasury affiliate enters into the exempted swap for the sole purpose of hedging or mitigating the commercial risk¹⁴ of one or more related affiliates that was transferred to the eligible treasury affiliate;
- (ii) The eligible treasury affiliate does not enter into swaps with its related affiliates or unaffiliated counterparties other than for the purpose of hedging or mitigating its own commercial risk or the commercial risk of one or more related affiliates;
- (iii) Neither any related affiliate that enters into swaps with the eligible treasury affiliate nor the eligible treasury affiliate, enters into swaps with or on behalf of any affiliate that is a financial entity ("financial affiliate"), or otherwise assumes, nets, combines, or consolidates the risk of swaps entered into by any financial affiliate,

¹⁴ For purposes of this relief, a swap "hedges or mitigates commercial risk" if it meets the requirement of Commission regulation 50.50(c).

except in the case of financial affiliates that qualify as eligible treasury affiliates under this letter; and

- (iv) Each swap entered into by the eligible treasury affiliate is subject to a centralized risk management program that is reasonably designed (A) to monitor and manage the risks associated with the swap, and (B) to identify the related affiliate or affiliates on whose behalf each exempted swap has been entered into by the eligible treasury affiliate.

Reporting Conditions

With respect to each swap that an eligible treasury affiliate (“electing counterparty”) elects not to clear in reliance on the relief provided in this letter, the reporting counterparty, as determined in accordance with § 45.8 of the Commission’s regulations, shall provide or cause to be provided the following information to a registered swap data repository or, if no registered swap data repository is available to receive the information from the reporting counterparty, to the Commission, in the form and manner specified by the Commission:¹⁵

- (i) Notice of the election of the relief and confirmation that the electing counterparty satisfies the General Conditions to the Swap Activity of this no-action relief specified above;
- (ii) How the electing counterparty generally meets its financial obligations associated with entering into non-cleared swaps by identifying one or more of the following categories, as applicable:
 - (A) A written credit support agreement;
 - (B) Pledged or segregated assets (including posting or receiving margin pursuant to a credit support agreement or otherwise);
 - (C) A written guarantee from another party;
 - (D) The electing counterparty’s available financial resources; or
 - (E) Means other than those described in (A)-(D); and
- (iii) If the electing counterparty is an entity that is an issuer of securities registered under section 12 of, or is required to file reports under section 15(d) of, the Securities Exchange Act of 1934:
 - (A) The relevant SEC Central Index Key number for such counterparty; and
 - (B) Acknowledgment that an appropriate committee of the board of directors (or equivalent body) of the electing counterparty has reviewed and approved the

¹⁵ Electing counterparties may rely on the relief provided in CFTC Letter No. 13-09 for intra-group swaps that are entered into between two eligible treasury affiliates, to the extent that such counterparties elect not to clear such swap based on the relief provided in this no-action letter.

decision to enter into swaps that are exempt from the requirements of section 2(h)(1), and if applicable, section 2(h)(8) of the CEA.

(iv) If there is more than one electing counterparty to a swap, the information specified in the Reporting Conditions of this no-action relief specified above shall be provided with respect to each of the electing counterparties.

(v) An entity that qualifies for the relief provided in this no-action letter may report the information listed in paragraphs (ii) and (iii) above, annually in anticipation of electing the relief for one or more swaps. Any such reporting under this paragraph will be effective for purposes of paragraphs (ii) and (iii) above for 365 days following the date of such reporting. During the 365-day period, the entity shall amend the report as necessary to reflect any material changes to the information reported.

(vi) Each reporting counterparty shall have a reasonable basis to believe that the electing counterparty meets the General Conditions to the Swap Activity for the no-action relief specified above.

This no-action letter, and the positions taken herein, represent the view of the Division only, and do not necessarily represent the position or view of the Commission or of any other office or division of the Commission. The relief issued by this letter does not excuse the affected persons from compliance with any other applicable requirements contained in the CEA or in the Commission's regulations issued thereunder. Further, this letter, and the relief contained herein, is based upon the information available to the Division. Any different or changed material facts or circumstances might render this letter void. As with all no-action letters, the Division retains the authority to, in its discretion, further condition, modify, suspend, terminate or otherwise restrict the terms of the no-action relief provided herein. This letter supersedes No-Action Letter 13-22.

If you have any questions, please do not hesitate to contact Meghan Tente, Attorney-Advisor, at (202) 418-5785.

Sincerely,

Phyllis Dietz
Acting Director