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May 2, 2011

VIA E-MAIL

Mr. David A. Stawick, Secretary
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: CFTC Legal Authority over Interaffiliate Transactions

Dear Mr. Stawick,

We have previously submitted comment letters on the issue of affiliate transactions, in which we recommended that such transactions not be subject to the execution and clearing requirements under the Dodd-Frank Wall Street Reform and Consumer Protection Act ("Dodd-Frank") and the related rules to be promulgated by the Commodity Futures Trading Commission (the "CFTC") ("PFI Comment Letters").[1] As noted in the PFI Comment Letters, many business enterprises use one affiliate to directly face the market as a "conduit" to hedge the net commercial and financial risk of the various operating affiliates within the larger corporate group. The use of a single conduit for the various affiliates within a larger corporate group diminishes the demands on the group's financial liquidity, operational assets and management resources, as affiliates do not have to establish independent relationships and unique infrastructure to face the market. We believe that transactions between affiliates do not present the issues and risks that give rise to a need for swap dealer registration or the application of the other requirements applicable to swaps (particularly the mandatory execution and clearing requirements), and were not intended by Congress to be encompassed within the relevant provisions of Dodd-Frank.

We understand that the staff of the CFTC is concerned that that CFTC does not have the legal authority to provide relief from the execution and clearing requirements of Dodd-Frank with respect to interaffiliate transactions. However, as discussed below, we believe that the CFTC has the legal authority to address this issue in a manner consistent with the language, as well as the purposes and intent, of Dodd-Frank and we urge the Commission to utilize this authority to ensure that transactions between affiliates are excluded from the various requirements.

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1 Comment Letter, from Richard A. Miller, Vice President and Corporate Counsel, Financial Management Law, the Prudential Insurance Company of America, dated September 17, 2010; and Comment Letter, from Richard. A. Miller, Corporate Counsel, Financial Management Law, the Prudential Insurance Company of America, dated February 17, 2011.

I. Interaffiliate transactions are not "swaps" under Dodd-Frank.

The CFTC has the clear authority under Section 721 of Dodd-Frank to provide further detail or guidance on the meaning and application of the term "swap," as defined under Dodd-Frank, and, under Section 723 of Dodd-Frank, to identify those swaps or categories of swaps that are subject to the execution and clearing requirements of Dodd-Frank. Pursuant to the CFTC's authority under Section 721, the CFTC can define the term "swap" to include or exclude specified categories of derivative products. In addition, however, the CFTC could, by regulation or interpretation, define the term "swap" to exclude transactions between two wholly-owned subsidiaries of the same parent company. In particular, because such transactions are effected between the same "person," there is no change in beneficial ownership of the rights and obligations under the "swap," and, consequently, there is no bona fide swap transaction. The CFTC could therefore conclude that a transaction between affiliates cannot be encompassed within the Dodd-Frank definition of a "swap" because only one "person" or "party" is involved in the transaction.

In this regard, the statutory language of Section 1a(47)(A)(iii) of the Commodity Exchange Act, as amended by Dodd-Frank (the "CEA"), refers to a swap as an agreement, contract, or transaction that provides for the exchange of payments "...between the parties to the transaction." In past practice, the CFTC has interpreted the term "parties" to mean entities that have different beneficial ownership or are under separate control.[2] Conversely, the CFTC has stated that commonly owned and controlled affiliates are "a single entity" or the "same person" for purposes of compliance with Commission regulations.[3] Therefore, given that an interaffiliate transaction between two wholly owned and controlled entities occurs between the same "person" and there is no change in beneficial ownership in such a transaction, interaffiliate transaction do not meet the statutory definition of a "swap" under Dodd-Frank.

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2 In guidance to designated contract markets, the CFTC has stated Exchange-for-Physical ("EFP") transactions must be bona fide transactions and that for an EFP to be bona fide, it must have "separate parties to the EFP, where the accounts involved have different beneficial ownership or are under separate control." CME, CBOT, NYMEX & COMEX, Rule 538 – ("Exchange for Related Positions"), June 11, 2010 Advisory Number CME Group RA1006-5.

3 "The Commission staff historically has considered commonly owned and controlled entities to be a single entity or the "same person" for purposes of compliance with Commission regulation 1.3(z)." CFTC Letter Interpretation, Re: Request for Confirmation of Interpretations Regarding "'Bona Fide Hedging" and "Exchanges of Futures for Product" (available May 9, 1994).

We also note that the CFTC has previously questioned whether it would be appropriate to consider swap transactions between affiliates for the purpose of determining whether a particular legal person is a swap dealer, as the economic reality of such swaps would simply represent an allocation of risk within a corporate group.[4] It would be anomalous for the CFTC now to declare that interaffiliate transactions should nevertheless be a treated as "swaps," requiring such transactions to be subject to execution and clearing requirements, as well as margin and capital requirements. Such a result would also create unnecessary confusion and legal uncertainty and, as discussed below, subject market participants to unnecessary cost and burden while not furthering the purposes of Dodd-Frank.

II. Interaffiliate transactions should not be subject to the execution or clearing requirement.

Section 2(h)(2)(A)(i) of the CEA gives the CFTC the authority to determine which swaps or group, category, type, or class of swap should be required to be cleared. We respectfully urge the CFTC to use this authority to determine that swaps between wholly owned affiliates are a category of swaps that are not required to be executed or cleared under Dodd-Frank. For the reasons noted above, such an outcome would be consistent with Dodd-Frank, as Section 2(h)(1)(A) of the CEA, makes it unlawful for any "person" to engage in swaps, unless the swaps are cleared. As discussed above, transactions between affiliates are not swaps between "persons," as the CFTC has long considered interaffiliate transactions to be between the same "person" for the purposes of CFTC regulations. Therefore, transactions between the same "person" should not be included in the category of swaps that are required to be cleared.

Such an outcome would be consistent with Congressional intent, as the Chairman of the Senate Agriculture Committee and one of the primary authors of Title VII of Dodd-Frank stated "While most large financial entities are not eligible to use the end user exemption for standardized swaps entered into with third parties, it would be appropriate for the SEC and CFTC to exempt from mandatory clearing and trading inter-affiliate swap transactions between wholly-owned affiliates of a financial entity."[5]

Furthermore, a requirement that transactions between affiliates be subject to the execution and clearing requirements is unnecessary and inconsistent with the purposes of Dodd-Frank. First, competitive execution and centralized clearing are unnecessary in the context of transactions between affiliates, which do not need to be protected against risks of unfair or off-market pricing or direct bilateral credit risk. Indeed, even if the transactions are cleared, affiliates cannot be protected from each other's credit risk because commonly owned affiliates are all subject to the

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4 Further Definition of ''Swap Dealer, ''Security-Based Swap Dealer,'' ''Major Swap Participant,'' ''Major Security-Based Swap Participant'' and ''Eligible Contract Participant', 75 Fed. Reg. 80174, 80183 (Dec. 21, 2010).

5 Cong. Record, July 15, 2010, S5921.

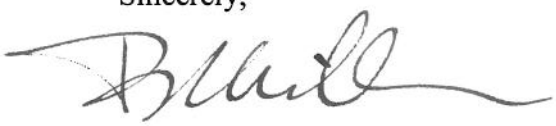
parent company's credit risk. Moreover, including transactions between affiliates in centrally executed markets and clearing houses will potentially mislead the market, by sending an inaccurate signal of the actual level of activity in the relevant market.

Finally, a determination that interaffiliate transactions are not suitable for clearing and are not required to be cleared would be consistent with the position taken by European regulators. Specifically, the proposed regulation of derivative transactions by the European Parliament explicitly carves out interaffiliate transactions from the clearing requirements for financial and non-financial counterparties.[6] Section 752 of Dodd-Frank requires the CFTC to consult and coordinate with international regulators on the regulation of swaps, and exempting interaffiliate from the clearing requirements would be consistent with the treatment of interaffiliate transactions by European regulators.

We understand that the CFTC may be concerned that excluding affiliate transactions from the requirements of Dodd-Frank might allow some entities to use such transactions as a means of circumventing these requirements. In our view, however, it would be extremely difficult, if not impossible, to use affiliate transactions for this purpose, given that the transactions would need to be between wholly-owned subsidiaries of the same parent company. In any event, even if an entity attempted to circumvent the requirements in this manner, Section 2(h)(4)(A) of the CEA gives the CFTC specific anti-evasion authority, which could be used in such instances.

We appreciate the opportunity to provide our comments to the CFTC on these issues and look forward to discussing these issues with the CFTC. Any questions about this letter may be directed to me at (973) 802-5901.

Sincerely,



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6 Proposal for a Regulation of the European Parliament and the Council on derivative transactions, central counterparties and trade repositories, Title II, Art.3, 2010/0250/COD (April 11, 2011).