



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk

CFTC Letter No. 14-25
No-Action
March 6, 2014
Division of Clearing and Risk

RE: Time-Limited No-Action Relief from Certain Provisions of the Treatment of Outward-Facing Swaps Condition in the Inter-Affiliate Exemption

Ladies and Gentlemen:

This letter is in response to a letter received by the Division of Clearing and Risk (“Division”) of the Commodity Futures Trading Commission (“Commission”) from the International Swaps and Derivatives Association (“ISDA”), on behalf of its members and other market participants that engage in swaps with affiliated entities. The letter requests that the Commission extend, among other things, certain March 11, 2014 deadlines contained in Commission regulation 50.52.¹

On April 11, 2013, the Commission published a final rule providing an exemption from required clearing for swaps between certain affiliated entities, subject to specific requirements and conditions (the “Inter-Affiliate Exemption”).² One of those conditions, the treatment of outward-facing swaps condition (“Outward-Facing Swaps Condition”), requires the clearing of swaps between affiliated counterparties claiming the Inter-Affiliate Exemption (“Eligible Affiliate Counterparties”) and unaffiliated counterparties.³ The Commission provided two temporary, alternative compliance frameworks to satisfy the Outward-Facing Swaps Condition to assist counterparties to transition to full compliance with Commission regulation 50.52(b)(4)(i),⁴ both of which expire on March 11, 2014.⁵

In order to (i) provide for an orderly transition as foreign jurisdictions implement mandatory clearing regimes and (ii) allow Eligible Affiliate Counterparties to enter into swaps that do not exceed a de minimis amount in jurisdictions that have not yet or will not in the near future

¹ 17 C.F.R. § 50.52.

² See Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 Fed. Reg. 21,749 (Apr. 11, 2013) (codified at 17 C.F.R. § 50.52).

³ Commission regulation 50.52(b)(4).

⁴ See 78 Fed. Reg. at 21,764.

⁵ Commission regulations 50.52(b)(4)(ii)-(iii).

implement a mandatory clearing regime, the Division will not recommend that the Commission commence an enforcement action against an entity that utilizes Commission regulation 50.52(b)(4)(ii) or (iii) to meet the requirements of Outward-Facing Swaps Condition until 11:59 pm on December 31, 2014, subject to the conditions described herein.

I. Applicable Regulatory Requirements

Under section 2(h)(1)(A) of the Commodity Exchange Act (“CEA”), “it shall be 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 a [DCO] that is exempt from registration under [the CEA] if the swap is required to be cleared.” On November 29, 2012, the Commission adopted its first clearing requirement determination, requiring that swaps meeting the specifications of four classes of interest rate swaps and two classes of credit default swaps be cleared.⁶ The six classes of swaps are defined according to certain specifications set forth in § 50.4 of the Commission’s regulations.

On April 11, 2013, pursuant to its general exemptive authority under section 4(c)(1) of the CEA,⁷ the Commission published final rules providing a clearing exemption for swaps between certain affiliated entities, subject to several conditions.⁸ One of those conditions, the Outward-Facing Swaps Condition, applies to swaps between Eligible Affiliate Counterparties and unaffiliated counterparties (“outward-facing swaps”).⁹ The Outward-Facing Swaps Condition was adopted to address the Commission’s concerns about evasion of the clearing requirement and the potential systemic risk associated with uncleared, inter-affiliate swaps involving non-U.S. affiliates.¹⁰

⁶ 17 C.F.R. §§ 50.2, 50.4; Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012) (codified at 17 C.F.R. pt. 50).

⁷ See CEA section 4(c)(1); 7 U.S.C. § 6(c)(1).

⁸ 17 C.F.R. § 50.52; see 78 Fed. Reg. 21,749. Besides requiring compliance with the Outward-Facing Swaps Condition, the Inter-Affiliate Exemption requires that (i) both counterparties elect not to clear the swap; (ii) the terms of the swap are documented in a swap trading relationship document (or the counterparties comply with Commission regulation 23.504 if one of the affiliated counterparties is a swap dealer or major swap participant); and (iii) the swap be subject to a centralized risk management program (or, if one of the counterparties is a swap dealer or major swap participant, the requirements of Commission regulation 23.600 are met). See Commission regulation 50.52(b)(1)-(3). In addition, the reporting counterparty, as defined in Commission regulation 45.8, must report certain information to a registered or provisionally-registered swap data repository. See Commission regulation 50.52(c)-(d).

⁹ 17 CFR 50.52 § (b)(4)(i).

¹⁰ See 78 Fed. Reg. at 21,762.

Pursuant to the Outward-Facing Swaps Condition each eligible affiliate counterparty must clear all outward-facing swaps to the extent that the swap is required to be cleared according to Commission regulation 50.4.¹¹

As discussed in the preamble to the Inter-Affiliate Exemption, in order to provide for an orderly transition period and in response to concerns about timing and sequencing issues associated with the implementation of non-U.S. jurisdictions' mandatory clearing regimes, the Commission provided several alternative compliance frameworks for compliance with the Outward-Facing Swaps Condition.¹² Commission regulation 50.52(b)(4)(ii) provides an alternative compliance framework for entities located in the European Union, Japan,¹³ and Singapore.¹⁴ Commission regulation 50.52(b)(4)(iii) is an alternative compliance framework for entities located in all other jurisdictions.

Until March 11, 2014, Eligible Affiliate Counterparties located in Japan, the European Union, and Singapore can satisfy the Outward-Facing Swaps Condition by: (i) paying and collecting full

¹¹ Commission regulation 50.52(b)(4)(i) lists specific ways Eligible Affiliate Counterparties may satisfy the Outward-Facing Swaps Condition. Commission regulation 50.52(b)(4)(i) states:

Each eligible affiliate counterparty that enters into a swap, which is included in a class of swaps identified in § 50.4, with an unaffiliated counterparty shall:

- (A) comply with the requirements for clearing the swap in section 2(h) of the Act and this part;
- (B) comply with the requirements for clearing the swap under a foreign jurisdiction's clearing mandate that is comparable, and comprehensive but not necessarily identical, to the clearing requirement of section 2(h) of the Act and this part, as determined by the Commission;
- (C) comply with an exception or exemption under section 2(h)(7) of the Act or this part;
- (D) comply with an exception or exemption under a foreign jurisdiction's clearing mandate, provided that (1) the foreign jurisdiction's clearing mandate is comparable, and comprehensive but not necessarily identical, to the clearing requirement of section 2(h) of the Act and this part, as determined by the Commission; and (2) the foreign jurisdiction's exception or exemption is comparable to an exception or exemption under section 2(h)(7) of the Act or this part, as determined by the Commission; or
- (E) clear such swap through a registered derivatives clearing organization or a clearing organization that is subject to supervision by appropriate government authorities in the home country of the clearing organization and has been assessed to be in compliance with the Principles for Financial Market Infrastructures.

¹² See 78 Fed. Reg. at 21,763-66.

¹³ In 2010, the Japanese government amended the Financial Instruments and Exchange Act to require the phased implementation of mandatory clearing of certain derivative transactions.

¹⁴ The Commission created the alternative compliance framework for entities located in the European Union, Japan, and Singapore because those jurisdictions had, at the time the Inter-Affiliate Exemption was issued, "made significant progress in implementing their clearing regimes." 78 Fed. Reg. at 21,763.

variation margin on all swaps with unaffiliated counterparties; or (ii) paying and collecting full variation margin on all swaps with all other Eligible Affiliate Counterparties.¹⁵ Pursuant to Commission regulation 50.52(b)(4)(ii)(B), certain Eligible Affiliate Counterparties located in the European Union, Japan, or Singapore do not have to comply with the Outward-Facing Swaps Condition until March 11, 2014, if (i) the one counterparty that directly or indirectly holds a majority ownership interest in the other counterparty or the third party that directly or indirectly holds a majority ownership interest in both counterparties is not a “financial entity” as defined in section 2(h)(7)(C)(i) of the CEA; and (ii) neither Eligible Affiliate Counterparty is affiliated with a swap dealer or major swap participant.

The Commission also provided a similar alternative compliance framework for Eligible Affiliate Counterparties not located in the European Union, Japan, and Singapore, under certain circumstances.¹⁶ Specifically, Commission regulation 50.52(b)(4)(iii) provides that if an Eligible Affiliate Counterparty located in the United States enters into swaps that are included with in a class of swaps subject to Commission regulation 50.4 with Eligible Affiliate Counterparties located in non-U.S. jurisdictions other than the European Union, Japan, and Singapore, and the aggregate notional value of such swaps subject to Commission regulation 50.4 does not exceed five percent of the aggregate notional value of all swaps subject to Commission regulation 50.4 held by the Eligible Affiliate Counterparty located in the United States, then such swaps shall be deemed to satisfy the requirements of the Outward-Facing Swap Condition until March 11, 2014 by either (i) paying and collecting full variation margin on all swaps with unaffiliated counterparties; or (ii) paying and collecting full variation margin on all swaps with all other Eligible Affiliate Counterparties.¹⁷ However, if the aggregate notional value of such swaps exceeds five percent, then the eligible affiliate counterparties cannot take advantage of the alternative compliance framework and must instead comply with Commission regulation 50.52(b)(4)(i) in order to elect the Inter-Affiliate Exemption.

II. Summary of Relief Requested

Market participants have cited the difficulty in meeting the requirements of the Outward-Facing Swaps Condition because the Commission has not announced that any non-U.S. jurisdiction has promulgated a comparable and comprehensive clearing requirement. The Division believes that extending the alternative compliance frameworks until December 31, 2014 may promote the adoption of comparable and comprehensive clearing requirements. The Division also believes that such extensions will allow for a more orderly transition as jurisdictions establish and implement clearing requirements and the Commission issues comparability determinations with regard to those requirements. In addition, this relief will allow Eligible Affiliate Counterparties that enter

¹⁵ See Commission regulation 50.52(b)(4)(ii)(A).

¹⁶ See Commission regulation 50.52(b)(4)(iii).

¹⁷ See *id.* In each instance, the notional value is measured in U.S. dollars and calculated for each calendar quarter.

into swaps that do not exceed a de minimis amount in jurisdictions that have not yet, or will not in the near future, implement a mandatory clearing regime to prepare to come into compliance with Outward-Facing Swaps Condition.

The Division notes that there has been progress made in other jurisdictions with respect to mandatory clearing regimes, but at this time it appears that no jurisdiction has a mandatory clearing regime encompassing the products and participants that the Commission's clearing requirement includes.

III. Division No-Action Position

The Division, recognizing the benefits of additional time for an orderly transition period with regard to the timing and sequencing issues associated with the implementation of mandatory clearing regimes in non-U.S. jurisdictions, has determined to provide the no-action relief described below.

The Division will not recommend that the Commission commence an enforcement action against an entity that utilizes Commission regulation 50.52(b)(4)(ii) or 50.52(b)(4)(iii) to meet the requirements of the Outward-Facing Swaps Condition in the Inter-Affiliate Exemption until 11:59 p.m. (eastern), December 31, 2014, if:

1. The Eligible Affiliate Counterparties claiming the Inter-Affiliate Exemption otherwise satisfy all of the requirements of Commission regulation 50.52;
2. A counterparty to the swap must not be located in a non-U.S. jurisdiction in which the Commission has determined a comparable and comprehensive clearing requirement exists;
3. The Eligible Affiliate Counterparties electing the relief provided by this no-action letter shall promptly provide to the Division, upon request, documentation regarding their compliance with any aspect of this no-action letter and Commission regulation 50.52, including information regarding an entity's compliance with an alternative compliance framework.

The Division notes that as foreign mandatory clearing regimes come into effect the Division will monitor their implementation and will modify the relief contained in this letter to the extent that this relief is inconsistent with or provides a way to avoid the clearing requirement contained in the CEA or a clearing mandate of a foreign jurisdiction.

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.

If you have any questions, please do not hesitate to contact Eric Lashner, Special Counsel, at (202) 418-5393 or elashner@cftc.gov.

Sincerely,

Ananda Radhakrishnan
Director