



## U.S. COMMODITY FUTURES TRADING COMMISSION

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### Division of Clearing and Risk

CFTC Letter No. 16-81  
No-Action  
November 28, 2016  
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**

The purpose of this letter is to extend no-action relief previously granted by the Division of Clearing and Risk (“Division”) of the Commodity Futures Trading Commission (“Commission”) under No-Action Letter 15-63 that addressed certain challenges faced by market participants arising from the fact that other jurisdictions are still in the process of implementing mandatory clearing regimes.<sup>1</sup> Those challenges pertained to the ability of market participants to rely on a rule promulgated by the Commission in 2013 that exempts from the clearing requirement certain swaps between affiliates. Because foreign jurisdictions have made significant progress in implementing mandatory clearing regimes, but have not yet fully implemented regimes that encompass the range of products and participants that the Commission’s clearing requirement includes, market participants have faced challenges in complying with the conditions of the exemption. The Division’s prior no-action relief made it temporarily easier for market participants to satisfy the conditions of the exemption. The Division in this letter is extending that relief for another year in order to further provide for an orderly transition as other jurisdictions implement mandatory clearing regimes.

#### **Inter-Affiliate Exemption from Clearing**

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”).<sup>2</sup> 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

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<sup>1</sup> The Division is in receipt of a letter to the Commission from the International Swaps and Derivatives Association, Inc., dated October 11, 2016, requesting an extension of the previous no-action relief and highlighting the issues facing market participants.

<sup>2</sup> Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 Fed. Reg. 21,749 (Apr. 11, 2013) (codifying 17 C.F.R. § 50.52).

Counterparties”) and unaffiliated counterparties.<sup>3</sup> The Commission provided two temporary, alternative compliance frameworks to satisfy the Outward-Facing Swaps Condition to assist counterparties in transitioning to full compliance with Commission regulation 50.52(b)(4)(i),<sup>4</sup> both of which expired on March 11, 2014, under the terms of the regulation.<sup>5</sup>

On March 6, 2014, the Division granted time-limited relief to entities using Commission regulation 50.52(b)(4)(ii) or (iii) to meet the requirements of the Outward-Facing Swaps Condition until December 31, 2014.<sup>6</sup> The Division then extended this relief twice more, on November 7, 2014,<sup>7</sup> and on November 17, 2015 (“2015 No-Action Relief”).<sup>8</sup> As discussed in the preamble to the Inter-Affiliate Exemption, the purpose of the relief, and its subsequent extensions by no-action letter, was 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 implemented a mandatory clearing regime, or will not in the near future.<sup>9</sup>

While the Division notes that significant progress has been made with regard to the implementation of mandatory clearing regimes in foreign jurisdictions,<sup>10</sup> it also believes that an extension of the 2015 No-Action Relief would continue to serve the purposes set forth above. Therefore, as explained further below, the Division will not recommend that the Commission commence an enforcement action against an entity that uses Commission regulation 50.52(b)(4)(ii) or (iii) to meet the requirements of the Outward-Facing Swaps Condition until the earlier of (i) 11:59 pm (eastern), December 31, 2017, or (ii) with respect to a particular jurisdiction, 60 days after the date on which the Commission announces that it has made a comparability determination described in regulation 50.52(b)(4)(i), subject to the conditions described herein.

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<sup>3</sup> Commission regulation 50.52(b)(4).

<sup>4</sup> 78 Fed. Reg. at 21,764.

<sup>5</sup> Commission regulation 50.52(b)(4)(ii)-(iii).

<sup>6</sup> CFTC Letter No. 14-25 (extending the alternative compliance frameworks until December 31, 2014), available at: <http://www.cftc.gov/LawRegulation/CFTCStaffLetters/No-ActionLetters/index.htm>.

<sup>7</sup> CFTC Letter No. 14-135, (extending the alternative compliance frameworks until December 31, 2015), available at: <http://www.cftc.gov/LawRegulation/CFTCStaffLetters/No-ActionLetters/index.htm>.

<sup>8</sup> CFTC Letter No. 15-63, (extending the alternative compliance frameworks until December 31, 2016), available at: <http://www.cftc.gov/LawRegulation/CFTCStaffLetters/No-ActionLetters/index.htm>.

<sup>9</sup> 78 Fed. Reg. at 21,763-66.

<sup>10</sup> See Clearing Requirement Determination Under Section 2(h) of the CEA for Interest Rate Swaps, 81 Fed. Reg. 71,202, 71,203-71,205 (Oct. 14, 2016) (providing a summary of the implementation status of interest rate swap clearing requirements issued in Australia, the European Union, and Mexico, and the status of such requirements to be issued in Canada, Hong Kong, Singapore, and Switzerland).

### **Applicable Regulatory Requirements**

Under section 2(h)(1)(A) of the Commodity Exchange Act (“CEA”), it is unlawful for any person to engage in a swap unless the swap is cleared at a derivatives clearing organization (“DCO”) that is registered with the Commission or exempt from registration if the swap is required to be cleared. On November 29, 2012, the Commission adopted its first clearing requirement determination for four classes of interest rate swaps and two classes of credit default swaps.<sup>11</sup> Pursuant to the Commission’s determination, swaps within the six classes must be cleared if they meet the specifications set forth in Commission regulation 50.4. On September 28, 2016, the Commission adopted an expansion of the clearing requirement to include interest rate swaps denominated in currencies that were not included in the first clearing requirement determination.<sup>12</sup>

On April 11, 2013, pursuant to its general exemptive authority under section 4(c)(1) of the CEA, the Commission promulgated final rules providing a clearing exemption for swaps between certain affiliated entities, subject to several conditions.<sup>13</sup> One of those conditions, the Outward-Facing Swaps Condition, applies to swaps between Eligible Affiliate Counterparties and unaffiliated counterparties.<sup>14</sup> 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.<sup>15</sup> The Outward-Facing Swaps Condition

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<sup>11</sup> Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012) (codifying 17 C.F.R. § 50).

<sup>12</sup> Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps, 81 Fed. Reg. at 71,239-71,240 (amending § 50.4(a)).

<sup>13</sup> 17 C.F.R. § 50.52; see 78 Fed. Reg. 21,749. To utilize the Inter-Affiliate Exemption, in general: (i) both counterparties must elect not to clear the swap; (ii) the terms of the swap must be documented in a swap trading relationship document; and (iii) the swap must be subject to a centralized risk management program. See Commission regulation 50.52(b)(1)-(3). In addition, the reporting counterparty to the swap, 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).

<sup>14</sup> 17 CFR § 50.52(b)(4)(i).

<sup>15</sup> According to Commission regulation 50.52(b)(4)(i), Eligible Affiliate Counterparties may satisfy the Outward-Facing Swaps Condition by: (i) clearing the swap according to section 2(h) of the CEA and part 50 of the Commission’s regulations; (ii) clearing the swap according to a foreign jurisdiction’s clearing mandate, if the Commission has determined the mandate is comparable and comprehensive but not necessarily identical to the clearing requirement of section 2(h) of the CEA and part 50 of the Commission’s regulations; (iii) complying with an exception or exemption under section 2(h)(7) of the CEA or part 50 of the Commission’s regulations; (iv) complying with an exception or exemption under a foreign jurisdiction’s clearing mandate, if the Commission has determined both the mandate and the clearing exception or exemption are comparable and comprehensive but not necessarily identical to the mandate and exception or exemption of section 2(h) of the CEA or part 50 of the Commission’s regulations; or (v) clearing the swap through a registered DCO 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.

addresses the Commission's concerns with evasion of the clearing requirement and the potential impact on systemic risk posed by uncleared, inter-affiliate swaps involving non-U.S. affiliates.<sup>16</sup>

As mentioned above, in order to provide for an orderly transition period and in response to concerns about timing issues associated with the implementation of non-U.S. jurisdictions' mandatory clearing regimes, the Commission provided two alternative compliance frameworks for compliance with the Outward-Facing Swaps Condition.<sup>17</sup> Until March 11, 2014, Eligible Affiliate Counterparties located in Japan, the European Union, and Singapore could satisfy the Outward-Facing Swaps Condition by: (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.<sup>18</sup>

Certain Eligible Affiliate Counterparties located in the European Union, Japan, or Singapore did not have to comply with the Outward-Facing Swaps Condition until March 11, 2014, if (i) the one counterparty that directly or indirectly held a majority ownership interest in the other counterparty or the third party that directly or indirectly held a majority ownership interest in both counterparties was not a "financial entity" as defined in section 2(h)(7)(C)(i) of the CEA; and (ii) neither Eligible Affiliate Counterparty was affiliated with a swap dealer or major swap participant.<sup>19</sup>

The Commission also provided a similar alternative compliance framework for Eligible Affiliate Counterparties located outside the United States, European Union, Japan, and Singapore.<sup>20</sup> Specifically, Commission regulation 50.52(b)(4)(iii) provides that if an Eligible Affiliate Counterparty located in the U.S. enters into swaps that are required to be cleared according 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 U.S., then such swaps were 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.<sup>21</sup>

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<sup>16</sup> 78 Fed. Reg. at 21,762.

<sup>17</sup> 78 Fed. Reg. at 21,763-66. Commission regulation 50.52(b)(4)(ii) provides an alternative compliance framework for entities located in the European Union, Japan, and Singapore, and Commission regulation 50.52(b)(4)(iii) provides an alternative compliance framework for entities located in all other non-U.S. jurisdictions.

<sup>18</sup> Commission regulation 50.52(b)(4)(ii)(A).

<sup>19</sup> Commission regulation 50.52(b)(4)(ii)(B).

<sup>20</sup> Commission regulation 50.52(b)(4)(iii).

<sup>21</sup> Id. In each instance, the notional value is measured in U.S. dollars and calculated for each calendar quarter.

The 2015 No-Action Relief effectively extended each of these deadlines to allow Eligible Affiliate Counterparties to use the alternative compliance frameworks in Commission regulations 50.52(b)(4)(ii) and (iii) until December 31, 2016.

### **Summary of Relief**

The Division recognizes that Australia, the European Union, Japan, and Mexico have promulgated and begun implementing mandatory clearing regimes and that Canada, Hong Kong, Singapore, and Switzerland have made significant progress towards adopting clearing mandates.<sup>22</sup> The Commission will evaluate whether such foreign jurisdictions' clearing mandates are comparable and comprehensive, but not necessarily identical to, the Commission's clearing mandate.

The Division understands the challenges faced by market participants in meeting the requirements of the Outward-Facing Swaps Condition. The Division believes that extending the ability to use the alternative compliance frameworks will continue to promote the adoption of comparable and comprehensive clearing requirements and will allow for a more orderly transition as jurisdictions establish and implement clearing requirements until such time as the Commission is able to consider issuing comparability determinations for mandatory clearing regimes in foreign jurisdictions. In addition, this relief will allow Eligible Affiliate Counterparties that enter into swaps that do not exceed a de minimis amount in foreign jurisdictions that have not yet, or will not in the near future, implement a mandatory clearing regime to prepare to come into compliance with the Outward-Facing Swaps Condition.

### **Division No-Action Position**

The Division, recognizing that additional time to use the alternative compliance frameworks will encourage an orderly transition period with regard to the timing 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 uses 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 the earlier of (i) 11:59 pm (eastern), December 31, 2017, or (ii) with respect to a particular jurisdiction, 60 days after the date on which the Commission announces that it has made a comparability determination described in regulation 50.52(b)(4)(i), if:

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<sup>22</sup> Clearing Requirement Determination Under Section 2(h) of the CEA for Interest Rate Swaps, 81 Fed. Reg. at 71,203-71,205.

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 promptly provide 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 Peter A. Kals, Special Counsel, at (202) 418-5466 or [pkals@cftc.gov](mailto:pkals@cftc.gov).

Sincerely,

Jeffrey M. Bandman  
Acting Director