



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk

CFTC Letter No. 13-22
No-Action
June 4, 2013
Division of Clearing and Risk

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

Ladies and Gentlemen:

The Division of Clearing and Risk (Division) of the Commodity Futures Trading Commission (CFTC or Commission) has received a number of inquiries from market participants requesting 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 entities that meet the definition of "financial entity" solely under section 2(h)(7)(C)(i)(VIII) of the CEA because they are "predominately engaged in activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956," when such financial entities are acting on behalf of non-financial affiliates within a corporate group.

The Division understands that these affiliates (hereinafter referred to as treasury affiliates) may undertake hedging activities on behalf of affiliates within a corporate group, or 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.

Accordingly, the Division will not recommend that the Commission take an enforcement action against certain treasury affiliates within non-financial companies, as defined and described in this no-action letter, for a treasury affiliate's failure to comply with the requirements of section 2(h)(1) of the CEA and part 50 of the Commission's regulations, subject to the conditions and requirements described herein.

I. Applicable Regulatory Requirements

Under section 2(h)(1)(A) of the 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 within

four classes of interest rate swaps and two classes of credit default swaps (CDS) must be cleared.¹ The six classes of swaps are defined by reference to certain specifications set forth in § 50.4 of the Commission's regulations. Without further action by the Commission, all persons not able to claim an exception or an exemption from clearing pursuant to section 2(h)(7) of the CEA or part 50 of the Commission's regulations, would be required to clear all swaps meeting the specifications set forth in § 50.4 of the Commission's regulations, pursuant to the compliance schedule further described below. Since the adoption of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the Commission has adopted one exception² and one exemption³ from required clearing.

Specifically, 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. 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 a further condition to electing the end-user exception, § 50.50(b) of the Commission's regulations requires that the reporting counterparty, as determined in accordance with § 45.8 of the Commission's regulations, report certain information pertaining to the entity electing the exception, including a notice of the election of the exception, to a registered swap data repository (SDR) (or if no registered SDR is available to receive the information, to the Commission).

In addition, on April 11, 2013, the Commission adopted final rules that provide a clearing exemption for swaps between certain affiliated entities, subject to several conditions. While eligible affiliate counterparties, as defined in § 50.52(a) of the Commission's regulations, that are either financial entities or non-financial entities may elect the inter-affiliate exemption from required clearing, the Commission anticipates that the inter-affiliate exemption primarily will be elected when both of the swap counterparties are financial entities, and thus are not eligible to claim the end-user exception under section 2(h)(7)(A) of the CEA and § 50.50 of the Commission's regulations.⁵ Among other conditions, the inter-affiliate exemption requires the reporting counterparty, as determined in accordance with § 45.8 of the Commission's regulations, to report certain information pertaining to both eligible affiliate counterparties, including a notice

¹ Clearing Requirement Determination Under Section 2(h) of the CEA, 77 FR 74284 (Dec. 13, 2012) (hereinafter referred to as the Clearing Requirement Determination).

² End-User Exception to the Clearing Requirement for Swaps, 77 FR 42559 (July 19, 2012).

³ Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR 21749 (Apr. 11, 2013).

⁴ The Commission notes that pursuant to the Commission's regulations and the CEA, 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), and Commission regulation 50.50(d).

⁵ See, e.g., Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 FR at 21770 n.105.

of the election of the exemption, to a registered SDR (or if no registered SDR is available to receive the information, to the Commission).⁶

Without further action by the Division or the Commission, starting on June 10, 2013, all Category 2 Entities, as defined in the Swap Transaction Compliance and Implementation Schedule, that are not able to claim an exception or exemption from clearing pursuant to section 2(h)(7) of the CEA or part 50 of the Commission's regulations, will be required to clear swaps subject to the clearing requirement in § 50.4 of the Commission's regulations.⁷

II. Summary of Relief Requested

As noted above, the Division has received a number of inquiries requesting relief from required clearing for affiliates of non-financial companies that fall within the definition of "financial entity" solely under section 2(h)(7)(C)(i)(VIII) of the CEA because they are "predominantly engaged in activities of a financial nature, as defined in section 4(k) of the Bank Holding Company Act of 1956," when acting on behalf of affiliates that otherwise would be eligible to elect the end-user exception from required clearing when entering into swaps with unaffiliated counterparties or with another treasury affiliate.⁸ Market participants have requested relief from required clearing for swaps entered into by treasury affiliates if the swaps hedge or mitigate commercial risk of non-financial affiliates.

⁶ See Commission regulation 50.52(c).

⁷ See Swap Transaction Compliance and Implementation Schedule: Clearing Requirement Under Section 2(h) of the CEA, 77 FR 44441 (July 30, 2012). Pursuant to the compliance schedule, swap dealers, major swap participants, and private funds active in the swaps market were required to comply with the clearing requirement starting on March 11, 2013 ("Category 1 Entities"). Accounts managed by third-party investment managers, as well as ERISA pension plans, have until September 9, 2013, to begin clearing swaps that are subject to the clearing requirement and entered into on or after that date ("Category 3 Entities"). All other financial entities are required to clear swaps beginning on June 10, 2013, for swaps that are subject to the clearing requirement and entered into on or after that date ("Category 2 Entities"). See Clearing Requirement Determination, 77 FR at 74319-21. With regard to the CDS indices on European corporate names, iTraxx, the Clearing Requirement Determination provided that, if no DCO offered iTraxx for client clearing by February 11, 2013, the Commission would delay compliance for those swaps until 60 days after an eligible DCO offers iTraxx indices for client clearing. On February 25, 2013, the Commission received notice from ICE Clear Credit LLC, a Commission-registered DCO, that it had begun offering customer clearing of the iTraxx CDS indices that are subject to the clearing requirement in Commission regulation 50.4(b). In accordance with the timeframe previously set forth by the Commission, the following compliance dates apply to the clearing of iTraxx indices: Category 1 Entities: Friday, April 26, 2013; Category 2 Entities: Thursday, July 25, 2013; and Category 3 Entities: Wednesday, October 23, 2013. See Press Release, CFTC's Division of Clearing and Risk Announces Revised Compliance Schedule for Required Clearing of iTraxx CDS Indices (Feb. 25, 2013), available at <http://www.cftc.gov/PressRoom/PressReleases/pr6521-13>.

⁸ 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 have indicated, however, that treasury affiliates often enter into swaps on behalf of non-financial affiliates as principal to the swap and not as agent.

Market participants have represented that many non-financial companies execute a significant portion of their swaps through a wholly-owned treasury affiliate that hedges risks for the consolidated non-financial company by, among other things, entering into swaps on behalf of non-financial affiliates. The treasury affiliate often serves as the primary external market-facing entity for the entire corporate group.

Market participants also have described that, in addition to the general benefits of concentrating expertise and reducing redundancy within the corporate group, treasury affiliates may provide benefits specifically for risk management. The treasury affiliate can aggregate similar risks from swaps entered into with different non-financial affiliates and enter into one outward-facing swap rather than having each affiliate establish its own trading relationship with third parties and enter into its own outward-facing swaps. In addition, the treasury affiliate may first net affiliate transactions internally before entering into third-party hedging transactions thereby reducing the total notional amount of outward-facing swaps as compared to the notional amount that would result from having each affiliate enter into its own outward-facing swap directly.

III. 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 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.

- (ii) The person's ultimate parent¹¹ is (A) not a financial entity as defined in section 2(h)(7)(C)(i) of the CEA,¹² and (B) the ultimate parent must be able to identify all of its wholly- and majority-owned affiliates and, of those identified affiliates, a majority must qualify for the end-user exception under § 50.50 of the Commission's regulations;
- (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;
 - (D) a major security-based swap participant; or
 - (E) a nonbank financial company that has been designated as systemically important by the Financial Stability Oversight Council;¹³ and
- (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;

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.

- (G) a credit union; or
- (H) 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.

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 for an entity described in (i).

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 by operation of one or more swaps with such related affiliates;
- (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 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).

- (iv) Each swap entered into by the eligible treasury affiliate is subject to a centralized risk management program that is reasonably designed to monitor and manage the risks associated with the swap; and
- (v) The payment obligations of the eligible treasury affiliate on the exempted swap are guaranteed by its non-financial parent, an entity that wholly-owns or is wholly-owned by its non-financial parent, or the related affiliates for which the swap hedges or mitigates commercial risk.

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.

In order to provide sufficient time for the reporting of the information required under this no-action relief, counterparties electing the relief provided under this no-action letter will not be required to comply with the reporting requirements for electing the relief, as required under this no-action letter, until September 9, 2013.¹⁶

The no-action relief provided herein contains a collection of information, as that term is defined in the Paperwork Reduction Act.¹⁷ Therefore, a control number for the collection must be obtained from the Office of Management and Budget (OMB). In accordance with 44 U.S.C. § 3507(d) and 5 C.F.R. §§ 1320.8 and 1320.10, the Division will, by separate action, prepare an information collection request for review and approval by OMB, and will publish in the Federal Register a notice and request for public comments on the collection burdens associated with the no-action relief. If approved, an agent may not rely on the Division's determination not to recommend enforcement action to the Commission unless it provides the information that the Division has determined is essential to the provision of this no-action relief.

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

¹⁶ The additional time period granted for purposes of reporting the election of the exemption under this no-action letter shall not otherwise affect, delay or modify such counterparties' other applicable reporting obligations under the Commission's regulations or pursuant to other action or relief provided by an office or Division of the Commission, including but not limited to, the regulatory reporting requirements under part 45 of the Commission's regulations.

¹⁷ 44 U.S.C. §§ 3501 *et seq.*

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.

Sincerely,

Ananda Radhakrishnan
Director