



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Clearing and Risk

CFTC Letter No. 17-66
No-Action
December 14, 2017
Division of Clearing and Risk

Re: No-Action Relief from Certain Provisions of the Outward-Facing Swaps Condition in the Inter-Affiliate Exemption from the Clearing Requirement

The purpose of this letter is to extend and modify no-action relief previously granted by the Division of Clearing and Risk (“Division”) of the Commodity Futures Trading Commission (“Commission” or the “CFTC”) under CFTC Letter No. 16-81 and CFTC Letter No. 16-84¹ regarding compliance with certain provisions of the Commission’s exemption from the swap clearing requirement for affiliated counterparties (“Inter-Affiliate Exemption”).² In issuing this letter, the Division is responding to a request from the International Swaps and Derivatives Association, Inc. (“ISDA”), dated November 14, 2017, requesting an extension of both CFTC Letter No. 16-81 and CFTC Letter No. 16-84 and certain additional no-action relief (“ISDA Request”).

Background

Under section 2(h)(1)(A) of the Commodity Exchange Act (“CEA”), if the Commission has determined that a swap is required to be cleared, it is unlawful for any person to engage in such a swap unless the swap is cleared at a derivatives clearing organization (“DCO”) that is registered with the Commission or exempt from registration (“Clearing Requirement”). Pursuant to two prior rulemakings, the Commission has determined that four classes of interest rate swaps and two classes of credit default swaps must be cleared.³

The Inter-Affiliate Exemption includes several requirements and conditions. For example, the exemption may be elected only by affiliated counterparties that meet the definition of “Eligible

¹ CFTC Letter No. 16-81 (Nov. 28, 2016) and CFTC Letter No. 16-84 (Dec. 15, 2016).

² Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 Fed. Reg. 21,750 (Apr. 11, 2013) (adopting 17 C.F.R. § 50.52).

³ Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012) and Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps, 81 Fed. Reg. 71,202 (Oct. 14, 2016). The Clearing Requirement is codified in Part 50 of the Commission’s regulations. See 17 C.F.R. § 50.4.

Affiliate Counterparty,”⁴ and certain information concerning how the affiliated counterparties meet their financial obligations associated with entering into uncleared swaps must be reported to a Commission-registered swap data repository.⁵

Under another condition, the treatment of outward-facing swaps condition, (“Outward-Facing Swaps Condition”), each Eligible Affiliate Counterparty must clear all swaps with unaffiliated counterparties to the extent that the swaps are required to be cleared pursuant to Commission regulation 50.4.⁶ As explained by the Commission in its 2013 adopting release, the Outward-Facing Swaps Condition is intended to prevent swap market participants from using the Inter-Affiliate Exemption to transfer risks to U.S. companies and financial markets by entering into uncleared swaps with non-U.S. affiliates and, in turn, such non-U.S. affiliates entering into swaps with unaffiliated counterparties, in jurisdictions that do not have mandatory clearing regimes comparable to the Commission’s clearing requirement regime.⁷

In 2013, recognizing that many non-U.S. jurisdictions had not yet implemented mandatory clearing regimes, the Commission provided two alternative compliance frameworks that permit Eligible Affiliate Counterparties to pay and collect variation margin on uncleared swaps instead of complying with the Outward-Facing Swaps Condition.⁸ One framework is available for non-U.S. Eligible Affiliate Counterparties located in the European Union, Japan, or Singapore,⁹ and the other framework is available for non-U.S. Eligible Affiliate Counterparties located in any other non-U.S. jurisdiction (“other non-U.S. jurisdictions”).¹⁰ The framework applicable to counterparties located in other non-U.S. jurisdictions is available only if a five percent test is met.¹¹ The Commission included this five percent test because at the time it adopted the Inter-Affiliate Exemption, only the European Union, Japan, and Singapore had made progress toward

⁴ Commission regulation 50.52(a).

⁵ Commission regulation 50.52(c)(2).

⁶ Commission regulation 50.52(b)(4)(i). The Outward-Facing Swaps Condition does not require a swap to be cleared if an eligible exception or exemption to the Clearing Requirement under subpart C of Part 50 is elected, or if the swap is subject to a non-U.S. mandatory clearing regime, or an exception or exemption thereto, that the Commission has deemed to be comparable to the Commission’s Clearing Requirement. To date, the Commission has not issued any such comparability determination.

⁷ Clearing Exemption for Swaps Between Certain Affiliate Entities, 78 Fed. Reg. at 21,762.

⁸ Commission regulation 50.52(b)(4)(ii)-(iii).

⁹ Commission regulation 50.52(b)(4)(ii).

¹⁰ Commission regulation 50.52(b)(4)(iii).

¹¹ According to this five percent test, under Commission regulation 50.52(b)(4)(iii), the aggregate notional value of swaps included in a class of swaps identified by Commission regulation 50.4 (classes of swaps covered by the Commission’s Clearing Requirement) executed between an Eligible Affiliate Counterparty located in the U.S. and an Eligible Affiliate Counterparty located in a non-U.S. jurisdiction other than the European Union, Japan, or Singapore may not exceed five percent of the aggregate notional value of all swaps included in a class of swaps identified by Commission regulation 50.4 that are executed by the U.S. Eligible Affiliate Counterparty.

implementing mandatory clearing regimes.¹² Under both frameworks, the Eligible Affiliate Counterparty located outside of the U.S. may either (i) pay and collect full variation margin on all swaps with unaffiliated counterparties; or (ii) pay and collect full variation margin on all swaps with all other Eligible Affiliate Counterparties.¹³

Prior No-Action Relief Extending Availability of Alternative Compliance Frameworks

When the Commission adopted the Inter-Affiliate Exemption, it limited the availability of the two alternative compliance frameworks until March 11, 2014.¹⁴ Acting pursuant to requests from ISDA, since 2014, the Division has periodically extended the availability of the frameworks, most recently in CFTC Letter No. 16-81. In CFTC Letter No. 16-81, the Division stated that it would not recommend that the Commission commence an enforcement action against an entity that uses either alternative compliance framework to meet the requirements of the Outward-Facing Swaps Condition until the earlier of (i) 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 Commission regulation 50.52(b)(4)(i).

Compliance Dates of the Expanded Interest Rate Swap Clearing Requirement and Prior No-Action Relief

The Commission's first Clearing Requirement, adopted in 2012, applied to certain interest rate swaps denominated in U.S. dollar, euro, sterling, and yen, as well as certain credit default swaps.¹⁵ The Commission's 2016 expansion of the Clearing Requirement covered certain fixed-to-floating interest rate swaps denominated in Australian dollar, Canadian dollar, Hong Kong dollar, Mexican peso, Norwegian krone, Polish zloty, Singapore dollar, Swedish krona, and Swiss franc, as well as other interest rate swaps products.¹⁶

Compliance with the 2016 expansion of the Clearing Requirement was phased in as analogous clearing requirements took effect in Australia, Canada, the European Union, Hong Kong, and Mexico.¹⁷ The first compliance date for the expanded Clearing Requirement was December 13, 2016, which was 60 days after the final rule amendment was published in the Federal Register. That date applied to Australian dollar-denominated fixed-to-floating interest rate

¹² Clearing Exemption for Swaps Between Certain Affiliate Entities, 78 Fed. Reg. at 21,764.

¹³ Commission regulation 50.52(b)(4)(ii)-(iii).

¹⁴ Id.

¹⁵ Commission regulation 50.4. See also Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012).

¹⁶ Commission regulation 50.4(a). See also Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps, 81 Fed. Reg. 71,202 (Oct. 14, 2016).

¹⁷ Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps, 81 Fed. Reg. at 71,229-71,230.

swaps and basis swaps, certain interest rate swap products covered by the European Union's clearing requirement,¹⁸ and Mexican peso-denominated fixed-to-floating interest rate swaps because mandatory clearing regimes in Australia, the European Union, and Mexico were in effect prior to the publication of the Commission's expanded Clearing Requirement.¹⁹ This year, two compliance dates have passed: July 10, 2017, which was the compliance date for Canadian dollar-denominated fixed-to-floating interest rate swaps and overnight index swaps; and August 30, 2017, which was the compliance date for Hong Kong dollar-denominated fixed-to-floating interest rate swaps.²⁰ The compliance dates for Swiss franc- and Singapore dollar-denominated fixed-to-floating interest rate swaps will take place on the earlier of: (i) 60 days after the first clearing requirement compliance date for such swaps, or (ii) October 15, 2018, which is two years following publication of the expanded Clearing Requirement.²¹

Responding to a request from ISDA,²² in CFTC Letter No. 16-84, the Division granted no-action relief until December 31, 2017, for an entity that uses the alternative compliance framework described under Commission regulation 50.52(b)(4)(ii), in connection with a swap executed opposite an Eligible Affiliate Counterparty located in Australia or Mexico. In issuing Letter No. 16-84, the Division recognized that the expansion of the Clearing Requirement to include certain interest rate swaps denominated in Australian dollars and Mexican pesos meant that there likely would be an increase in the aggregate notional value of swaps identified in a class described in regulation 50.4 executed between an Eligible Affiliate Counterparty in the U.S. and an Eligible Affiliate Counterparty located in Australia or Mexico. Consequently, it would be impractical for counterparties located in Australia or Mexico to comply with the five percent test applicable to the alternative compliance framework intended for Eligible Affiliate Counterparties located in non-U.S. jurisdictions other than the European Union, Japan, or Singapore.

Since the issuance of CFTC Letter No. 16-84, compliance dates under the expanded Clearing Requirement have passed for certain swaps denominated in Canadian dollars and Hong Kong dollars. As a result, ISDA represents that the five percent test is no longer practical for Eligible Affiliate Counterparties located in Canada or Hong Kong. Likewise, once the compliance date for Swiss franc-denominated interest rate swaps takes place (on or before October 15, 2018), ISDA represents that the five percent test may no longer be practical for an Eligible Affiliate Counterparty located in Switzerland.

¹⁸ These interest rate swap products are: Norwegian krone-, Polish zloty-, and Swedish krona-denominated fixed-to-floating interest rate swaps and forward rate agreements, as well as euro-, sterling-, and U.S. dollar-denominated overnight index swaps with terms between two and three years.

¹⁹ Clearing Requirement Determination Under Section 2(h) of the Commodity Exchange Act for Interest Rate Swaps, 81 Fed. Reg. at 71,203 and 71,205.

²⁰ *Id.* at 71,230.

²¹ The Commission adopted this compliance date structure because at the time of the publication of the 2016 Clearing Requirement final rule neither Switzerland nor Singapore had announced compliance dates for Swiss-franc- or Singapore dollar-denominated interest rate swaps. *Id.* at 71,229-71,230.

²² Letter to the Commission from the International Swaps and Derivatives Association, Inc., dated Nov. 16, 2016.

Summary of Relief

Based on ISDA's representations, and recognizing that Eligible Affiliate Counterparties have been relying on the two alternative compliance frameworks to the Outward-Facing Swaps Condition pursuant to CFTC Letter No. 16-81 and CFTC Letter No. 16-84 for the past four years, the Division has determined to extend the no-action relief granted under CFTC Letter No. 16-81 and CFTC Letter No. 16-84 until the earlier of: (i) December 31, 2020 at 11:59 pm (Eastern Time); or (ii) the effective date of amendments to Commission regulation 50.52.

In addition, the Division is modifying Letter No. 16-84 to include instances when an entity relies upon the alternative compliance framework described under Commission regulation 50.52(b)(4)(ii) in connection with a swap executed opposite an Eligible Affiliate Counterparty located in Canada, Hong Kong, or Switzerland.

Division No-Action Position

For the foregoing reasons, the Division will not recommend that the Commission commence an enforcement action against:

- A. 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; or
- B. An entity that uses Commission regulation 50.52(b)(4)(ii) to meet the requirements of the Outward-Facing Swaps Condition in the Inter-Affiliate Exemption in connection with a swap executed opposite an Eligible Affiliate Counterparty located in Australia, Canada, Hong Kong, Mexico, or Switzerland,

until the earlier of: (i) December 31, 2020 at 11:59 pm (Eastern Time); or (ii) the effective date of amendments to Commission regulation 50.52, subject to the following conditions:

- 1. The Eligible Affiliate Counterparties claiming the Inter-Affiliate Exemption otherwise satisfy all of the requirements of Commission regulation 50.52; and
- 2. 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 compliance with the alternative compliance frameworks provided in Commission regulation 50.52(b)(4)(ii) or 50.52(b)(4)(iii).

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

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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.

Sincerely,

Brian A. Bussey
Director