



U.S. COMMODITY FUTURES TRADING COMMISSION

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Division of Market Oversight

CFTC Letter 16-80
No-Action
November 28, 2016
Division of Market Oversight

Re: Extension of Time-Limited No-Action Relief from Commodity Exchange Act Section 2(h)(8) for Swaps Executed Between Certain Affiliated Entities that Are Not Exempt from Clearing Under Commission Regulation 50.52

Dear Ms. Rozenberg:

This letter responds to a request received from the International Swaps and Derivatives Association, Inc. (“ISDA”), on behalf of its members and other market participants that engage in inter-affiliate swaps, that the Commodity Futures Trading Commission (“Commission” or “CFTC”) exercise its authority pursuant to section 4(c) and other applicable provisions of the Commodity Exchange Act (the “Act”) to establish a permanent exemption for inter-affiliate swaps from the trade execution requirement under section 2(h)(8) of the Act, irrespective of whether such swaps are cleared or maintained bilaterally in reliance on Commission Regulation 50.52 or another exemption or exception from clearing. In addition, ISDA requests that the relief provided under CFTC Letter No. 15-62 be extended by further no-action in order to allow time for Commission action and to forestall market uncertainty. The no-action relief provided under CFTC Letter No. 15-62 extended relief provided by CFTC Letter Nos. 14-136 and 14-26 and will expire on 11:59 p.m. (Eastern Time) December 16, 2016.

The Division of Market Oversight (“Division”) continues to assess the situation involving inter-affiliate swap trading and the trade execution requirement, including establishing a permanent solution, and will thus extend the no-action relief provided under CFTC Letter No.15-62 until 11:59 pm (Eastern Time) on December 31, 2017.

Background

Section 2(h)(8) of the Act requires that transactions involving swaps subject to the clearing requirement set forth under 2(h)(1) of the Act be executed on or pursuant to the rules of a designated contract market (“DCM”) or swap execution facility (“SEF”), unless no DCM or SEF makes such swaps available to trade or such swaps qualify for the clearing exception under section 2(h)(7) of the Act (the “trade execution requirement”).¹ Swaps subject to the trade

¹ 7 U.S.C. § 2(h)(8).

execution requirement must be executed in accordance with the execution methods described in Commission Regulation 37.9(a)(2).²

Commission Regulation 50.52 provides that a swap between affiliates is exempt from the clearing requirement if (1) the counterparties are eligible affiliate counterparties as set forth in Commission Regulation 50.52(a),³ and (2) the conditions set forth in Commission Regulation 50.52(b) are satisfied (the “Inter-Affiliate Clearing Exemption”). In addition, the counterparties must satisfy reporting requirements set forth in Commission Regulations 50.52(c) and (d).

In the preamble to the rules setting forth a process for a DCM or SEF to make a swap available to trade, the Commission stated that inter-affiliate swaps that are exempt from clearing under Commission Regulation 50.52 are not subject to the trade execution requirement.⁴ However, swaps involving eligible affiliate counterparties that do not satisfy Commission Regulation 50.52(b) or another exception or exemption from the clearing mandate are subject to the trade execution requirement.

On March 6, 2014, the Division issued CFTC Letter No-14-26 in response to a request for relief received from ISDA.⁵ In its request, ISDA asserted that applying the trade execution requirement to inter-affiliate swap transactions between eligible affiliate counterparties that do not satisfy Commission Regulation 50.52(b) would introduce unnecessary costs and inefficiencies without any benefits. ISDA stated that inter-affiliate transactions are intended to manage risk between affiliates and are not arms-length transactions. According to ISDA, requiring that such transactions be executed on a SEF or DCM would not promote the pre-trade price transparency and price discovery goals associated with the trade execution requirement because affiliate counterparties are not primarily concerned with obtaining fully competitive

² Under Commission Regulation 37.9(a)(2), swaps subject to the trade execution requirement must be executed on an Order Book, as defined in Commission Regulation 37.3(a)(3) or a Request for Quote System, as defined in Commission Regulation 37.9(a)(3) in conjunction with an Order Book.

³ Commission Regulation 50.52(a) defines eligible affiliate counterparties to be related entities, in which (1) one counterparty, directly or indirectly, holds a majority ownership interest in the other counterparty, and the counterparty that holds such majority interest reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS), and the statements include the financial results of the majority-owned counterparty; or (2) a third party, directly or indirectly, holds a majority ownership interest in both counterparties, and the third party reports its financial statements on a consolidated basis under GAAP and IFRS, and the statements include the financial results of both counterparties. 17 C.F.R. § 50.52(a)(1)(i)-(ii). A counterparty or third party directly or indirectly holds a “majority ownership interest” if it directly or indirectly holds a majority of the equity securities of an entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership.” 17 C.F.R. § 50.52(a)(2)(i).

⁴ See 78 Fed. Reg. 33,606 n.1.

⁵ The initial request from ISDA was dated February 19, 2014.

pricing. ISDA further stated that execution of such swaps through an order book or request for quote would not assure that the affiliates would be matched with one another as intended and thus preclude the intended inter-affiliate risk transfers.

The Division granted ISDA's request, providing that it would not recommend that the Commission take enforcement action against any eligible affiliate counterparty that executes a swap transaction with another eligible affiliate counterparty without complying with section 2(h)(8) of the Act. Such relief was provided until December 31, 2014. In granting this relief, the Division acknowledged the adverse impact the trade execution requirement could have on the ability of companies to manage risk. The Division also was mindful of the trade execution mandate under the Act and the intent of the Commission's implementing regulations to promote pre-trade price transparency in the swaps market. The Division stated that it would assess whether applying the trade execution requirement to inter-affiliate swap transactions would promote pre-trade price transparency in the swaps market during the period of relief.

On November 7, 2014, in response to a request from ISDA similar to that previously received,⁶ the Division issued CFTC Letter No. 14-136 extending the relief granted in CFTC Letter No. 14-26 until December 31, 2015. In response to a third request from ISDA,⁷ the Division issued CFTC Letter No. 15-62 on November 17, 2015 and extended CFTC Letter No. 14-136. In both extensions, the Division explained that the rationale for relief was unchanged from when it issued CFTC Letter No. 14-26, and it needed additional time to assess whether the relief should be permanent.

Request for Extension of No-Action Relief

On October 11, 2016, ISDA again requested that the Commission exercise its authority pursuant to section 4(c) of the Act to establish a permanent exemption for inter-affiliate swaps from the trade execution requirement under section 2(h)(8) of the Act. To allow time for the Commission to consider the request, ISDA also requested that the Commission further extend the relief granted in CFTC Letter No. 15-62.

Extension of Time-Limited No-Action Relief for Eligible Affiliate Counterparties from the Trade Execution Requirement

The Division has determined to extend the no-action relief granted by CFTC Letter No. 15-62 until 11:59 p.m. (Eastern Time) on December 31, 2017. While the Division recognizes the effect that the trade execution requirement could have on a company's risk management structure, it nevertheless continues to assess whether the application of the trade execution requirement to inter-affiliate swap transactions would promote pre-trade price transparency in the swaps market. To provide the Division more time to assess this issue and potentially establish a permanent solution, the Division will grant the above time-limited no-action relief and will not recommend that the Commission take enforcement action against any eligible

⁶ The second request from ISDA was dated October 2, 2014.

⁷ The third request from ISDA was dated August 31, 2015.

affiliate counterparty that executes a swap transaction with another eligible affiliate counterparty without complying with section 2(h)(8) of the Act.

Market participants should be aware that the no-action positions taken herein do not excuse affected persons from compliance with any other applicable requirements of the Act or the Commission's regulations thereunder, in particular, the applicable swap reporting requirements and clearing requirements, including the requirements and conditions for eligible affiliate counterparties not to clear a swap pursuant to Commission Regulation 50.52 or the requirements to clear a swap pursuant to Commission Regulations 50.2 and 50.4.⁸ This letter, and the no-action positions taken herein, represent the views of the Division only, and do not necessarily represent the positions or views of the Commission or of any other division or office of the Commission's staff. As with all no-action letters, the Division retains the authority to condition further, modify, suspend, terminate or otherwise restrict the terms of the no-action relief provided herein, in its discretion.

If you have any questions concerning this correspondence, please contact Nancy Markowitz, Deputy Director, Division of Market Oversight, at (202) 418-5453 or nmarkowitz@cftc.gov.

Sincerely,

Vincent A. McGonagle
Director
Division of Market Oversight

⁸ The applicable swap reporting requirements are set forth under parts 43, 45, and 50 of the Commission's regulations. The applicable clearing requirements are set forth under section 2(h)(1) of the Act and part 50 of the Commission's regulations. Eligible affiliate counterparties that wish to avail themselves of the inter-affiliate clearing exemption must fulfill additional conditions and requirements set forth in Commission Regulations 50.52(b)-(d).