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CFTC Letter No. 16-84
No-Action
December 15, 2016
Division of Clearing and Risk

RE: No-Action Relief from Regulation 50.52(b)(4)(ii) for Swaps with Eligible Affiliate Counterparties Located in Australia or Mexico

The Division of Clearing and Risk ("Division") is in receipt of a letter to the Commodity Futures Trading Commission ("Commission") from the International Swaps and Derivatives Association, Inc. ("ISDA"), dated November 16, 2016, requesting that certain provisions of the exemption from the swap clearing requirement for affiliated counterparties (Commission regulation 50.52(b)(4)(ii)) be available for swaps executed between certain U.S. swap market participants and their affiliated counterparties located in Australia, Canada, Hong Kong, Mexico, Singapore, or Switzerland ("ISDA Request").

In light of the December 13, 2016 compliance date for the Commission's expansion of its clearing requirement to include certain interest rate swaps denominated in Australian dollars or Mexican pesos, the purpose of this letter is to permit regulation 50.52(b)(4)(ii) to be relied upon for swaps entered into with certain affiliated counterparties located in Australia or Mexico until 11:59 pm (eastern), December 31, 2017.

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 ("Inter-Affiliate Exemption").[1] 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.[2]

The Commission provided two temporary, alternative compliance frameworks to satisfy the Outward-Facing Swaps Condition in order to assist counterparties in transitioning to full

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

[2] Commission regulation 50.52(b)(4).

compliance with Commission regulation 50.52(b)(4)(i),[3] both of which would have expired on March 11, 2014, under the terms of the regulation.[4] In No-Action Letter 16-81, the Division renewed a pre-existing extension of the alternative compliance frameworks so that the frameworks would remain available until December 31, 2017.[5] Pursuant to No-Action Letter 16-81, 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 therein.

Under regulation 50.52(b)(4)(ii), Eligible Affiliate Counterparties located in the European Union, Japan, 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.[6] In issuing regulation 50.52(b)(4)(ii), the Commission limited the provision to swaps with counterparties located in the European Union, Japan, or Singapore because, at the time, those were the jurisdictions that had adopted, and were in the process of implementing, swap clearing regimes.[7]

In No-Action Letter 16-81, the Division recognized 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.[8] While No-Action Letter 16-81 extended the availability of regulation 50.52(b)(4)(ii) to December 31, 2017, the letter did not make the provisions available for swaps with Eligible Affiliate Counterparties located in additional jurisdictions, *i.e.*, other than the European Union, Japan, or Singapore.

Under regulation 50.52(b)(4)(iii), an Eligible Affiliate Counterparty located in the U.S. may comply with certain variation margin provisions like those available under regulation 50.52(b)(4)(ii), in lieu of clearing, for a swap executed opposite an Eligible Affiliate Counterparty located in a non-U.S. jurisdiction other than the European Union, Japan, or Singapore. However,

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[3] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 Fed. Reg. at 21,764.

[4] Commission regulation 50.52(b)(4)(ii)-(iii).

[5] CFTC Letter 16-81 (Nov. 28, 2016).

[6] Commission regulation 50.52(b)(4)(ii)(A).

[7] Clearing Exemption for Swaps Between Certain Affiliated Entities, 78 Fed. Reg. at 21,764.

[8] No-Action Letter 16-81 at page 5 (citing 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)).

the provisions of regulation 50.52(b)(4)(iii) are only available if a five percent test is met. According to this test, 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 regulation 50.4 that are executed by the U.S. Eligible Affiliate Counterparty. As with regulation 50.52(b)(4)(ii), No-Action Letter 16-81 extended the availability of regulation 50.52(b)(4)(iii) until December 31, 2017.

2016 Expansion of the Clearing Requirement for Interest Rate Swaps

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 approved its first clearing requirement determination for four classes of interest rate swaps, including swaps denominated in U.S. dollar, euro, sterling, and yen, as well as two classes of credit default swaps.[9] 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 approved an expansion of the clearing requirement to include interest rate swaps denominated in currencies that were not included in the first clearing requirement determination.[10] The expansion covers fixed-floating interest rate swaps denominated in nine currencies in addition to U.S. dollar, euro, sterling, and yen: Australian dollar, Canadian dollar, Hong Kong dollar, Mexican peso, Norwegian krone, Polish zloty, Singapore dollar, Swedish krona, and Swiss franc; as well as certain other interest rate swap products.[11]

Compliance with the expanded interest rate swap clearing requirement is being phased in as analogous clearing requirements take effect in Australia, Canada, the European Union, Hong Kong, Mexico, Singapore, and Switzerland.[12] The first compliance date of the expanded interest rate swap clearing requirement is December 13, 2016, (60 days after the final clearing requirement determination was published in the Federal Register). This compliance date applies to Australian

[9] Clearing Requirement Determination Under Section 2(h) of the CEA, 77 Fed. Reg. 74,284 (Dec. 13, 2012) (codifying 17 C.F.R. § 50).

[10] 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)).

[11] Amended regulation 50.4(a).

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

dollar-denominated fixed-floating interest rate swaps and basis swaps, as well as to Mexican peso-denominated fixed-floating interest rate swaps. In April 2016, Australia and Mexico began requiring compliance with their own mandatory clearing regimes covering these swaps.

ISDA Request

The ISDA Request petitions the Commission to amend regulation 50.52(b)(4)(ii), or, in the interim, for no-action relief, so that the alternative compliance framework of regulation 50.52(b)(4)(ii) is made available for a swap between a U.S. Eligible Affiliate Counterparty and an Eligible Affiliate Counterparty located in Australia, Canada, Hong Kong, Mexico, Singapore, or Switzerland. ISDA believes that this action should be taken in recognition of the fact that those jurisdictions have "taken action towards implementing clearing mandates for interest rate swaps" since the publication date of regulation 50.52 in 2013. The ISDA Request petitions further that regulation 50.52(b)(4)(ii) be made available for swaps with Eligible Affiliate Counterparties located in each of these jurisdictions as the interest rate swaps denominated in the currencies issued by each of these jurisdictions are required to be cleared according to the compliance schedule provided in the Commission's expanded interest rate swap clearing requirement.[13] For example, December 13, 2016 is the compliance date for Australian dollar-denominated fixed-floating interest rate swaps and basis swaps, as well as for Mexican peso-denominated fixed-floating interest rate swaps.

ISDA asserts that U.S. Eligible Affiliate Counterparties have been relying on the alternative compliance framework under regulation 50.52(b)(4)(iii) for swaps with Eligible Affiliate Counterparties located in Australia, Canada, Hong Kong, Mexico, Singapore, and Switzerland, but due to the expansion of the Commission's clearing requirement to include swaps denominated in the currencies issued by these jurisdictions, this framework will no longer be available.[14] Because regulation 50.4 now includes interest rate swaps denominated in Australian dollars, Mexican pesos, and the seven other currencies newly referenced in regulation 50.4, ISDA asserts that the aggregate notional value of the swaps, identified in a class described in regulation 50.4, executed by a U.S. Eligible Affiliate Counterparty with a counterparty in Australia, Canada, Hong Kong, Mexico, Singapore, or Switzerland will exceed five percent of the aggregate notional value of all of the swaps identified in regulation 50.4 executed by the U.S. Eligible Affiliate Counterparty. An Australian Eligible Affiliate Counterparty, for example, generally will execute far more swaps denominated in Australian dollars than in any other currency. Prior to the expansion of the clearing requirement, Australian dollar-denominated interest rate swaps were not identified in regulation 50.4, and, therefore, these swaps would not be counted towards the five percent limit under regulation 50.52(b)(4)(iii).

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

[14] Additional information provided by ISDA to Division staff, dated Dec. 6, 2016.

Summary of Relief

The Division recognizes that Australia and Mexico have promulgated and implemented mandatory clearing regimes. The Division believes that extending the availability of the alternative compliance framework under regulation 50.52(b)(4)(ii) for swaps with Eligible Affiliate Counterparties located in Australia and Mexico through no-action relief is appropriate until 11:59 pm (eastern), December 31, 2017.

Division No-Action Position

The Division, recognizing the implementation of mandatory clearing regimes in Australia and Mexico, 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) 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 or Mexico until 11:59 pm (eastern), December 31, 2017, if:

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 an entity's compliance with the alternative compliance framework provided in regulation 50.52(b)(4)(ii).

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.

Sincerely,

Jeffrey M. Bandman
Acting Director