

CLIENT UPDATE

NO-ACTION RELIEF FOR END-USERS FROM CERTAIN SWAPS REPORTING REQUIREMENTS

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On April 5, 2013, the Division of Market Oversight (“DMO”) and the Division of Clearing and Risk (“DCR,” together with DMO, the “Divisions”) of the Commodity Futures Trading Commission (the “CFTC”) issued a no-action letter (the “Inter-affiliate Swaps No-Action Letter”)¹ granting no-action relief to entities that are neither swap dealers nor major swap participants (“end-users”) from certain swap data reporting requirements under Parts 45 and 46 of the CFTC regulations and the reporting requirements related to the end-user exception from required clearing under section 50.50(b) of the CFTC regulations² for swaps entered into between affiliates, subject to certain conditions.

On April 9, 2013, DMO issued a no-action letter (the “Delayed Compliance No-Action Letter”)³ extending the date by which end-users must begin complying with the applicable swap data reporting requirements set forth in Parts 43, 45 and 46 of the CFTC regulations. The Delayed Compliance No-Action Letter sets a number of different compliance dates for swap data reporting depending on the class of swap being reported and whether the relevant counterparty that is required to report the swap under section 45.8 is a financial entity

1 CFTC No-Action Letter No. 13-09, dated April 5, 2013, <http://www.cftc.gov/PressRoom/PressReleases/pr6558-13>

2 Unless otherwise specified, all section references are to sections of the CFTC regulations.

3 CFTC No-Action Letter No. 13-10, dated April 9, 2013, <http://www.cftc.gov/PressRoom/PressReleases/pr6563-13>

under section 2(h)(7)(C) of the Commodity Exchange Act (the “CEA”).

INTER-AFFILIATE SWAPS NO-ACTION LETTER

Background

Part 43 establishes rules for real-time public reporting of swap transaction data. Part 45 establishes ongoing swap data recordkeeping and reporting requirements, including a requirement to report swap creation data (*i.e.*, primary economic terms and confirmation data) to a swap data repository (“SDR”). Part 46 establishes recordkeeping and reporting requirements for historical swaps, including a requirement to report certain historical swaps data to an SDR.⁴

Section 723(a)(3) of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd-Frank Act”) amended the CEA by adding section 2(h)(1)(A) of the CEA, which requires certain swaps to be submitted for clearing to a derivatives clearing organization (“DCO”). As of today, mandatory clearing is limited to four classes of interest rate swaps and two classes of credit default swaps.⁵

There is an exception and an exemption from mandatory swap clearing; notably, pursuant to section 2(h)(7) of the CEA and section 50.50, certain end-users can elect an exception to mandatory clearing when one of the swap counterparties is not a “financial entity,” is using the swap to hedge or mitigate commercial risks and notifies the CFTC how it generally meets its financial obligations associated with uncleared swaps.⁶

Further, on April 1, 2013, the CFTC adopted final rules providing a clearing exemption for swaps between certain affiliated entities, subject to certain conditions.⁷ In order to claim the inter-affiliate exemption from required clearing under section 50.52, the reporting counterparty, as determined in accordance with section 45.8, must report certain

4 Historical swaps include swaps entered into prior to July 21, 2010, the date of enactment of the Dodd-Frank Wall Street Reform and Consumer Protection Act (“pre-enactment swaps”), and swaps entered into on or after that date but prior to the applicable compliance date for swap data reporting (“transition swaps”).

5 For a list of swaps for which clearing is required, see Appendix B to our client memorandum, “Recent Developments Regarding CICI Requirements and Looming Deadlines for Compliance by End-Users of Swaps”:
<http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=a80a0ca5-96ee-42e9-95b5-0098fb68ef32>

6 Please refer to our client memorandum on the “end-user exception” for more information:
<http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=55afe714-de09-4954-9cb1-2de1baf17a52>

7 See our client memorandum, “Final CFTC Rules on Clearing Exemption for Swaps between Certain Affiliated Entities”:
<http://www.debevoise.com/newseventspubs/publications/detail.aspx?id=2dc4b916-e5aa-40ad-be3d-681a597079d3>

information pertaining to both affiliated counterparties⁸ to a registered SDR (or, if no registered SDR is available, to the CFTC), including a notice of the election of the exemption.⁹

As described below, the Inter-affiliate Swaps No-Action Letter provides conditional no-action relief from Part 45, section 50.50(b) and Part 46 reporting requirements with respect to swaps between affiliates within the same corporate group (“intra-group swaps”) that are not required to be cleared or that are required to be cleared but for which the parties may elect the end-user exception from clearing. However none of the no-action relief provided in the Inter-affiliate Swaps No-Action Letter applies to swaps for which the counterparties elect the inter-affiliate clearing exemption under section 50.52. Such swaps must comply with the reporting requirements specified in that clearing exemption and must be reported to an SDR under section 50.52(c), and by implication, Part 45. Furthermore, none of the no-action relief provided in the Inter-affiliate Swaps No-Action Letter excuses persons from compliance with any applicable real-time public reporting obligations under Part 43,¹⁰ or any other applicable requirements of the CEA or the CFTC regulations.

Relief from Ongoing Reporting of Swaps between Wholly-Owned Subsidiaries

The Inter-affiliate Swaps No-Action Letter provides that the Divisions will not recommend that the CFTC commence an enforcement action against a “reporting counterparty,” as defined in Part 45, for failure to comply with its obligations to report data for certain intra-group swaps to an SDR pursuant to sections 45.3(d)(1), 45.3(d)(3), 45.4(c)(1)(ii), 45.4(c)(2)(ii), 45.5 or 50.50(b) (collectively, the “Ongoing Reporting Rules”), subject to the following conditions:

8 The reporting requirements under section 50.52(c) in connection with the inter-affiliate exemption from clearing are nearly identical to the reporting requirements of section 50.50(b) in connection with the end-user exception, except that the information required to be reported under the inter-affiliate exemption pertains to both affiliate counterparties.

9 In the Inter-affiliate Swaps No-Action Letter, the CFTC notes that, while affiliated counterparties (as defined in section 50.52(a)) that are either financial entities or non-financial entities may elect the inter-affiliate exemption from clearing, the CFTC anticipates that this exemption will primarily be elected where both counterparties are financial entities, and thus are not eligible to claim the end-user exception under section 50.50. The CFTC adds that, given the additional conditions required under the inter-affiliate exemption, unless a non-financial entity is using intra-group swaps for purposes other than hedging or mitigating commercial risk, such entity is more likely to use the end-user exception under section 50.50, rather than the inter-affiliate exemption under section 50.52, when electing not to clear its intra-group swaps.

10 As a reminder, Part 43 reporting does not apply to internal swaps between 100%-owned subsidiaries of the same parent entity.

- Neither counterparty to the swap is itself a swap dealer (“SD”) or major swap participant (“MSP”), nor is either counterparty affiliated with an SD or MSP¹¹ or with a financial company that has been designated as systemically important by the Financial Stability Oversight Council pursuant to section 113 of the Dodd-Frank Act (the “Qualifying Corporate Group Requirement”);
- The counterparties are affiliated with one another in one of the following ways (the “100% Ownership Requirement”):
 - One counterparty (the “parent”), directly or indirectly, holds a 100% ownership interest¹² in the other counterparty (the “wholly-owned subsidiary”), and the parent reports its financial statements on a consolidated basis under Generally Accepted Accounting Principles (“GAAP”) or International Financial Reporting Standards (“IFRS”), and such consolidated financial statements include the financial results of the wholly-owned subsidiary; or
 - A third party, directly or indirectly, holds a 100% ownership interest in both counterparties, and the third party reports its financial statements on a consolidated basis under GAAP or IFRS, and such financial statements include the financial results of both affiliated counterparties.
- The swap is not executed on or pursuant to the rules of a designated contract market, swap execution facility, a foreign board of trade that is either registered with the CFTC under section 4(b) of the CEA and Part 48 of the CFTC regulations or operating pursuant to no-action relief granted by the CFTC, a trading facility (as defined in section 1a of the CEA), or any other trading platform where the orders of the affiliated counterparties may be exposed to potential execution against unaffiliated counterparties (the “Off-facility Requirement”);
- The swap is not submitted for clearing to a DCO (the “Uncleared Swap Requirement”);¹³
- The affiliated counterparties do not both elect the inter-affiliate clearing exemption under section 50.52 with respect to the swap;¹⁴

11 In effect, this condition requires that the affiliated counterparties are not part of a corporate group that includes an affiliate that is an SD or MSP.

12 For purposes of this condition, an affiliated counterparty or third party directly or indirectly holds a 100% ownership interest if it directly or indirectly holds 100% of the equity securities of an entity, or the right to receive upon dissolution, or the contribution of, 100% of the capital of a partnership.

13 Section 45.3 provides that if a swap is accepted for clearing by a DCO, the DCO must report all confirmation data for the swap.

- All swaps with unaffiliated entities (“outward-facing swaps”) entered into by either one of the affiliated counterparties are reported to a registered SDR pursuant to, or as if pursuant to, Parts 43, 45 and 46 (regardless of the location of the affiliated counterparty) (the “Outward-facing Swaps Reporting Requirement”);¹⁵ and
- A reporting counterparty relying on the foregoing relief maintains records of all swap data as required by Part 45 and, as part of such records, the reporting counterparty maintains internally generated swap identifiers for each swap subject to this relief, which records are made available to the CFTC for inspection and production promptly upon request, in a reportable form pursuant to sections 45.2 and 45.6, or any other form or manner as requested by the CFTC.

In the Inter-affiliate Swaps No-Action Letter, the CFTC provides that such internally generated swap identifiers must be sufficient to identify each swap uniquely, and thereby facilitate the aggregation of all data regarding each swap into a single data record that can track the swap over the course of its existence. The CFTC further specifies that such identifier must be an alphanumeric code which is unique in relation to all other such codes generated and assigned to any swaps that are (1) not reported to an SDR in reliance on the foregoing no-action relief and (2) entered into by the reporting counterparty or any of its affiliated entities.

The internally generated swap identifier will act in lieu of a unique swap identifier (“USI”) described in section 45.5. If, however, a swap that is not reported to an SDR in reliance on the foregoing relief must later be reported to an SDR (by requirement of the CFTC or otherwise), the reporting counterparty will be required to obtain a USI for that swap.

Relief from Ongoing Reporting of Swaps between Majority-Owned Subsidiaries

For reporting counterparties that do not qualify for the foregoing relief, the Divisions granted alternative relief for intra-group swaps involving majority-owned affiliates, permitting qualifying reporting counterparties to report certain intra-group swaps on a quarterly basis under Part 45 and section 50.50(b), as described below.

Specifically, the Inter-affiliate Swaps No-Action Letter provides that the Divisions will not recommend that the CFTC commence an enforcement action against a “reporting

¹⁴ For such swaps, the parties have to comply with the reporting requirements of that clearing exemption under section 50.52(c) and applicable Part 45 requirements.

¹⁵ If the unaffiliated counterparty to such an outward-facing swap is the required reporting party under Part 45, then the affiliated counterparty may rely on the unaffiliated counterparty to report.

counterparty,” as defined in Part 45, for failure to comply with its obligations to report data for certain intra-group swaps to an SDR pursuant to the Ongoing Reporting Rules within the time frames set forth in such rules, subject to the following conditions:

- The Qualifying Corporate Group Requirement is satisfied with respect to the swap;
- The counterparties are affiliated with one another in one of the following ways (the “Majority Ownership Requirement”):
 - One counterparty (the “parent”), directly or indirectly, holds a majority ownership interest¹⁶ in the other counterparty (the “majority-owned subsidiary”), and the parent reports its financial statements on a consolidated basis under GAAP or IFRS, and such consolidated financial statements include the financial results of the majority-owned subsidiary; or
 - 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 or IFRS, and such financial statements include the financial results of both affiliated counterparties.
- The Off-facility Requirement is satisfied with respect to the swap;
- The Uncleared Swap Requirement is satisfied with respect to the swap;
- The affiliated counterparties do not both elect the inter-affiliate exemption from clearing under section 50.52 with respect to the swap;
- The swap is not required to be reported pursuant to Part 43;
- Both affiliated counterparties comply with the Outward-facing Swaps Reporting Requirement with respect to all of their outward-facing swaps;
- A reporting counterparty relying on the foregoing relief maintains records of all swap data as required by Part 45 and makes such records available to the CFTC for inspection and production promptly upon request, in a reportable form pursuant to sections 45.2, 45.5 and 45.6, or any other form or manner as requested by the CFTC; and
- The reporting counterparty relying on the foregoing relief reports all swap data to an SDR, as described in Part 45, no later than 30 days following the end of each fiscal quarter. This quarterly reporting condition will commence on June 30, 2013. A

¹⁶ For purposes of this condition, an affiliated 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.

reporting counterparty subject to this condition must make an initial quarterly report within 30 days after the end of the first fiscal quarter ending on or after June 30, 2013, and such report must include all swap data required to be reported under Part 45 for the period between April 10, 2013 and the end of such fiscal quarter. Subsequently, quarterly reports must be completed within 30 days following the end of each fiscal quarter, and include all Part 45 swap data for the most recently completed quarter.

Relief from Part 46 Reporting Requirements for Historical Intra-Group Swaps

In addition to the foregoing relief, DMO granted no-action relief from reporting requirements under Part 46 for historical intra-group swaps, subject to certain conditions.

Specifically, the Inter-affiliate Swaps No-Action Letter provides that DMO will not recommend that the CFTC commence an enforcement action against a “reporting counterparty,” as defined in Part 46, for failure to comply with its obligations to report historical (pre-enactment or transition) swap data to an SDR as required by sections 46.3(a) or 46.3(b),¹⁷ subject to the following conditions:

- The reporting counterparty satisfies (1) either the 100% Ownership Requirement or the Majority Ownership Requirement and (2) each of the Qualifying Corporate Group Requirement, the Off-facility Requirement and the Uncleared Swap Requirement with respect to the historical swap; and
- A reporting counterparty relying on the foregoing relief maintains records of all pre-enactment and transition swap data as required by Part 46 and makes such records available to the CFTC for inspection and production promptly upon request, in a reportable form pursuant to section 46.2, or any other form as requested by the CFTC.

DELAYED COMPLIANCE NO-ACTION LETTER

Background

Pursuant to the compliance schedule set forth in Parts 43, 45 and 46, and taking into account certain no-action relief previously issued by the CFTC,¹⁸ absent the relief provided by the Delayed Compliance No-Action Letter, end-users would be required to begin

¹⁷ In the Inter-affiliate Swaps No-Action Letter, the CFTC notes that relief from section 50.50(b) is not necessary in the context of historical swaps reporting since reporting obligations under Part 46 only apply to swaps entered into prior to April 10, 2013, which is prior to any relevant compliance date for a market participant to elect an exception or exemption from required clearing.

¹⁸ See CFTC No-Action Letter No. 12-32, dated November 19, 2012, <http://www.cftc.gov/PressRoom/PressReleases/pr6414-12>

complying with the applicable reporting obligations under Parts 43, 45 and 46 by April 10, 2013.

In the Delayed Compliance No-Action Letter, the CFTC notes that, while Parts 43, 45 and 46 established a single compliance date for reporting by end-users with respect to all swap asset classes, the CFTC recognized that, due to differences in the levels of pre-existing automation and data normalization, complying with reporting obligations with respect to equity swaps, foreign exchange swaps and other commodity swaps could potentially be more challenging than complying with reporting obligations with respect to interest rate swaps and credit swaps.

Additionally, the CFTC notes that, in adopting Parts 43, 45 and 46, the CFTC recognized that end-users that are financial entities, as defined in section 2(h)(7)(C) of the CEA (“financial swap counterparties”) are more likely than end-users that are not financial entities (“non-financial swap counterparties”) to have pre-existing technological capability upon which to leverage when developing their swap data reporting systems. For this reason, in both Part 45 and Part 46, the CFTC allocated reporting responsibility for a swap between a non-financial swap counterparty and a financial swap counterparty to the financial swap counterparty.

The CFTC clarifies that any person that is exempted from the definition of “financial entity” for purposes of the clearing exception in section 2(h)(7)¹⁹ will be considered a non-financial swap counterparty for purposes of the no-action relief provided in the Delayed Compliance No-Action Letter.

Temporary Relief for Financial Swap Counterparties

In the Delayed Compliance No-Action Letter, the CFTC asserts that financial swap counterparties have been provided with a sufficient amount of time to come into compliance with their swap data reporting obligations under Parts 43 and 45 with respect to interest rate swaps and credit swaps. Therefore, the April 10, 2013 compliance date continues to apply to financial swap counterparties’ reporting obligations under Parts 43 and 45 with respect to interest rate swaps and credit swaps.

¹⁹ For purposes of the no-action relief provided in the Delayed Compliance No-Action Letter, the terms “financial entity” and “financial swap counterparty” include (1) SDs, (2) MSPs, (3) security-based swap dealers, (4) major security-based swap participants, (5) commodity pools, (6) private funds, (7) employee benefit plans and (8) persons predominantly engaged in activities that are in the business of banking, or in activities that are financial in nature, as defined in section 4(k) of the Bank Holding Company Act of 1956. These terms do not include certain other entities, including certain small insured depository institutions satisfying the requirements of section 2(h)(7)(C)(ii).

However, the Delayed Compliance No-Action Letter provides that, since commencement of reporting could potentially be more challenging with respect to equity swaps, foreign exchange swaps and other commodity swaps, DMO will not recommend that the CFTC take enforcement action against a financial swap counterparty for failing to report swap transaction data with respect to these three swap asset classes, pursuant to Part 43 and Part 45, until 12:01 a.m. eastern time on May 29, 2013.

In order to rely on this no-action relief, a financial swap counterparty must, by 12:01 a.m. eastern time on June 29, 2013, backload and report to an SDR all swap transaction data, for the period from April 10, 2013 to May 29, 2013, that such counterparty would have been required to report under Part 45 in the absence of such relief.

Additionally, the Delayed Compliance No-Action Letter provides that, in order to help ensure a smooth commencement of historical swaps reporting by financial swap counterparties, DMO will not recommend that the CFTC take enforcement action against a financial swap counterparty for failing to report historical swaps data, for all swap asset classes, pursuant to Part 46, until 12:01 a.m. eastern time on September 30, 2013.

Temporary Relief for Non-Financial Swap Counterparties

In the Delayed Compliance No-Action Letter, the CFTC states that providing non-financial swap counterparties with a limited period of no-action relief from reporting obligations under Parts 43 and 45, with respect to all swap asset classes, will enable such counterparties to consult further with the SDRs to which they will be reporting data, and with their SD, MSP and financial swap counterparties, regarding the issues faced and the solutions implemented within a “live” reporting environment, so that non-financial swap counterparties can leverage this experience when finalizing their own reporting systems and procedures.

Therefore, the Delayed Compliance No-Action Letter provides that DMO will not recommend that the CFTC take enforcement action against a non-financial swap counterparty for failing to report swap transaction data pursuant to Part 43 or Part 45:

- With respect to interest rate swaps and credit swaps, until 12:01 a.m. eastern time on July 1, 2013, on the condition that, by 12:01 a.m. eastern time on August 1, 2013, such counterparty backloads and reports to an SDR all transaction data, for the period from April 10, 2013 to July 1, 2013, that such counterparty would have been required to report under Part 45 absent this no-action relief; and

- With respect to equity swaps, foreign exchange swaps and other commodity swaps, until 12:01 a.m. eastern time on August 19, 2013, on the condition that, by 12:01 a.m. eastern time on September 19, 2013, such counterparty backloads and reports to an SDR all transaction data, for the period from April 10, 2013 to August 19, 2013, that such counterparty would have been required to report under Part 45 absent this no-action relief.

Additionally, in order to help ensure the smooth commencement of reporting by non-financial swap counterparties, the Delayed Compliance No-Action Letter provides that DMO will not recommend that the CFTC take enforcement action against a non-financial swap counterparty for failing to report historical swaps data, for all swap asset classes, pursuant to Part 46, until 12:01 a.m. eastern time on October 31, 2013.²⁰

The CFTC clarifies that the no-action relief provided in the Delayed Compliance No-Action Letter does not affect the recordkeeping obligations of end-users under Parts 43, 45 and 46. Records regarding any swap entered into by an end-user prior to 12:01 a.m. eastern time on April 10, 2013 must be maintained by such end-user in accordance with Part 46, and records regarding any swap entered into by an end-user on or after such time must be maintained by such end-user in accordance with Parts 43 and 45.

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Please do not hesitate to contact us if you have any questions.

April 11, 2013

²⁰ The CFTC clarifies in the Delayed Compliance No-Action Letter that any swap entered into by an end-user (including financial swap counterparties and non-financial swap counterparties) prior to 12:01 a.m. eastern time on April 10, 2013, for which such end-user has reporting responsibility, will be reportable by such end-user in accordance with Part 46.