Client update

CFTC Extends Temporary No-Action Relief for Swaps Between Eligible Affiliate Counterparties

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On November 7, 2014, the Division of Clearing and Risk (the "DCR") of the Commodity Futures Trading Commission (the "CFTC") issued a time-limited no-action letter (the "New Clearing No-Action Letter") extending for another year its existing no-action relief from the Outward-Facing Swaps Condition of the "Inter-Affiliate Exemption" from clearing, thereby allowing "Eligible Affiliate Counterparties" (as defined in CFTC regulation 50.52(a))[1] to continue to comply with certain temporary alternative compliance frameworks in lieu of complying with the Outward-Facing Swaps Condition. On the same day, the Division of Market Oversight (the "DMO") of the CFTC issued a time-limited no-action letter (the "New Trading No-Action Letter") extending for another year its existing no-action relief from the "trade execution requirement" for swaps between Eligible Affiliate Counterparties.

THE CLEARING NO-ACTION LETTER

Section 2(h)(1)(A) of the Commodity Exchange Act (the "CEA") provides that all swaps required by the CFTC to be cleared at a derivatives clearing organization ("DCO") must be so cleared. There are currently four classes of interest rate swaps and two classes of index credit default swaps subject to mandatory clearing in the United States, as set forth in section 50.4 of the CFTC regulations.

[1] The counterparties to a swap are eligible affiliate counterparties if: (i)(a) one counterparty, directly or indirectly, holds a majority ownership interest in the other counterparty and (b) the counterparty that holds the majority interest in the other counterparty 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 majority-owned counterparty; or (ii)(a) a third party, directly or indirectly, holds a majority ownership interest in both counterparties, and (b) the third party reports its financial statements on a consolidated basis under GAAP or IFRS, and such consolidated financial statements include the financial results of both of the swap counterparties. For this purpose, a counterparty or third party holds a "majority ownership interest" in another entity if it directly or indirectly holds a majority of the equity securities of that entity, or the right to receive upon dissolution, or the contribution of, a majority of the capital of a partnership.

On April 11, 2013, the CFTC published final rules providing an exemption from clearing for swaps between certain Eligible Affiliate Counterparties, subject to certain conditions (the "Inter-Affiliate Exemption").[2] Among the conditions was a requirement that each Eligible Affiliate Counterparty must comply with the clearing requirements for its outward-facing swaps under either section 2(h) of the CEA or under a foreign jurisdiction's clearing mandate that is comparable and comprehensive, but not necessarily identical to the clearing requirements of section 2(h) of the CEA and Part 50, as determined by the CFTC (such requirement, the "Outward-Facing Swaps Condition").

At the time the CFTC issued the Inter-Affiliate Exemption, no foreign jurisdiction had implemented a mandatory clearing regime; therefore, the CFTC provided for a temporary alternative compliance framework for Eligible Affiliate Counterparties located in Japan, the European Union and Singapore, and another alternative framework for Eligible Affiliate Counterparties located in any other foreign jurisdictions. The temporary relief based on these two alternative compliance frameworks was scheduled to expire on March 11, 2014, but was further extended until December 31, 2014, pursuant to a CFTC no-action letter (the "Original Clearing No-Action Letter").[3]

In the New Clearing No-Action Letter, the DCR notes that although progress has been made with regard to the implementation of mandatory clearing regimes in foreign jurisdictions, it does not appear (as of the date of the New Clearing No-Action Letter) that any jurisdiction has implemented a mandatory clearing regime encompassing the range of products and participants that the CFTC's clearing requirement includes, such that no foreign jurisdiction's clearing mandate is comparable to and as comprehensive as the CFTC's clearing mandate. As a result, the DCR concludes that extending the existing relief will continue to serve the purpose of the Original Clearing No-Action Letter—*i.e.*, providing for an orderly transition as foreign jurisdictions implement mandatory clearing regimes and allowing Eligible Affiliate Counterparties to enter into swaps that do not exceed a *de minimis* amount in jurisdictions that have not yet, or will not in the near future, implement a mandatory clearing regime to come into

[2] For more details on the Inter-Affiliate Exemption, see our client memorandum, "Final CFTC Rules on Clearing Exemption for Swaps Between Certain Affiliated Entities," available at: http://www.debevoise.com/insights/publications/2013/04/final-cftc-rules-on-clearing-exemption-for-swaps__

[3] See our client update, "Temporary No-Action Relief for Swaps Between Eligible Affiliate Counterparties," http://www.debevoise.com/insights/publications/2013/03/temporary-noaction-relief-for-swaps-between-elig__

compliance with the Outward-Facing Swaps Condition.

Therefore, the New Clearing No-Action Letter provides that the DCR will not recommend that the CFTC commence an enforcement action against an entity that continues to rely on the alternative compliance frameworks provided in CFTC regulations 50.52(b)(4)(ii) or 50.52(b)(4)(iii) until 11:59 pm (Eastern Time) on December 31, 2015, subject to the same conditions in the Original Clearing No-Action Letter. These conditions are:

- The Eligible Affiliate Counterparties claiming the Inter-Affiliate Exemption must otherwise satisfy all of the requirements of CFTC regulation 50.52;
- A counterparty to the swap must not be located in a non-U.S. jurisdiction in which the CFTC has determined a comparable and comprehensive clearing requirement exists; and
- The Eligible Affiliate Counterparties electing the relief provided by the New Clearing No-Action Letter shall promptly provide to the DCR, upon request, documentation regarding their compliance with any aspect of this no-action letter and CFTC regulation 50.52, including information regarding their compliance with an alternative compliance framework.

The DCR notes that as foreign clearing regimes come into effect, the DCR will monitor their implementation and will modify the foregoing relief to the extent that it is inconsistent with or provides a way to avoid the clearing requirement in the CEA or a foreign clearing mandate.

THE TRADING NO-ACTION LETTER

Section 2(h)(8) of the CEA provides that swaps subject to the mandatory clearing requirement in section 2(h)(1) of the CEA must 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 CEA (the "Trade Execution Requirement").[4]

In March 2014, the DMO issued a letter (the "Original Trading No-Action Letter")[5] granting no-action relief from the trade execution requirement for

[4] For more information on the Trade Execution Requirement, see our client memorandum, "Mandatory Exchange-Trading for Swaps" http://www.debevoise.com/insights/publications/2013/12/mandatory-exchangetrading-for-swaps

[5] See our client update, "Temporary No-Action Relief for Swaps Between Eligible Affiliate Counterparties," http://www.debevoise.com/insights/publications/2013/03/temporary-noaction-relief-for-swaps-between-elig__

inter-affiliate swaps, as the DMO recognized the impact of the trade execution requirement on the ability of affiliated companies to manage risk and needed additional time to assess whether the application of this requirement to inter-affiliate swaps would promote pre-trade price transparency in the swap market.

The New Trading No-Action Letter extends the relief in the Original Trading No-Action Letter for another year by providing that, until 11:59 pm (Eastern Time) on December 31, 2015, the DMO will not recommend that the CFTC take enforcement action against any Eligible Affiliate Counterparty that executes a swap with another Eligible Affiliate Counterparty without complying with section 2(h)(8) of the CEA. The DMO has not yet made a determination as to whether to establish a permanent exemption from the trade execution requirement for inter-affiliate swaps. The DMO is continuing its assessment as to whether applying the trade execution requirement to inter-affiliate swaps would promote pre-trade price transparency.

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Please do not hesitate to contact us with any questions.