

Client Update

Further Extension of Temporary No-Action Relief for Inter-Affiliate Swaps

NEW YORK

Byungkwon Lim
blim@debevoise.com

Emilie T. Hsu
ehsu@debevoise.com

Peter Chen
pchen@debevoise.com

Aaron J. Levy
ajlevy@debevoise.com

On November 17, 2015, the Division of Clearing and Risk (“DCR”) of the Commodity Futures Trading Commission (the “CFTC”) issued a time-limited no-action letter (the “2015 Inter-Affiliate Clearing No-Action Letter”)¹ further extending the existing no-action relief from the clearing requirement in the Commodity Exchange Act (“CEA”) and the CFTC regulations for swaps between “Eligible Affiliate Counterparties”² that comply with certain temporary alternative compliance frameworks established by the CFTC with respect to their outward-facing swaps (*i.e.*, swaps with unaffiliated counterparties) that would otherwise be subject to mandatory clearing.

On the same day, the Division of Market Oversight (“DMO”) of the CFTC issued a time-limited no-action letter (the “2015 Inter-Affiliate Trading No-Action Letter”)³ further extending its existing no-action relief from the Trade Execution Requirement (as defined below) for swaps between Eligible Affiliate Counterparties.

THE INTER-AFFILIATE CLEARING NO-ACTION LETTERS

Section 2(h)(1)(A) of 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

¹ CFTC Letter No. 15-63, dated November 17, 2015, available at: <http://www.cftc.gov/idc/groups/public/@lrllettergeneral/documents/letter/15-63.pdf>.

² For additional detail on the definition of “Eligible Affiliate Counterparties” and the Inter-Affiliate Exemption generally, 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 CFTC Letter No. 15-62, dated November 17, 2015, available at: <http://www.cftc.gov/idc/groups/public/@lrllettergeneral/documents/letter/15-62.pdf>.

credit default swaps subject to mandatory clearing in the United States, as set forth in section 50.4 of the CFTC regulations.

The CFTC regulations provide an exemption from clearing for swaps between certain Eligible Affiliate Counterparties, subject to certain conditions (the “Inter-Affiliate Exemption”),⁴ including that each Eligible Affiliate Counterparty must comply with the clearing requirement for its outward-facing swaps under either section 2(h) of the CEA or under a foreign jurisdiction’s clearing mandate that is comparable to, and as comprehensive as, the U.S. clearing requirement, as determined by the CFTC (the “Outward-Facing Swaps Condition”).

At the time the CFTC issued final rules adopting the Inter-Affiliate Exemption, no foreign jurisdiction had implemented a mandatory clearing regime; therefore, the CFTC provided a temporary alternative compliance framework for Eligible Affiliate Counterparties located in Japan, the European Union and Singapore, and another alternative framework for those located in any other foreign jurisdiction. This temporary relief was scheduled to expire on March 11, 2014, but was later extended until December 31, 2014, and then extended again until December 31, 2015, pursuant to successive no-action letters.⁵

In the 2015 Inter-Affiliate Clearing No-Action Letter, the DCR notes that although foreign jurisdictions have made progress on implementing mandatory clearing regimes, no jurisdiction has yet implemented a mandatory clearing regime encompassing the range of products and participants subject to the CFTC’s clearing requirement, 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 prior no-action letters.

⁴ 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>.

⁵ See our client update, “Temporary No-Action Relief for Swaps Between Eligible Affiliate Counterparties,” available at: <http://www.debevoise.com/insights/publications/2013/03/temporary-noaction-relief-for-swaps-between-elig>.
See also our client update, “CFTC Extends Temporary No-Action Relief for Swaps Between Eligible Affiliate Counterparties,” available at: <http://www.debevoise.com/insights/publications/2014/11/cftc-extends-temporary-no-action-relief>.

The 2015 Inter-Affiliate 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 the earlier of (1) 11:59 pm EST on December 31, 2016 or (2) with respect to a particular jurisdiction, 60 days after the CFTC announces it has made a comparability determination under CFTC regulation 50.52(b)(4)(i). To claim this relief, the following conditions must be satisfied:

- The counterparties must otherwise satisfy all of the requirements for the Inter-Affiliate Exemption set forth in CFTC regulation 50.52;
- Neither counterparty may be located in a non-U.S. jurisdiction in which the CFTC has determined a comparable and comprehensive clearing requirement exists; and
- The counterparties must promptly provide the DCR, upon request, with 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 U.S. clearing requirement or a foreign clearing mandate.

THE INTER-AFFILIATE TRADING NO-ACTION LETTERS

Section 2(h)(8) of the CEA requires that swaps subject to the U.S. clearing requirement must be executed on, or pursuant to the rules of, a designated contract market (“DCM”) or swap execution facility (“SEF”) if such swaps are “made available to trade” on a DCM or SEF (the “Trade Execution Requirement”).⁶

In March 2014, the DMO issued a no-action letter⁷ granting temporary relief from the Trade Execution Requirement for inter-affiliate swaps, in order to

⁶ For more information on the Trade Execution Requirement, see our client memorandum, “Mandatory Exchange-Trading for Swaps,” available at: <http://www.debevoise.com/insights/publications/2013/12/mandatory-exchangetrading-for-swaps>.

⁷ See our client update, “Temporary No-Action Relief for Swaps Between Eligible Affiliate Counterparties,” available at: <http://www.debevoise.com/insights/publications/2013/03/temporary-noaction-relief-for-swaps-between-elig>.

provide additional time for the DMO to assess whether the application of this requirement to inter-affiliate swaps would promote pre-trade price transparency in the swap market without unduly limiting the ability of affiliated companies to manage risk. In November 2014, the DMO issued another no-action letter⁸ extending this relief through December 31, 2015.

The 2015 Inter-Affiliate Trading No-Action Letter further extends this relief from the Trade Execution Requirement for swaps between Eligible Affiliate Counterparties for an additional year—until 11:59 pm EST on December 16, 2016.

In the letter, the DMO notes that it has not yet reached a determination as to whether to establish a permanent exemption from the Trade Execution Requirement for inter-affiliate swaps, and that it continues to assess whether applying this requirement to inter-affiliate swaps would promote pre-trade price transparency.

* * *

Please do not hesitate to contact us with any questions.

⁸ See our client update, “CFTC Extends Temporary No-Action Relief for Swaps Between Eligible Affiliate Counterparties,” available at: <http://www.debevoise.com/insights/publications/2014/11/cftc-extends-temporary-no-action-relief>.